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THE UNEMPLOYMENT COMPENSATION ASPECTS OF THE U.S. DEPARTMENT OF LABOR FY2007 BUDGET

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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THE UNEMPLOYMENT COMPENSATION ASPECTS OF THE U.S. DEPARTMENT OF LABOR FY2007 BUDGET

THURSDAY, MAY 4, 2006

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

The Subcommittee met, pursuant to notice, at 10:04 a.m., in room B–318, Rayburn House Office Building, Hon. Wally Herger (Chairman of the Subcommittee) presiding.

[The advisory and revised advisory announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
April 13, 2006
No. HR–8

CONTACT: (202) 225–1721

Herger Announces Hearing on Unemployment Compensation Aspects of U.S. Department of Labor Fiscal Year 2007 Budget

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the U.S. Department of Labor (DOL) budget for fiscal year 2007. **The hearing will take place on Wednesday, May 3, 2006, in B–318 Rayburn House Office Building, beginning at 2:00 p.m.**

Oral testimony at this hearing will be from both invited and public witnesses. Invited witnesses will include a representative from the DOL. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for possible inclusion in the printed record of the hearing.

BACKGROUND:

The Unemployment Compensation (UC) program provides benefits to unemployed workers who have a history of employment. Within a broad Federal framework, each State designs its own benefit program and imposes taxes on employers to pay for regular unemployment benefits. A Federal tax also is imposed on employers to fund the Federal responsibilities under the system, including certain administrative expenses, loans to States, and the Federal half of extended unemployment benefit costs for certain workers. Taxes collected are kept in Federal trust funds that are part of the unified Federal budget. During calendar year 2005, $33 billion in unemployment benefits was paid to nearly 8 million eligible workers.

The DOL budget for fiscal year 2007 includes a number of proposals designed to strengthen the integrity and otherwise improve the operation of the UC system. Proposals included in the budget would increase the use of eligibility reviews, better prevent and recover overpayments, speed returns-to-work of unemployment beneficiaries, improve tax collection, and extend the 0.2 percent Federal Unemployment Tax Act ("FUTA") surtax.

In announcing the hearing, Chairman Herger stated: "The President's budget includes a number of proposals designed to improve the efficiency and effectiveness of the unemployment compensation system in paying benefits and helping laid off workers get back on the job. The Subcommittee also wants to make this system work better for States, employers, and especially unemployed workers. I look forward to hearing from the Administration and others about proposals included in President's budget designed to do just that."

FOCUS OF THE HEARING:

The focus of the hearing will be on unemployment-related issues in the DOL fiscal year 2007 budget.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Michael Morrow or Kevin Herms at (202) 225–1721 no later than the close of business **Wednesday, April 26, 2006**. The telephone request should be followed by a formal written request faxed to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515, at (202) 225–2610. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Committee staff at (202) 225–1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing in lieu of a personal appearance. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE–MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 200 copies, along with an *IBM compatible 3.5-inch diskette in WordPerfect or MS Word format*, of their prepared statement for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee office, B–318 Rayburn House Office Building, no later than close of business on Monday, May 1, 2006.** The 200 copies can be delivered to the Subcommittee staff in one of two ways: (1) Government agency employees can deliver their copies to B–318 Rayburn House Office Building in an open and searchable box, but must carry with them their respective government issued identification to show the U.S. Capitol Police, or (2) for non-government officials, the copies must be sent to the new Congressional Courier Acceptance Site at the location of 2nd and D Streets, N.E., **at least 48 hours prior to the hearing date. Please ensure that you have the address of the Subcommittee, B–318 Rayburn House Office Building, on your package, and contact the staff of the Subcommittee at (202) 225–1025 of its impending arrival.** *Due to new House mailing procedures, please avoid using mail couriers such as the U.S. Postal Service, UPS, and FedEx.* When a couriered item arrives at this facility, it will be opened, screened, and then delivered to the Committee office, within one of the following two time frames: (1) expected or confirmed deliveries will be delivered in approximately 2 to 3 hours, and (2) unexpected items, or items not approved by the Committee office, will be delivered the morning of the next business day. The U.S. Capitol Police will refuse all non-governmental courier deliveries to all House Office Buildings.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Wednesday, May 17, 2006. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing can follow the same procedure listed above for those who are testifying and making an oral presentation. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item 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 submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies 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. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

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

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.

*** * * CHANGE IN DATE AND TIME * * ***

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
April 24, 2006
No. HR–8 Revised

CONTACT: (202) 225–1025

Change in Date and Time for Hearing on Unemployment Compensation Aspects of U.S. Department of Labor Fiscal Year 2007 Budget

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee hearing on the unemployment compensation aspects of U.S. Department of Labor Fiscal Year 2007 Budget, previously scheduled for 2:00 p.m. on Wednesday, May 3, 2006, in room B–318 Rayburn House Office Building, **will now be held on Thursday, May 4, 2006, at 10:00 a.m.**

All other details for the hearing remain the same. (See Human Resources Advisory No. HR–8, dated April 13, 2006).

Chairman HERGER. Good morning, and welcome to today's hearing on the President's budget proposals for the U.S. Department of Labor (DOL) for Fiscal Year (FY) 2007. The economy grew a robust 4.8 percent in the first quarter of 2006. That is the fastest growth since the third quarter of 2003 and the 18th consecutive quarter of growth. Since the 2003 tax cuts, economic growth has averaged a strong 3.9 percent. With that growth, the economy has created millions of jobs. During the last year, the economy created an average of 174,000 jobs each month, which is expected to continue in tomorrow's job report for April. Since August 2003, we have seen a total of 5.2 million jobs. The unemployment rate is a very low 4.7 percent, the lowest since July 2001 and below the average of the 1960s, 1970s, 1980s, and 1990s.

Still, despite the sharp drop in the number of unemployed Americans in recent years, too many Americans remain unemployed. We owe it to all workers to examine what we can do to better connect unemployed workers with jobs to stimulate even more growth and job creation. We also owe it to taxpayers to ensure unemployment benefit payments are correct. The Office of Management and Budget estimates that more than $3 billion in unemployment benefits were incorrectly paid in 2005. There is plenty of work to be done in that area as well. The President's DOL budget proposals under our jurisdiction have two purposes. First, to promote better program integrity when it comes to collecting unemployment taxes and paying unemployment benefits. Second, and more importantly, to help workers get back on the job quickly.

This Subcommittee has explored the issue of improper unemployment benefit taxes and payments before and acted. In 2002, we provided States a record infusion of Federal funds they could use to improve unemployment benefit program integrity, among other purposes. In 2004, we passed the State Unemployment Tax Act (SUTA) Dumping Prevention Act (P.L. 108–295) meant to ensure employers who lay off more workers pay their fair share of unemployment taxes. That law also gave States access to the National Directory of New Hires (NDNH) so they could ensure unemployment benefits end when workers go back to work. Earlier this year, we heard from the Government Accountability Office (GAO) about their research, which showed that workers who collect unemployment benefits stay unemployed more than twice as long as those who don't collect benefits. I was pleased to note bipartisan agreement on that hearing on the need to help unemployed workers quickly return to work. That background will be on our minds today as we learn more about the Administration's FY2007 budget proposals. After hearing from the DOL, we will hear from a variety of witnesses representing GAO, the States, Government employees, think tanks, and other interested parties. They will provide more context about the DOL budget proposals. I am pleased to note that every group that requested to testify at this hearing will appear before us today. We look forward to the testimony of all our witnesses. Mr. McDermott, would you care to make a statement?

[The opening statement of Chairman Herger follows:]

Opening Statement of The Honorable Wally Herger, Chairman, Subcommittee on Human Resources, and a Representative in Congress from the State of California

Good morning and welcome to today's hearing on the President's budget proposals for U.S. Department of Labor for fiscal year 2007.

The economy grew a robust 4.8 percent in the first quarter of 2006. That's the fastest growth since the third quarter of 2003, and the 18th consecutive quarter of growth. Since the 2003 tax cuts, economic growth has averaged a strong 3.9 percent.

With that growth, the economy has created millions of jobs. During the last year, the economy created an average of 174,000 jobs each month, which is expected to continue in tomorrow's jobs report for April. Since August 2003, we have seen a total of 5.2 million jobs. The unemployment rate is a very low 4.7 percent, the lowest since July 2001 and below the average of the 1960s, 1970s, 1980s and 1990s.

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Earlier this year, we heard from the Government Accountability Office about their research showing that workers who collect unemployment benefits stay unemployed more than twice as long as those who don't collect benefits. I was pleased to note bipartisan agreement at that hearing on the need to help unemployed workers quickly return to work. That background will be on our minds today as we learn more about the Administration's fiscal year 2007 budget proposals.

After hearing from the Department of Labor, we will hear from a variety of witnesses representing GAO, the states, government employees, think tanks, and other interested parties. They will provide more context about the DOL budget proposals.

I am pleased to note that every group that requested to testify at this hearing will appear before us today. We look forward to the testimony of all our witnesses.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I think when you come to one of these hearings, it is always interesting to have Mr. Herger and I present our view of the world because you get two different views of what is going on. I think, as we convene this morning, it is fair to say that we know two things for certain. The American economy is changing, and the Federal Government is not changing fast enough to meet the needs of the people of this country. Now, not long ago, economic growth and job security across the American landscape seemed understandable and predictable by a vast majority of workers, whether it be blue collar or white collar or whatever. But those days, really, are gone. Technological change and an increasing interconnected world have expanded the opportunities for some and dramatically increased uncertainty for others. Now in this new national workplace, support programs should do more than enable workers to upgrade their skills and help them transition from one job to the next when they must. The statistics

make clear that our concerns are warranted and real action is essential if we are to serve the American people. On that point, Mr. Herger and I agree.

Job security is declining precipitously for certain segments of the population, especially men in their 40s and 50s. According to the Bureau of Labor Statistics (BLS) from the DOL, the median tenure for the current employment of men age 45 to 54 has dropped from 12.8 years on a job in 1983 to 9.6 years on a job in 2004. That is a 25 percent decrease. For men ages 55 to 64, it is even worse. The median employment tenure has declined 33 percent over the same period. In short, these workers are much more likely to change jobs than their counterparts of 20 years ago. Some of what you are seeing here today or hearing today is a reflection of what has happened to the job market. Some job changes are voluntary, of course. But many are not. Hardships like factory closings, corporate downsizing, technology are forcing painful changes upon our workers. The transitions can be difficult and stressful, even for displaced workers who find new employment. For example, according to a biannual BLS report again—that is DOL—5.3 million Americans were laid off jobs they held for more than 3 years between the years 2001 and 2003. Even as recently as the last 4 or 5 years, you are still getting a clear majority of those reemployed lost wages compared to their prior job. They went to a job making less money.

The reality is that over one-third of these workers lost 20 percent or more of their prior earnings. They are taking a 20 percent drop. Furthermore, low-income workers experience much wider income swings today compared to 20 years ago. More and more vulnerable families are being brought to the brink of financial ruin. That is where we are, and here is what we are doing about it. Now I commend the Administration for suggesting ways in which the integrity of the Unemployment Insurance (UI) Program can be strengthened, even as I question how these particular proposals would be implemented. It is one of America's most valuable programs, and it is important to prevent overpayments and fraud, whether committed by individuals or by employers. We should, however, I think attempt to hold individuals harmless when small or modest errors occur through no fault of their own and equally address the issue of UI underpayments. The challenge we have to address is to improve the UI Program overall.

Benefit levels in some States are entirely too low to serve the purpose of the program or to meet the needs of people. Give somebody $221 a month, as some States do, is simply not an adequate replacement of the finances that they had when they had a job. In many States, the maximum weekly unemployment benefit is enough to buy a few tanks of gasoline, which is going up, forcing workers to choose between putting food on the table and conducting a meaningful job search using their car. Furthermore, today's economy relies more and more on part-time employees who are frequently denied unemployment benefits when they lose their jobs. Finally, we have got to put some teeth into efforts to ensure that employers are paying their fair share. Why does the Administration oppose efforts to crack down on employers who misclassify their employees as contract workers for the purposes of avoiding of paying unemployment taxes? Even if we address all of these issues,

we have to recognize that the UI Program is not enough to meet the challenges that a globalized economy presents. Currently, there are two Federal programs that constitute the bulk of our first response capability.

The Employment Services (ES) Program aims to match job seekers with current employment opportunities, and the Workforce Investment Act (WIA) (P.L. 105–220) provides job training and placement services through local One-Stop Centers. We have them in Seattle, and I visited them. At a minimum, I can't understand why the Administration defends its policy to continually decrease funding for these programs to the tune of $2.2 billion at a time when businesses and workers they rely upon are challenged most. The ES Program enjoys wide support within the business community because it links employers with workers that possess skill sets that they are looking for. The Federal Government has made a positive difference in the lives of countless Americans through these programs, and we can and should do more. Congress can help some displaced workers by making it easier for them to move to new jobs. Congress could develop a means by which labor policy provides a cushion for workers transitioning into new jobs and improves economic security for workers and families experiencing the turbulence of a fast-moving economy. In addition, Congress could implement economic tax and education policies that reflect the 21st century economy and create family wage job opportunities in the future. In Washington State, we used to have unemployment that dealt with loggers and fishermen and airplane employees, all of whom during certain periods of the year knew they weren't going to be working. You don't work in the woods in the snow. You don't fish when fish is out of season. You have an unemployment program. That is not what we have today. Regrettably, I believe the Congress is not doing enough to help the American worker. This Nation was founded on the principle that hard work produces results, and it is our responsibility to recognize the new economic reality and pass progressive legislation that safeguards the American dream. Unemployment insurance came into being in this country in 1935, when there was nothing for a worker who lost, and we had the major Depression. It has been adjusted some over the years. But the 21st century, hard work still ought to mean economic security and upward mobility for the American people, and I look forward to hearing today from today's witnesses and finding out what is ahead for this Committee. Thank you, Mr. Chairman.

Chairman HERGER. Thank you, Mr. McDermott. Before we move on to our testimony today, I want to remind our witnesses to limit their oral statements to 5 minutes. However, without objection, all of the written testimony will be made a part of the permanent record. To start the hearing today, we will hear from the DOL budget proposals from the Honorable Mason Bishop, Deputy Assistant Secretary in the Employment and Training Administration at the DOL. Mr. Bishop?

STATEMENT OF THE HONORABLE MASON BISHOP, DEPUTY ASSISTANT SECRETARY, EMPLOYMENT AND TRAINING ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. BISHOP. Thank you, Mr. Chairman and distinguished Members of the Subcommittee. I am pleased to have the opportunity to testify before you today relating to the President's FY2007 budget request as it does relate to the UI Program. The Administration is committed to improving the benefit payment and tax integrity of the Federal-State UI system. Although States put much effort into preventing, detecting, and recovering improper benefit payments, they are still too high. In FY2005, an estimated $3 billion in UI benefits were paid in error. We project that a little more than half of this amount, or about $1.6 billion, is attributable to causes that States can detect in the course of normal program operations and potentially recover. While access to new databases and automated data matches have improved States' ability to identify potential improper payments quickly, investigations required to establish payments as improper and collection efforts are very labor intensive.

Thanks to the efforts of this Subcommittee, loopholes in many of the State UI laws that had permitted some employers to pay less than their fair share of State unemployment taxes were closed when Congress enacted the SUTA Dumping Prevention Act of 2004. Investigating potential cases of SUTA dumping is time-consuming, and the legal costs associated with prosecution of these cases is quite high. However, no new Federal funds were provided to States to enforce their new SUTA dumping statutes. The department has developed a set of legislative proposals that will help States obtain new tools and resources to combat improper benefit payments and employer tax evasion. These proposals will, first, allow States to use up to 5 percent of all recovered improper payments for additional Benefit Payment Control activities. Second, allow States to use up to 5 percent of tax payments recovered as a result of employer fraud or tax evasion, such as SUTA dumping, for additional tax integrity activities. Third, we would require States to impose at least a 15 percent penalty on improper payments due to claimant fraud and to use any fines collected for additional Benefit Payment Control activities.

Next we would allow States to permit collection agencies to retain up to 25 percent of hard to collect fraud payments and delinquent employer taxes they recovered. We would also provide an incentive for employers to respond to requests for information more timely and completely. Employers accounts would be charged when they cause improper payments. This would be required only if the improper payment were due to the failure of the employer to provide timely or accurate information and if the employer had established a pattern of failing to respond on a timely basis or adequately to such requests. Next we would require all employers to report a start work date to the State Directory of New Hires to improve improper payment detection and better target investigations. Finally, our proposal would authorize the U.S. Department of Treasury to intercept Federal income tax refunds to recover improper payments of UI benefits and certain unpaid employer taxes. Together, these seven legislative proposals would reduce improper payments and increase improper payment recoveries and delin-

quent tax collections by an estimated $2.36 billion over 5 years and $5.4 billion over 10 years.

Our proposal also includes a provision that will give States the opportunity to test changes in the UI Program designed to better serve the 21st century economy and the workforce. It authorizes the Secretary of Labor to waive certain Federal requirements at States' request to permit them to run demonstration projects that would accelerate the reemployment of claimants or improve the effectiveness of the State in carrying out UI administrative activities. The legislative proposals I just described would give States access to additional funds in the long term. The department's request for FY2007 appropriations include a modest increase of $40 million to give States additional resources right away to expand certain improper payment reduction efforts. Specifically, we request $10 million to prevent and detect fraudulent UI claims filed using personal information stolen from unsuspecting workers. We also propose $30 million to expand the Reemployment and Eligibility Assessment initiative, which ensure eligibility requirements are met by UI beneficiaries and offers personalized assistance with work search plans and other services through One-Stop Career Centers Nation wide. These proposals would pay for themselves in reduced benefit payment outlays, and we estimate over $225 million in savings. In conclusion, I do thank the Chairman and the Subcommittee for allowing me to come testify and would be willing to answer any questions the Subcommittee might have. Thank you.

[The prepared statement of Mr. Bishop follows:]

Statement of The Honorable Mason Bishop, Deputy Assistant Secretary, Employment and Training Administration, U.S. Department of Labor

Good morning. Chairman Herger, Ranking Member McDermott and distinguished members of the Subcommittee, thank you for this opportunity to discuss the President's Fiscal Year (FY) 2007 Budget proposals related to Unemployment Insurance (UI).

The Administration is committed to improving the benefit payment and tax integrity of the federal-state UI system and has developed a set of legislative proposals for your consideration that will give states new tools and resources to combat improper benefit payments and evasion of employer taxes. Reducing improper payments is an important component of the President's Management Agenda, and the Department of Labor (the Department) is committed to aggressively implementing this agenda to improve the results our programs deliver for taxpayers.

Although states put much effort into preventing, detecting, and recovering improper benefit payments, the number of such payments is still too high. This is a major concern for Secretary Chao and the Department. In FY 2005, an estimated $3 billion in UI benefits were paid in error. We project that a little more than half of this amount, $1.6 billion, is attributable to causes that states can detect *in the course of normal program operations* and potentially recover. However, to date, states have been successful in detecting only 59% of these estimated payments. Further, only about half of the improper payments detected are subsequently collected. While access to new databases and automated data matches have improved states' ability to identify potential improper payments quickly, investigations required to establish payments as improper and collection efforts are still quite staff and time intensive. The Department is continuing to work with the states to find better and more efficient ways to reduce improper payments.

Thanks to your leadership, Chairman Herger and Ranking Member McDermott, and the bipartisan efforts of this Subcommittee and the Congress, loopholes in many state UI laws that had permitted some employers to pay less than their fair share of state unemployment taxes were closed when Congress enacted the SUTA Dumping Prevention Act of 2004 (Public Law 108–295). I am pleased to report that all states—except Alaska—have enacted state statutes to combat SUTA (state unemployment tax act) dumping. However, enforcement of the law is still essential. As

Carl Camden of Kelly Services noted in last year's hearing on implementing this legislation "You can have the tightest laws on the books and the slickest detection tools in place . . . it's all meaningless if you drop the ball with enforcement." As states have begun implementing their SUTA dumping laws, it has become clear that these practices have been widespread and costly to state unemployment funds. Prior to implementation of SUTA dumping legislation, Michigan estimated it was losing between $62 and $95 million annually in state unemployment taxes because of this practice. In addition, as of April 2005, North Carolina showed just over $18 million lost due to SUTA dumping. However, investigating potential cases of SUTA dumping is time consuming, and the legal costs associated with prosecution of these cases are quite high. No new Federal funds were provided to states to enforce their new SUTA dumping statutes.

Legislative Proposals

The Department believes that it is in many states' self-interest to devote additional resources to prevention, detection, and recovery of improper benefit payments and to enforcement of SUTA dumping laws. And the Department is committed to helping States obtain new tools and resources to help reduce fraud and benefit overpayments, as recommended in a recent Program Assessment Rating Tool review of the UI program. To this end, the Department has developed a set of legislative proposals that will give states access to additional resources to combat improper payment and employer tax evasion.

Allow States to Use a Percentage of All Recovered Improper Payments for Benefit Payment Control (BPC) Activities. Under current Federal law, all improper payments collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits.

We propose to amend Federal law to *permit* states to use up to 5% of all improper payments recovered to augment administrative funding for BPC activities. This 5% would be deposited in a special state fund where it could be used only for this purpose.

This amendment would reduce improper payments and increase improper payment recoveries by an estimated $86 million over five years and $236 million over ten years.

Allow States to Use a Percentage of Certain Tax Payments for Tax Integrity Activities. Under current Federal law, all taxes collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits.

We propose to amend Federal law to *permit* states to use up to 5% of tax payments recovered following a state investigation and assessment of taxes owed due to employer fraud or tax evasion such as SUTA dumping for additional UI tax enforcement activities. This 5% would be deposited in a special state fund and would be used only for this purpose.

This amendment would increase recoveries of unpaid taxes by an estimated $13 million over five years and $19 million over ten years.

Require States to Impose at Least a 15% Penalty on Fraud Improper Payments. Currently, all states impose penalties on employers who are delinquent in paying contributions. It makes sense to require all states to impose a similar fine whenever it determines an individual has defrauded the system. The Department's Office of Inspector General (OIG) has devoted considerable resources to uncovering UI fraud; these investigations suggest that UI fraud schemes are more complex, costly, and far reaching than in the past.

Individuals who commit UI fraud—a very small percent of all beneficiaries—are sometimes required to do nothing more than repay the amount received fraudulently. While a limited disqualification from future benefits may be imposed, this sanction is meaningless if the individual goes back to work and remains employed. Although state laws provide for criminal penalties, cases are rarely prosecuted due to the relatively low dollar amounts involved and the high cost of prosecution.

Under our proposal, the Social Security Act would be amended to *require* states to impose a penalty of not less than 15% on improper payments that are due to fraud and to deposit any fines collected in a special state fund, from which they may be withdrawn onlyfor BPC activities. The proposal is limited to improper payments due to fraud to ensure that penalties will be required only when there was intent to deceive on the part of the beneficiary.

This amendment would reduce improper payments and increase improper payment recoveries by an estimated $314 million over five years and $855 million over ten years.

Allow States to Permit Collection Agencies to Retain a Percentage of Fraud Improper Payments and Delinquent Employer Taxes Recovered. Sev-

eral states have explored using private collection agencies to collect certain improper payments or delinquent employer taxes. One of the problems states have encountered is finding a way to pay the private agency's costs of collection, which can be up to 25% of the amount collected. Federal law would be amended to permit up to 25% of any amount collected by the collection agency on fraud improper payments or delinquent taxes to be retained by that agency. This would be permitted only when the State UI agency has (1) made its own collection efforts and (2) declared the amount uncollectible. Thus, the proposal only applies to hard-to-collect debt that would not otherwise be collected.

This amendment would increase recoveries of improper payments and delinquent taxes by an estimated $126 million over five years and $341 million over ten years.

In addition, our budget includes legislative proposals that would support the Department's integrity activities by providing states with new tools to more effectively prevent, identify, and recover improper payments and delinquent taxes.

Prohibit States from Non-Charging Employers When Improper Payments Occur Due to Employer Fault. Our budget proposal also includes an amendment that would reduce one of the most common reasons for improper payment—an erroneous initial determination of eligibility—by providing employers with an additional incentive to respond to state requests for separation information.

Employers sometimes fail to respond or provide incomplete or late responses to requests for information related to reasons their former employees were separated from employment. When this happens, payments may be issued based on the beneficiary's statement and "charged" to the employer's experience rating account, which may later cause his/her tax rate to increase. The employer may appeal after benefits have been paid and provide information at an appeal hearing that results in benefits being denied retroactively. The benefits already paid are established as improper payments, and in many states, the employer's account is relieved of those benefit charges. If the employer had responded fully and timely, the improper payment would have been avoided as well as the administrative costs connected with appeals and establishment and recovery of improper payments. States tell us they believe that some employers are not as conscientious as they should be in meeting deadlines for providing information about reasons for separation, and routinely file appeals at which information is provided that results in their being relieved of charges for benefits already paid.

To provide an incentive for more timely and complete responses, Federal law would be amended to *prohibit* relief from charging when the employer or its agent is at fault, even if the improper payment is eventually recovered. The prohibition would only apply if the improper payment was due to the failure of the employer to provide timely or accurate information and if the employer had established a pattern of failing to respond on a timely basis or adequately to such requests.

This amendment would reduce improper payments by an estimated $84 million over five years and $233 million over ten years.

Require Employers to Report "Start Work Date" to the State Directory of New Hires. The SUTA Dumping Prevention Act granted state UI agencies access to the National Directory of New Hires, which allowed states access to a wider universe of hires, including those by Federal agencies and multi-state employers who may report all new hires to a single state. Access to these data has proved to be extremely valuable. States matching UI payment files with the national directory have seen a significant increase in the number of improper payments identified compared to the number identified using their own state new hire directories. As you may know, individuals who are working and receiving UI benefits concurrently are the single largest cause of improper UI payments.

However, these data could be even more effective for UI payment integrity if all employers report the date when an individual started work. When the start work date is not provided to the directory, states must contact employers to get this information—a time consuming and costly process. In some cases, investigations may not be pursued because of the lack of the start date in the directory. The Department's OIG has recommended amendments to Federal law to require employers to report a new hire's first day of earnings.

For this reason, we propose to amend Federal law to require that the date the individual starts work be reported by all employers to the applicable state directories of new hires, which in turn will report this information to the National Directory of New Hires. This amendment would reduce improper payments and increase improper payment recoveries by an estimated $60 million over five years and $167 million over ten years.

Authorize the U.S. Department of the Treasury to Intercept Federal Income Tax Refunds for Certain UI Purposes. The Administration's FY 2005 and FY 2006 budgets included legislative proposals authorizing the U.S. Department of

the Treasury to recover improper payments of UI benefits through offset from an individual's Federal income tax refunds via the Treasury Offset Program (TOP)—a government-wide debt matching and payment offset system that matches delinquent debts owed to various government agencies to Federal income tax refunds. This year's proposal is expanded to also authorize the collection of certain unpaid employer taxes using TOP.

Both the National Governor's Association and the National Association of State Workforce Agencies passed resolutions encouraging the use of the TOP system for recovering these debts.

This amendment would increase recoveries of benefit improper payments and delinquent taxes by an estimated $1.677 billion over five years and $3.55 billion over ten years, thereby contributing to state UI trust fund solvency and lower employer taxes.

Together, these seven legislative proposals would reduce improper payments and increase improper payment recoveries and delinquent tax collections by an estimated $2.360 billion over 5 years and $5.401 billion over 10 years. We are pleased that the FY 2007 Budget Resolution passed by the Senate and the Budget Resolution passed by the House Budget Committee both include our UI integrity proposal and are hopeful Congress will enact this legislation before the 109th Congress adjourns.

The FY 2007 budget also includes a legislative proposal that will give states the opportunity to demonstrate innovative initiatives to better serve the 21st century economy and workforce. The UI program was designed over 70 years ago when our economy and workforce were quite different than they are today. While the program has served our nation's workers and economy well, we should be open to exploring innovations that could improve its performance in the future.

Permit States to Request Waivers of Certain Federal Requirements. Certain requirements of Federal law may limit states' flexibility in establishing new ways to help beneficiaries become reemployed quickly or undertake other innovations to improve the administration of the UI program. This new proposal would authorize the Secretary of Labor to waive certain Federal requirements at states' request to permit them to run demonstration projects that would accelerate the reemployment of claimants or improve program administration. It is important to note that the Department could not grant a waiver if it would limit the state's ability to promptly determine and pay benefits to eligible workers or deny due process of the law. The demonstration would also have to be cost neutral with respect to the effect on the state unemployment fund. The proposal would permit states to experiment with program design in ways that may benefit unemployed workers and provide important experience and information for the federal-state UI system. We would welcome the opportunity to work with you on demonstrations that spur innovation and flexibility in the UI program.

Appropriations Requests

The legislative proposals I just described would give states access to additional funds in the long term. However, following enactment at the Federal level, state legislation will be required before certain proposals related to new resources can be implemented. Thus, there would be some delay before theses funds would be available. The Department's request for FY 2007 appropriations includes increased funding for state UI operations to reduce improper payments and speed the reemployment of UI beneficiaries. This modest increase of $40 million would give states additional resources right away, in FY 2007, to expand certain improper payment reduction efforts.

Each of the increases proposed for FY 2007 would more than pay for itself in reduced benefit payment outlays from state unemployment funds. I hope that you will communicate your support for the initiatives described below to the Committee on Appropriations.

Combat Identity Theft. Also in support of UI payment integrity, the FY 2007 budget requests an appropriation of $10 million to prevent and detect fraudulent UI claims filed using personal information stolen from unsuspecting workers. Most UI claims are now filed by telephone or the Internet, making the UI program convenient for unemployed workers to access and more efficient to administer. However, telephone and electronic access create new opportunities for schemes to obtain benefits fraudulently. The Department's OIG documented identity theft schemes in the UI program as a top management challenge. At the core of the OIG's concerns is that identity theft is now conducted by "nontraditional organized crime groups" that result in more sophisticated fraud schemes than previously seen within the UI program. The OIG reported that two schemes, one involving four states, were responsible for over $11 million lost to the unemployment trust fund. Based on available

data, we estimate that the nationwide incidence of identity theft improper payments is approximately $313 million a year out of benefit outlays totaling $32 billion a year.

The $10 million request for FY 2007 would be used to deploy a suite of safety checks that include automated address verifications, electronic screens to detect "at risk" claims, staff training to detect the warning signs that are indicative of fraud, increased investigative staffing, and enhanced employer outreach efforts. The requested funds for identity theft prevention and detection would enable states to staff positions to promptly examine and reconcile discrepancies in individuals' personal identifiers before first payments are made. The proposed safeguards would more than pay for themselves, as these activities are expected to prevent an estimated $77 million in improper payments. We think this is a good investment of scarce taxpayer resources.

Ensuring Continued Eligibility and Promoting Reemployment. Another key element to improving UI payment integrity is ensuring that UI beneficiaries meet requirements for continued eligibility. In general, beneficiaries must be able to work, be available to work, and actively seek work to remain eligible. Facilitating reemployment of UI beneficiaries is also a priority for the UI program. The best way to help UI beneficiaries is to help them find good jobs quickly. We have developed an initiative that supports both of these objectives.

Last year, the Department provided funds to 20 states and the District of Columbia to provide Reemployment and Eligibility Assessments, or REAs, to UI beneficiaries. A number of independent studies found that attention to eligibility and reemployment service needs assessments resulted in relatively shorter claims duration for beneficiaries by speeding reemployment and reducing improper payments. The REAs strengthen the integrity of the UI program by assuring eligibility requirements are met and offering personalized assistance with work search plans and other services through One-Stop Career Centers. In the FY 2007 budget, we request an appropriation of $30 million to expand the REA initiative to additional states for reviewing beneficiary eligibility and providing job search assistance in person. We estimate that this $30 million expansion of current REA efforts would reap as much as $151 million in savings to state unemployment funds.

Conclusion

Thank you for the opportunity to present initiatives that we believe will improve the benefit payment and tax integrity of our nation's UI program and promote innovations that can make it more responsive to the demands of our 21st century economy and workforce. We look forward to working with the Subcommittee on these issues. I will be glad to respond to any questions you may have.

Chairman HERGER. Thank you, Mr. Bishop. The gentleman from Louisiana, Mr. McCrery, to inquire.

Mr. MCCRERY. Thank you, Mr. Chairman. Mr. Bishop, I noticed in the Administration's budget proposal that you propose to extend the 0.2 percent FUTA surtax. As you know, that was created a number of years ago as a temporary surtax. Why does the Administration think it is necessary to continue that temporary surtax?

Mr. BISHOP. Well, as you know, we looked at that surtax a few years back in terms of reform——

Mr. MCCRERY. Right.

Mr. BISHOP. —and I think that we would continue to want to tie that to reform efforts. At this point, the Office of Management and Budget made a decision that they wanted to recommend to Congress to continue that surtax in order to assure that there were moneys in the Federal unemployment trust fund to conduct the kinds of activities we need to do.

Mr. MCCRERY. Well, what is the balance on the trust fund now?

Mr. BISHOP. Do you know the latest balance? Thirty billion? I will have to get that.

Mr. MCCRERY. It is about $30 billion, isn't it?

Mr. BISHOP. Thirty billion roughly, I believe. Yes.

Mr. MCCRERY. How much do we spend in a typical year from the trust fund?

Mr. BISHOP. Well, our appropriation for State administrative activities is roughly $2.7 billion to $2.8 billion. Then there obviously are loans that some States have. We don't have many States that have loans at this time. As you know, when we run into recessionary times, which we did about 4 years ago, often the trust fund can go down quite a bit, and with redact distributions and other things. We do believe in having a healthy trust fund level. But again, you know, it is a really a balancing act that Congress and the Administration have to discuss, and we can continue to discuss that with you if you like.

Mr. MCCRERY. I hope we do. It sounds to me, Mr. Chairman, like the Administration is really holding on to that surtax as some sugar to include in a future reform proposal, which is fine. But in the past few years, actually, the Administration has had a proposal for reform, which basically dealt with moving to the States much of the responsibility for collection and distribution of administrative taxes and costs. What has happened to those proposals? Are you looking at polishing those and bringing them back to us? Or what is the status?

Mr. BISHOP. Well, again, we would be more than willing to talk to Congress at any time around administrative funding reform. We have not specifically proposed that in the FY2007 budget. Instead, we have proposed the UI waiver proposal that we believe would give States—while they wouldn't, under our waiver proposal, specifically be able to do administrative funding reform, they would be able to ask for waivers that might help speed the reemployment of claimants or other administrative efficiencies they might be able to find in their laws. We have felt that through waiver authority, it may demonstrate that States can operate these programs in different ways that better connect to the 21st century rather than the 20th century when the law was originally created back in the 1930s. While we don't have a specific proposal for administrative funding reform, if Congress would like to engage in that discussion, we would be more than willing to do so. But at this point, we have proposed the UI waiver authority so we can at least get the ball rolling and start showing that, indeed, States probably can make more sense of the program as it is currently constituted.

Mr. MCCRERY. Okay. Well, thanks. We look forward to working with you to reform the system, and I appreciate your somewhat frank answer to the question. I yield back, Mr. Chairman.

Chairman HERGER. I thank the gentleman. The gentleman from Washington, Mr. McDermott, to inquire.

Mr. MCDERMOTT. Mr. Bishop, witnesses on the next panel will testify that Federal funding for the administration of UI has failed to keep pace with inflation. Do you agree with that?

Mr. BISHOP. I agree that we are in a tight budget cycle and that often there are many competing priorities.

Mr. MCDERMOTT. Do you agree that they have failed to keep up with inflation?

Mr. BISHOP. I don't have evidence of that.

Mr. MCDERMOTT. You don't have any evidence of that. You disagree with that?

Mr. BISHOP. I don't have—I don't have evidence. I disagree——

Mr. MCDERMOTT. We have a fundamental disagreement about whether——

Mr. BISHOP. The States get adequate funding in order to operate their State UI programs currently.

Mr. MCDERMOTT. By your definition. You say it is a statement you are making. They get adequate money?

Mr. BISHOP. They are all able to run their UI systems with the moneys they receive currently.

Mr. MCDERMOTT. But is it possible, if you are not keeping up with inflation and don't have enough people and whatever, that you then let some things slide through because you just don't have enough people to look at the data?

Mr. BISHOP. Well, it is just like any program. When you are managing programs at the Federal, State, or local level, any programs, you have competing priorities, and you have to take the moneys you have and deal with the competing priorities you have. Many of the competing priorities in the program, obviously, are benefit timeliness, payment accuracy, overpayments, and the like. They have to take the administrative moneys they receive and meet those competing priorities.

Mr. MCDERMOTT. Do the best they can with it.

Mr. BISHOP. Sure.

Mr. MCDERMOTT. That is okay. I understand that. If there is a problem, then the next question I have is I see your proposal to seize the Federal tax refunds from individuals who have received overpayments.

Mr. BISHOP. Yes.

Mr. MCDERMOTT. Does it make any distinction between whose fault it is?

Mr. BISHOP. It does. Yes, it does. There are actually a number of different kinds of overpayments, and there are some overpayments that are not the fault of the individual. Typically, the way it operates is when overpayments are not the fault of the individual, then the States do not establish overpayment recoveries in those cases. The only overpayments that would go to the Internal Revenue Service (IRS) are those that are at the fault of the claimant that have been established by the State, due process is provided to the claimant, and then that goes to the IRS for that collection.

Mr. MCDERMOTT. You are not going to take innocent mistakes?

Mr. BISHOP. No, we would not. Our proposal provides for due process——

Mr. MCDERMOTT. We haven't seen the legislative language. That is why I am saying——

Mr. BISHOP. Yes.

Mr. MCDERMOTT. You know, I am operating in the dark here as to what you really want to do, and I get worried when I am operating in the dark with you guys.

Mr. BISHOP. Well, we apologize for that. We have just finished up our legislative language, and you will have it today.

Mr. MCDERMOTT. Your statement is that it will not be applied to somebody where there is an innocent mistake?

Mr. BISHOP. That is correct.

Mr. MCDERMOTT. Okay. Now if the Administration is interested in helping the UI recipients, it seems to me it is questionable why you would allow annual funding for the employment-related services to decline by $1.4 billion since 2002. What is your justification for cutting the money in a program which seems to be working? I mean, unemployment is down and everything. Why would you go in and cut the money?

Mr. BISHOP. Which? I am sorry. I am not sure what you are referencing when you say we cut $1.4 billion.

Mr. MCDERMOTT. In the cuts in the WIA and the ES Program, CRS says you cut $1.4 billion from 2002.

Mr. BISHOP. Well, first of all, the Employment Service Program has gone down. There was a cut last year of roughly $60 million. Thirty million dollars in the basic employment service and then the elimination of the reemployment service grants. Let me just walk you through——

Mr. MCDERMOTT. But $60 million——

Mr. BISHOP. Sixty million in the ES.

Mr. MCDERMOTT. —is not $1.4 billion.

Mr. BISHOP. Well, I would have to see where CRS is coming up with the $1.4 billion target. They may be including our proposed 2007 budget for the WIA because I am not sure where $1.4 billion would be coming from. But let me just quickly explain what the situation is. Right now, essentially, I hate to admit, but in this country we fund two workforce investment systems. We fund a State-based employment service system and a locally based WIA system. The labor exchange services authorized under the Wagner-Peyser Act (P.L. 73–30) for the ES are the exact same services that are authorized by the WIA, and they are called "core services." We essentially are funding duplicative and inefficient administrative bureaucracies in the States and local communities. In fact, we are only training 200,000 people with $4 billion in this country right now. Given the public policy priority we have as a result of our need to be competitive in a global economy, where we need to give people better access to post secondary training activities and we are only graduating 200,000 in a program with $4 billion, we think that we can do a lot better. We have proposed the consolidation of these programs into one. We can still, even with the President's FY2007 budget request for WIA, more than triple the number of workers trained because so much of the moneys are going to administrative overhead and bureaucracy and competing bureaucracies out there.

Mr. MCDERMOTT. It is your testimony that there will be no reduction in services by taking that money out and making one program out of it?

Mr. BISHOP. That is my testimony because right now——

Mr. MCDERMOTT. That legislative language is before the Congress?

Mr. BISHOP. Yes, it is. Right now, out of that $4 billion, as States report to us, about $1.2 billion to $1.5 billion of that goes to administrative infrastructure. We are only training, exiting 200,000 people in training right now under the WIA. Again, the services authorized under the Wagner-Peyser Act and the services authorized under the WIA are the exact same services. You have

got State-based ES, locally based WIA services. The One-Stop Career Centers you reference? I can show you One-stop Career Centers all over the country where you have got a One-Stop in one community and an employment service office in the exact same community competing for business. Even where they have brought them together in the same building, I can show you buildings where you go to one side, and it is the employment service. You go to the other side, it is the WIA. When you ask them who goes where, you get this sort of mumbled jumbled, "Well, if you are this guy or that guy or that," and you can't even explain it. We are not doing any favors to workers in this country by continuing to operate the programs as we are. They are inefficient. They are administratively burdensome. There is lots of overhead. We can do a lot better, and that is what we have proposed.

Mr. MCDERMOTT. Well, you are making a heavy charge, and we will have some people here from the States, and we will ask them about it. Thank you.

Mr. BISHOP. Sure.

Chairman HERGER. I thank the gentleman. The gentleman from Colorado, Mr. Beauprez, to inquire.

Mr. BEAUPREZ. Thank you, Mr. Chairman. Thank you, Mr. Bishop, for being with us today. I applaud your efforts to try to make the program better. One of the places that I am sure concerns you, I take it, from your testimony is the overpayment issue. Nine percent of total benefits paid out is, I think, excessive by almost anybody's definition. It would seem to me that technology today probably offers some hope for improvement in that overpayment problem, $3 billion. Tell me, where is the hope? How can we get our arms around this, I hope, quickly?

Mr. BISHOP. Well, first, technology has been wonderful just in its opportunity to allow people to apply for UI. Most people, often we get asked, "Where are the unemployment offices?" There really aren't any anymore. Because of the Internet and telephone technology and other technologies, people now can apply in a much more easier, customer-service focused fashion. Where technology has helped us on the overpayment side are with things like better—many States now have agreements with the Social Security Administration, where we are using technology to cross match Social Security numbers. So that if somebody falsely grabbed a Social Security number and applied for UI benefits, we can start to find out now that that is a fraudulently obtained Social Security number. That is one major example. Also, the access to not only State Directory of New Hires, but Congress gave the workforce agencies access to the NDNH to assure that one of the biggest reasons for overpayments are people who go back to work, but then maybe collect an extra week or two, even though they have gone back to work. Well, now we have access to the NDNH, the States do. As a result of that, the ability to make that technological connection, we know when people are going back to work, and then we can set up an overpayment collection if we need to do so in those kinds of cases. Those are two big examples of how we——

Mr. BEAUPREZ. We have got a legitimate—well, not legitimate. We have got an overpayment problem to people who at least are legitimately supposed to here and working, but we have also got a

payment problem to people who aren't even supposed to be legally working here?

Mr. BISHOP. No, no, no. There are reasons why—there are particular reasons whey there are overpayments. Probably the largest reason for an overpayment that is the fault of the claimant is the claimant going back to work, but yet continuing to make a claim even though that individual has gone back to work.

Mr. BEAUPREZ. I understand that.

Mr. BISHOP. If you are an undocumented worker or illegal immigrant, whatever you want to call it——

Mr. BEAUPREZ. Illegal.

Mr. BISHOP. —you are not allowed to work in the country. Therefore, you are not allowed to collect UI. However, there are cases, whether individuals here illegally or legally, where maybe they fraudulently obtain a Social Security number.

Mr. BEAUPREZ. Right.

Mr. BISHOP. They need that Social Security number in order to apply for UI. We now are in the process of connecting all States to be able to cross match with the Social Security Administration to assure that Social Security numbers are not being fraudulently obtained and used for UI purposes. We started a pilot in two States. That was resoundingly successful. Now we are in the process of rolling that out to every State.

Mr. BEAUPREZ. Let me ask you then, one of the biggest questions I get asked by employers who would like to comply with the law that says you have to hire only legal workers is that they don't have access to a good system to verify that their Social Security numbers they are being given are accurate. Will that possibility exist in the very near future?

Mr. BISHOP. Congressman, I can't answer that question. That is not within the realm of my discussion here on UI. That may be Homeland Security or another agency could help with that or another part of DOL. But I just don't have information on whether that is available or not.

Mr. BEAUPREZ. Well, let me stay on point then. We have got an overpayment problem. Do we also have a problem of some percentage of absolutely false, erroneous payments?

Mr. BISHOP. Yes.

Mr. BEAUPREZ. Do we know what that number is?

Mr. BISHOP. We do. Like I said, let me give you kind of a quick breakdown, sort of a three broad category breakdown, the way we do it. We have what are called nonfraud recoverable overpayments, which are overpayments in the absence of fraud or abuse, but they are recoverable. That is about $1.4 billion. Then we have what are called the nonfraud not recoverable, where there was an absence of fraud or abuse, and the State does not choose to recover it. This gets to what Congressman McDermott was asking. Those are cases where an employer may have overstated quarterly wages, and so the recipient received more than he or she should have, and it wasn't their fault. Therefore, the State typically won't collect those back. That is about $722 million. Then we do have fraudulent overpayments, and that is about $811 million last year. That is kind of the three broad. Clearly, the first and third are the ones we really want to go after.

Mr. BEAUPREZ. Aggregated together, about $3 billion?

Mr. BISHOP. About $3 billion. That is correct.

Mr. BEAUPREZ. Thank you. I yield back, Mr. Chairman.

Chairman HERGER. Thank you. The gentleman from California, Mr. Becerra, to inquire.

Mr. BECERRA. Thank you, Mr. Chairman. Thank you, Mr. Bishop, for being here with us. Let me ask a couple of questions going back to a point that was raised by the gentleman from Washington, Mr. McDermott, on the tax refund offset that the Administration is proposing. If you grant the authority to seize some of these refunds that individuals receive for taxes paid for the purpose of collecting overpayments in unemployment that was given to the individuals, did I hear you say to Mr. McDermott that it would not include the seizing of refunds from those individuals where the overpayment that the individual received was as a result of innocent error?

Mr. BISHOP. That is correct. In other words, the reason is, Congressman, because the State in those situations would not set an overpayment recovery in the first place. In other words, if, like I mentioned in my second piece here, if it was due to, say, the employer had overstated the quarterly wages and so, therefore, the recipient received more than he or she should have, the State won't set up an overpayment recovery in that case. Therefore, there would be nothing to then send to the IRS.

Mr. BECERRA. Tell me if there are any examples that you can think of where an individual would have received an overpayment in UI that was due not to the individual's intention to defraud the Government, but where the refund, the tax refund that that individual may receive would still be subject to seizure? Is there any example?

Mr. BISHOP. I can't think of an example where that would happen.

Mr. BECERRA. Okay. So long as the individual who received the UI overpayment did not receive it as a result of any intentional fraud, that individual would not be subject to having his or her tax refund seized for the purpose of collecting the overpayment?

Mr. BISHOP. That is correct. Then let me just again add that when an overpayment is established by the State, those recipients have due process rights. If they feel that that overpayment has been set inappropriately or incorrectly or that, they have the ability to appeal and go through a continual appeals process. That process would have to play itself out before any referral to the IRS would occur.

Mr. BECERRA. Thank you for that response. With regard to enlisting debt collection agencies to recover overpayments and delinquent unemployment compensation (UC) taxes, do you have a sense of how much we would pay someone to collect moneys owed to the Government?

Mr. BISHOP. I don't have a particular figure in my head. I think it would be similar to how other entities, Government sometimes allows private collection agencies to collect on behalf of other kinds of delinquent——

Mr. BECERRA. I would be very interested, Mr. Chairman, to the point, to the degree that the agencies and the Federal department

here could give us a response. I would be very interested to know where they head in this proposal. Because I have seen some proposals come forward from the Administration, where we would be paying debt collectors something in the order of 25 percent to over 50 percent of the amount that is due to the Government as a duty for that debt collection when we know that the Federal Government, through its own enforcement agencies, could do it for a lot less money. It is just a matter of making sure you have a force in place within the Government to do so. I would be very interested to see what we come up with. Because I don't want this to be soft debt collectors who go out there and make money on the taxpayers' dime simply because the Government made an error in not collecting or in overpaying. I would be very interested in getting that information.

Mr. BISHOP. Okay.

Mr. BECERRA. Thank you. Final question would be a little bit off the subject on the issue of the minimum wage. We have not seen an increase in the minimum wage in close to 10 years now. At this stage, at $5.15 an hour, the minimum wage is at its lowest point ever. Even if you make the minimum wage, for a full year's work—and over 2 million Americans today are working full time at the minimum wage—you are earning less, about two-thirds of what we consider to be poverty. You can't even meet the threshold of what we consider to be poverty working at the minimum wage. While there are 2 million people who receive at the full-time basis the minimum wage, you have another 10 million Americans who earn something between $5.15 an hour, the minimum wage, to about $7 an hour. On top of that, if you include folks who make between $7 and $8 an hour, which is still a very, very modest wage, you are talking about another 8 million Americans who would fall into that category. Have there been any discussions within the DOL with the Secretary, Secretary Chao, about the need to try to increase the working wage for many millions of Americans who are right now earning the minimum wage at $5.15 an hour?

Mr. BISHOP. We have a lot of conversations about helping increase wages, but let me tell you the context of the conversations we have. The context of the conversations we have are about the data that shows the gap that is emerging in our country between those that have post secondary educational attainment. That is not just 4-year degrees. It may be 2-year degrees, industry-recognized certifications, licenses, and so forth, apprenticeship programs. Those who do and those who do not. The concern we have is that if you look at that data, we have to, as a Government, our national policy has to be about trying to provide as much access to people as possible through various successful post secondary programs, specifically through community colleges often. That is the conversation we have. That is how people's wages are going to rise. Their wages are going to rise through the ability to connect to post secondary and to go into very well-paying jobs, whether they be skilled jobs like in skilled trades or whether it be professional jobs or the like. We have many, many individuals who, with better access to post secondary education and training, could get higher wages. That is the kind of conversation we have been having.

Chairman HERGER. The gentleman's time has expired.

Mr. BECERRA. Thank you, Mr. Chairman.

Chairman HERGER. The gentlelady from Pennsylvania, Ms. Hart, to inquire.

Ms. HART. Thank you, Mr. Chairman. I want to touch on that issue before I jump into another question. I thought that was a very appropriate answer. A lot of the States have already addressed the minimum wage issue themselves. Notably, Washington State has a minimum wage of $7.63 an hour. It is interesting, if you look at unemployment rates and some of the States that actually have raised the minimum wage, and I don't think the news is good, depending on how high they go, if they are going over what the market might want to demand. But I think our goal is to certainly find more opportunities for people to get educated so that they will obviously earning more money. I wanted to make that point. I think it is important for the UI Program to provide for opportunities for people to become reemployed as quickly as possible. I mean, obviously, there are time limits and other things placed on the program on purpose because the goal is not for people to be unemployed for as long as they can be under the program. The goal is for them to have some sustenance while they are looking and until they find another job. I noticed in your testimony a proposal to allow for waivers for certain requirements in the unemployment program, different rules. Can you give us some examples——

Mr. BISHOP. Sure.

Ms. HART. —of unemployment waiver programs that some of the States could choose to operate if Congress actually makes this authority available to the States? I am interested in that and some of the things that you may be looking to learn from the types of waivers that we would grant.

Mr. BISHOP. Yes, thank you, Congresswoman. First, our proposal for waivers would be in two broad areas. One, it would be waivers that would help facilitate more rapid reemployment, or the second would be methods of administration and more efficient ways to administer the program. Those are kind of the two broad areas. Frankly, our hope would be, just like when this kind of authority has been granted historically to States, that States would come up with things that we haven't even conceived of at this point. We have thought of particular instances where, through this waiver authority, there might be ways—for instance, there might be accounts that people would like to be able to, States may want to work with their folks to establish. I mean, part of the problem we have now is we have a black or white system. Either you are unemployed and you get a check, or you are employed and you don't. We can conceive of ideas that States may come up with sort of as the laboratories of democracy, which we like to say, whereby they may have ways to help people transition more easily from that sort of black or white kind of situation. Where they may want to set up accounts to help people use some of the money to get retrained while they are working or that maybe in certain cases they may want to do wage supplementation or other kinds of ideas. We are pretty much open to anything. We think that those are kind of the two broad areas. That within those two broad areas, there are things that the States would be creative about. I might add on the UI waiver authority that those waivers would not only come in

from the Governor, but they would have to be approved by State legislature. There is that check there. It would be approved by the Secretary, and that they would be time-limited demonstration projects and that they would have to be cost neutral, and the States would have to provide a final evaluation or report on the results of the demonstration as well. Our hope is to use this to learn, to be able to come to Congress and make suggestions on improvements in the program because, as has been stated earlier, it was created in 1935, and we are now in 2006. The economies of those two eras are very, very different.

Ms. HART. Thanks. Further on that, I know one of the goals that in years past was addressed very well was the change in welfare and the system.

Mr. BISHOP. Yes.

Ms. HART. Obviously, we saw it work really well and the States moving forward. Now we are looking at some changes in the medical liability system and how it has worked well in the State of California and how we really do need to implement that Nation wide. I think it is a great idea to give the States the freedom to do that for a lot of reasons. But obviously, they can see results more quickly. Certainly, it is a lot easier to get the support from the House and Senate here on the Federal level if we have seen some real positive results with the program. I think that is a great idea, and I am very supportive. Let us know what we can do to help that happen.

Mr. BISHOP. Thank you. I appreciate that. Thank you.

Ms. HART. I yield back, Mr. Chairman.

Chairman HERGER. I thank the gentlelady. Mr. Bishop, the SUTA Dumping Prevention Act of 2004 requires States to strengthen their UC laws to better prevent SUTA dumping, which involves unemployment tax avoidance schemes by some employers. That act also requires Secretary Chao to submit a report to Congress by July 15th of this year, 2006, assessing State actions to comply with this law and recommending any additional congressional actions. First, how is the implementation of this law going? Second, when will we receive your official report?

Mr. BISHOP. Well, I guess the easy answer is we will make sure we submit the official report by the date that Congress has mandated. I will turn to my staff behind me and remind them that they have got to make sure we get that report up here. But we think the SUTA dumping implementation has gone very, very well. We actually only have one State—unfortunately, we do still have one State outstanding that has not enacted their State SUTA dumping law. But all of the other States have complied. States have really begun the process of enforcing and looking after that. Right now, the States that piloted the SUTA dumping detection software found many cases of potential SUTA dumping. In Utah, they found 36 cases. Rhode Island, 21. In California, there was 419 cases of SUTA dumping. In Virginia, 62. Now this pilot was before the full legislation was enacted by the Congress, but it gives you some idea of what we saw early on as a result of those States piloting it. We will continue to monitor that, and we will, again, make sure we get the report up to you in a timely manner.

Chairman HERGER. Thank you. Could you tell us more about the outcomes in States that have started to match data in the NDNH with their State unemployment rolls? Are there savings that have already been found as a result of this?

Mr. BISHOP. If I could, if I could follow up with you with the answers to those questions? It is still a bit early in terms of the access because the access to that national directory occurred through the SUTA dumping legislation. If I could, if I could forward you up some early results from that, we could do that as a follow-up.

Chairman HERGER. That will be fine. Mr. Bishop, I want to thank you again for testifying.

Mr. MCDERMOTT. Could I ask one clarifying question?

Chairman HERGER. Quickly, yes.

Mr. MCDERMOTT. We were presented with the text of this legislation just at the beginning of this hearing. I hadn't had a chance to look at it when I asked a previous question. I have looked at it now, and it authorizes the IRS to recap overpayments. But I don't see anything that says the States cannot seek overpayments and the IRS can't help them do that if the overpayment was not at the individual's fault. Now you state that the States won't go after people when it is not their fault. But the legislation does not state that. But it is your intention, what Mrs. Chao sent up here dated May 3, the intention of that is that the States cannot go against people if it is not their fault?

Mr. BISHOP. That would be the intention. If the Subcommittee feels we need to work on language that makes that more clear, we would love to work with you on that.

Mr. MCDERMOTT. I would hope you would look at section five.

Mr. BISHOP. Okay.

Mr. MCDERMOTT. Because that is the section where I looked for it, called "Collection of Past Due," and I think that that is where you ought to work out some language so that it is clear.

Mr. BISHOP. Okay. We will definitely do that.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Chairman HERGER. You are welcome. Again, thank you very much, Mr. Bishop, for your testimony.

Mr. BISHOP. Thank you, Mr. Chairman.

Chairman HERGER. Would the next panel please have a seat at the table? On this panel, we will be hearing from Dr. Sigurd Nilsen, director of education, workforce, and income security issues at the GAO. Roosevelt Halley, president-elect of the National Association of State Workforce Agencies (NASWA). My Ranking Member, do you have a constituent of yours that you would like to introduce?

Mr. MCDERMOTT. Mr. Chairman, I would like to introduce Mr. Devereux, who is executive director of the American Federation of State and County Municipal Employees (AFSCME) in Washington State and also I think vice president of the international. Is that correct?

Mr. DEVEREUX. That is correct.

Chairman HERGER. Thank you very much.

Mr. MCDERMOTT. He represents the workers on the frontline, and so we look forward to hearing his thoughts today. Thank you for your courtesy.

Chairman HERGER. You are welcome. Thank you. Good to have you with us.

Mr. DEVEREUX. Thank you.

Chairman HERGER. Dr. Wayne Brough, adjunct scholar at the American Institute for Full Employment. Howard Rosen, visiting fellow at the Institute for International Economics. Dr. Tim Kane, director of the Center for International Trade and Economics at the Heritage Foundation. Dr. Nilsen?

STATEMENT OF SIGURD NILSEN, PH.D., DIRECTOR, EDUCATION, WORKFORCE, AND INCOME SECURITY ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Dr. NILSEN. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss the DOL's FY2007 budget request for the UI Program. I will focus on two areas. First, Labor's efforts to prevent improper benefit payments and, second, what is being done to help speed UI claimants' return to work. Regarding improper payments. Labor estimates that about $3.4 billion in UI overpayments occurred Nation wide in 2004, as you have heard already, including almost $2 billion that is attributable to UI claimants alone. These overpayments occur for a variety of reasons, including unreported or erroneously reported earnings in income, the most common cause, accounting for about 28 percent of overpayments.

In addition, some UI overpayments result from identity-related violations. Labor estimates that approximately $313 million in overpayments result from identity theft each year. Labor has introduced several initiatives to help States improve their ability to detect and prevent overpayments in the UI program. Most notably, Labor has initiated a pilot using the NDNH to identify and prevent overpayments by identifying UI claimants who may be working. In 2005, three States participated in the pilot. Five other States are now participating, and Labor says that by the end of this year, they will have 29 States participating in this program. Initial results show that the overpayment detections increased by between 40 percent and 114 percent as a result of the access to this directory of new hires. Labor has also funded States to exchange data with the Social Security Administration on a real-time basis, giving States the ability to verify UI claimants' identity and prevent most overpayments due to fraudulent or mistaken use of Social Security numbers.

Labor's budget request includes $10 million to detect and prevent fraudulent UI benefit claims using personal information stolen from workers. Labor estimates that this could generate savings of at least $77 million. As we have heard, Labor has provided its legislative proposal, which appears to increase its focus on overpayments. The proposal will allow Treasury to intercept Federal income tax refunds to recover UI overpayments and allow States to use a small percentage of recovered overpayments to fund their Benefit Payment Control and program integrity activities. It was our understanding also that the proposal will contain provisions

that will require States to charge employers a higher UI tax rate when claimants are overpaid, if it is determined that the overpayment was the employer's fault, such as when the employers fail to provide wage information to the State in a timely manner.

Turning now to efforts to help speed UI claimants' return to work. We found that States make use of Federal UI program requirements to help connect claimants with reemployment services usually beginning at the time their initial claim is filed. States primarily target reemployment services to claimants identified through Federally required claimant profiling systems, a process that uses a statistical model to identify claimants who are most likely to exhaust their benefits before finding work. While claimants identified and referred to services through profiling can access the services available to all job seekers through the One-Stop system, participation in the services they are referred to is mandatory for profiled claimants. In 2005, Labor began awarding Reemployment and Eligibility Assessment Grants that focus on face-to-face eligibility interviews to ensure program compliance, coupled with referrals to reemployment services. For 2007, Labor has requested $30 million to continue this effort, and Labor estimates that this could be used to conduct interviews with about a half million claimants and save about $150 million by reducing the average duration of UI benefits.

Despite efforts to link UI claimants to reemployment services, little data are available to gauge the extent to which these efforts are having the intended result. Few States go beyond the limited Federal reporting requirements to routinely track the extent to which UI claimants receive reemployment services. Fewer still monitor outcomes for UI claimants who receive these services. Labor has some initiatives that may begin to shed light on claimant outcomes, but these efforts may not go far enough. Labor has added a performance measure on the reemployment rate for their UI claimants. While Labor is evaluating the profiling process, it focuses exclusively on how well the models predict whether a claimant will exhaust UI benefits, not on whether the process results in shorter benefit durations or better employment outcomes for claimants. Finally, no additional funds have been requested in FY2007 specifically to conduct evaluations on profiling. Mr. Chairman, this completes my prepared statement. I would be happy to answer any questions you or Members of the Subcommittee may have.

[The prepared statement of Dr. Nilsen follows:]

Statement of Sigurd Nilsen, Ph.D., Director, Education, Workforce, and Income Security Issues, U.S. Government Accountability Office

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to assist you in your deliberations on Unemployment Insurance (UI) program performance issues as they relate to the Department of Labor's (Labor) $2.7 billion fiscal year 2007 budget request for the UI program. My testimony will focus primarily on the results of our past work in UI benefit overpayment and reemployment services. The UI program has been a key component in ensuring the financial security of America's workforce for over 70 years. The UI program is a federal-state partnership designed to partially replace lost earnings of individuals who become unemployed through no fault of their own and, which in turn, helps to stabilize the economy in times of economic downturn. In fiscal year 2004, the UI program covered about 129 million wage and salary workers and paid about $41 billion in benefits to nearly 9 million workers who had lost their jobs.

Labor and states have a shared responsibility to enhance UI program performance by ensuring that only eligible individuals receive benefits while on the UI rolls and to foster reemployment. However, Labor's Office of Inspector General (OIG) and others have found that numerous aspects of the UI program may be vulnerable to fraud and to improper payments to claimants, and, despite the size and scope of this program, there has been little information at the national level to fully assess states' efforts to foster reemployment.

Today, I will draw upon results of recent reports we have completed that provide information on UI program performance issues. In particular, I will discuss in relation to Labor's budget request (1) Labor's efforts to identify, estimate, and prevent improper benefit payments, and (2) what is being done at the state and federal levels to help speed UI claimants' return to work. To address the first question, we drew upon two of our recent studies. In the first study, we reviewed Labor guidance, data, and reports and interviewed Labor officials and groups involved in unemployment insurance.[1] In the second study, which reviewed states' efforts to estimate improper payments on state-administered federal programs, including UI, Food Stamps, Medicaid, and other programs, we primarily conducted surveys of state officials, interviewed federal and state officials, and reviewed performance and accountability reports and our prior reports.[2] To address the second question, we drew upon the results of another of our previous study, where we had conducted telephone interviews with UI and workforce development officials in 50 states; sent a follow-up questionnaire to gather information on the strategies states use to collect data on UI claimants who receive reemployment services; interviewed state and local program officials during site visits in Georgia, Maryland, Michigan, and Washington; and interviewed Labor officials and other experts in the area of UI and reemployment services.[3]

In summary, Labor estimates that about $3.4 billion in UI benefits was overpaid nationwide in calendar year 2004, but is taking actions to help states improve their ability to detect and prevent overpayments. Labor attributes a majority of overpayments to improper actions taken by claimants, although states and employers can also contribute to overpayments. Labor has introduced a number of initiatives to help states improve their ability to detect and prevent overpayments, including new computer matches with federal databases, a new core performance measure intended to provide states with added incentives for detecting and preventing overpayments, and additional funding for states' overpayment detection efforts. Labor's budget request for fiscal year 2007 includes funding to continue some of these efforts. As annual overpayments reach the billions, it will be important for federal and state stakeholders to take the necessary action to address the overpayment issue. Avoiding improper payments may do more to enhance program performance in the long term than detecting and collecting overpayments after they have occurred. To help UI claimants return to work quickly, states most often make use of federal UI program requirements to connect claimants with available services at various points in their claims. In addition, states provide targeted reemployment services to particular groups of UI claimants. The federal requirement of claimant profiling is typically the primary mechanism for targeting reemployment services to specific claimants. However, despite states' efforts to design systems that link UI claimants to reemployment services, few data are available to gauge the extent to which their efforts are having the intended result. Labor's current and planned initiatives may help fill the information gap, but they fall short of providing a comprehensive understanding of services and outcomes for UI claimants.

Background

The UI program was established by Title III of the Social Security Act in 1935 and is a key component in ensuring the financial security of America's workforce. The program serves two primary objectives: (1) to temporarily replace a portion of earnings for workers who become unemployed through no fault of their own and (2) to help stabilize the economy during recessions by providing an infusion of consumer dollars into the economy. UI is made up of 53 state-administered programs that are subject to broad federal guidelines and oversight. In fiscal year 2004, these programs covered about 129 million wage and salary workers and paid benefits totaling $41.3 billion to about 8.8 million workers.

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[1] GAO, Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments, GAO–02–697 (Washington, D.C.: July 12, 2002).

[2] GAO, Improper Payments: Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs, GAO–06–347 (Washington, D.C.: Apr. 14, 2006).

[3] GAO, Unemployment Insurance: Better Data Needed to Assess Reemployment Services to Claimants, GAO–05–413 (Washington, D.C.: June 24, 2005).

Federal law provides minimum guidelines for state programs and authorizes grants to states for program administration. States design their own programs, within the guidelines of federal law, and determine key elements of these programs, including who is eligible to receive state UI benefits, how much they receive, and the amount of taxes that employers must pay to help provide these benefits.[4] State unemployment tax revenues are held in trust by the federal government and are used by the states to pay for regular weekly UI benefits, which typically can be received for up to 26 weeks.

To receive UI benefits, an unemployed worker must file a claim and satisfy the eligibility requirements of the state in which the worker's wages were paid. Generally, states require that workers must have a minimum amount of wages and employment over a defined base period, typically about a year before becoming unemployed, and have not already exhausted the maximum amount of benefits or benefit weeks to which they would be entitled because of other recent unemployment. In addition workers must have become unemployed for reasons other than quitting a job or being fired for work-related misconduct, and be able and available to work. In order to demonstrate that they are able to work and available for work and are still unemployed, claimants must submit a certification of continuing eligibility—by mail, telephone, or Internet, depending on the state—throughout the benefit period. This practice is usually done weekly or biweekly. States may continue to monitor claimant eligibility through an eligibility review program, in which certain claimants are periodically contacted to review their eligibility for benefits, work search activities, and reemployment needs.

UI Performance Measurement

Labor has the responsibility under Title III of the Social Security Act for ensuring that states operate effective and efficient UI programs. Various provisions of federal law require that certain UI activities be performed promptly and accurately. Section 303(a)(1) of the Social Security Act requires, as a condition of a state's receiving UI administrative grants, "such methods of administration . . . as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due." Labor uses various administrative data to provide information on the functioning of all UI program activities. Labor divides the measures into two categories: core measures, which entail oversight on key performance areas representative of the UI program, and management information measures, which facilitate the analysis of performance and to assist in planning corrective activities when necessary.

One of Labor's performance measurement efforts is the Benefit Accuracy Measurement (BAM) program, which is designed to determine the accuracy of paid and denied claims in the UI program. It does this by reconstructing the UI claims process from samples of weekly payments and denied claims using data verified by trained investigators. For claims that were overpaid, underpaid, or improperly denied, the BAM program determines the cause of and the party responsible for the error, the point in the UI claims process at which the error was detected, and actions taken by the agency and employers prior to the error. For erroneously paid claims, the BAM program determines the amount of benefits the claimants should have received, which becomes the basis for subsequent recovery efforts. BAM provides two rates of improper payments. The first, the Annual Report Overpayment Rate, includes estimates of nearly every divergence from what state law and policy dictate the payment should have been. The second rate, the Operational Overpayment Rate, includes only recoverable overpayments states are most likely to detect through ordinary overpayment detection and recovery procedures. Operational overpayments are the most likely to be detected and established for eventual recovery and return to the UI Trust Fund.

Reemployment Services

Since UI was established, there have been two major changes in the nation's workforce development system that have directly affected states' UI programs. Specifically, in November 1993, Congress enacted legislation amending the Social Security Act to require that each state establish a Worker Profiling and Reemployment Services (WPRS) system and implement a process typically referred to as claimant profiling. The claimant profiling process uses a statistical model or characteristics screen to identify claimants who are likely to exhaust their UI benefits before find-

[4] In accordance with federal law, all state UI systems are experience rated so that employers' contribution rates vary on the basis of their experience with unemployment. In practice, this typically means that an employer who lays off many workers that claim unemployment insurance benefits will pay more in taxes than an employer that lays off fewer workers.

ing work. Claimants identified through this process are then referred to reemployment services while they are still early in their claim. For profiled claimants, participation in designated reemployment services becomes an additional requirement for continuing eligibility for UI benefits. The second major change was the enactment of the Workforce Investment Act of 1998, which requires states and localities to bring together about 17 federally funded employment and training services into a single system—the one-stop system. State UI programs are mandatory partners in the one-stop system. Another mandatory partner is the federal Employment Service, established by the Wagner-Peyser Act in 1933 to link job seekers with job opportunities. The Employment Service (ES) has historically been collocated with state UI offices to facilitate UI claimants' access to federally funded labor exchanges, job search assistance, job referral, placement assistance, assessment, counseling, and testing.

Labor's 2007 Budget Request

For UI, Labor's fiscal year 2007 budget includes a request for $2.7 billion. This amount is about $101 million higher than the fiscal year 2006 enacted level. This request, according to Labor's budget overview, funds projected workloads and includes several UI program increases. First, Labor is proposing a $30 million increase in fiscal year 2007 for the amount available to states to conduct reemployment and eligibility reviews. Labor notes that the reviews—which entail in-person interviews with claimants at one-stop centers—can reduce overpayments as well as speed reemployment. Second, Labor is proposing a $10 million UI program increase to prevent and detect fraudulent claims due to identify theft. Labor proposes to use the new funding for staff to investigate and reconcile potential identity theft identified through data cross-matching.

More than $3.4 Billion in Overpayments Estimated in 2004, but Labor is Taking Some Actions to Enhance Program Integrity

Labor estimates that about $3.4 billion in UI benefits was overpaid nationwide in calendar year 2004, but is taking actions to help states improve their ability to detect and prevent overpayments. According to Labor's Benefit Accuracy Measurement program, in 2004 (the most recent year for which we could obtain specific data) claimants were responsible for a majority of the overpayments. Claimants may fail to report their work as required, or may use Social Security numbers (SSN) that did not exist or that belonged to other individuals to fraudulently obtain UI benefits, resulting in overpayments. State agencies may also contribute to overpayments if they fail to properly record eligibility information. In addition, employers may contribute to UI overpayments if they fail to report required information to states in a timely manner. Labor has introduced a number of initiatives to help states improve their ability to detect and prevent overpayments, including new computer matches with federal databases, a new core performance measure intended to provide states with added incentives for detecting and preventing overpayments, and additional funding for states' overpayment detection efforts. Labor's budget request for fiscal year 2007 includes funding to continue some of these efforts.

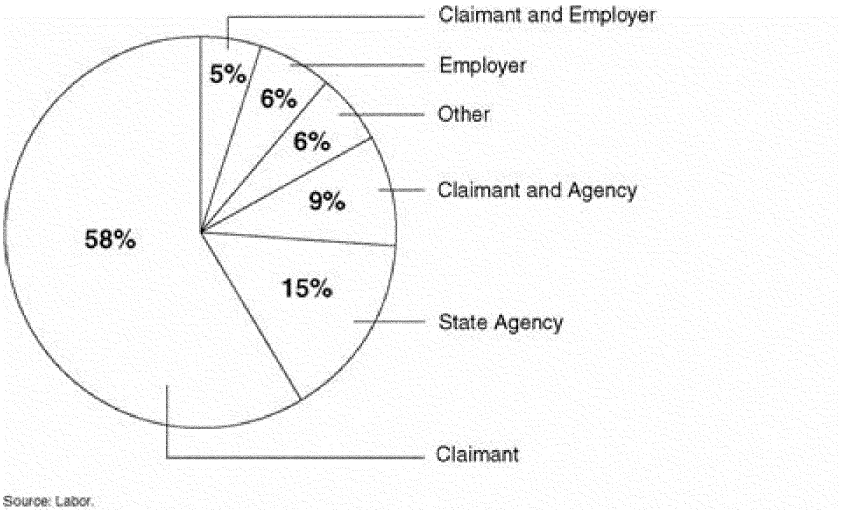
The Majority of Overpayments Are Attributable to Claimants

Of the $3.4 billion in overpayments identified nationwide by the BAM program in calendar year 2004,[5] almost $2 billion (58 percent) was attributable to UI claimants alone, while state agency errors and employers were responsible for overpayments by others (see fig. 1). With respect to claimants, overpayments may occur because individuals work while receiving benefits, fail to register with employment services (as required in most states), fail to look for a new job, or misrepresent their identity. In calendar year 2004, the most common cause of overpayments was unreported or erroneously reported earnings and income, accounting for almost 28 percent of overpayments in that year. The second-leading cause of overpayments—constituting 21 percent of all overpayments—was payments to individuals who are not entitled to UI benefits because of the circumstances under which they became unemployed (separation issues). Other sources of overpayments were attributable to individuals who failed to look for work (16 percent) and individuals who did not register for employment services (10 percent). Federal and state officials have reported that some types of overpayments are more difficult to detect than others. For example, in a prior report, some officials told us that it could be difficult for states to

[5] Of this amount, Labor officials told us that the states could have potentially detected and recovered $1.8 billion, or about 53 percent of the total overpayments it estimated occurred, using current procedures.

accurately determine, in a cost-effective manner, if a claimant was actively searching for work (an eligibility requirement in some states).

Figure 1: Responsibility for UI Overpayments (Calendar Year 2004)



Note: Percentages do not add to 100 percent because of rounding.

Other sources of overpayments include state agency errors and inaccurate or untimely information provided by employers. Labor's BAM program shows that state agency errors, such as failing to properly record important eligibility information such as wages, accounted for about 15 percent of all estimated overpayments in 2004. Employers accounted for about 6 percent of the total estimated overpayments in 2004. Employers and their agents do not always comply in a timely manner with state requests for information needed to determine a claimant's eligibility for benefits. For example, one Labor OIG audit found that $17 million in overpayments occurred in four states because employers did not respond to the states' request for wage information. Our work suggests that employers may resist requests to fill out paperwork from states because they view the process as time-consuming and cumbersome. In addition, because employers are unlikely to experience an immediate increase in the UI taxes they pay to the state as a direct result of overpayments, they do not see the benefit in complying with states' requests for wage data in a timely manner.

Our prior work and work by Labor's OIG also shows that some UI overpayments result from identity-related violations. For example, our prior work shows that in 2001, Labor identified about $1.4 million in UI overpayments resulting from Social Security violations.[6] Labor determined these overpayments to be the result of fraud. More recently, in its fiscal year 2007 budget justification, Labor estimated that approximately $313 million in overpayments results from identity theft each year. Labor's OIG has documented identity theft schemes as a major management challenge. For example, in its semiannual report to Congress, the OIG reported on a case in which individuals used more than 200 stolen identities to file 222 UI claims and obtain more than $693,000 in UI benefits from February 2001 through February 2005.[7]

Labor is Taking Actions to Help States Detect and Prevent Overpayments

Labor has introduced several initiatives to help states improve their ability to detect and prevent overpayments in the UI program. First, Labor has initiated a pilot using the National Directory of New Hires (NDNH) to further assist in identifying and preventing improper payments, including overpayments. The NDNH is a database, maintained by the Department of Health and Human Services' Office of Child

[6] GAO, Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments, GAO–02–697 (Washington, D.C.: July 12, 2002).

[7] Department of Labor, Office of Inspector General, Semiannual Report to the Congress, April 1, 2005—September 30, 2005, Vol. 54.

Support Enforcement, that contains information on all newly hired employees, quarterly wage reports for all employees, and UI claims nationwide. The NDNH enhances states' ability to detect unreported work violations by UI claimants working in other states or for certain employers that operate in multiple states. In addition, the NDNH can help improve the accuracy of Labor's error estimates. Information from the NDNH cross-match can be readily integrated into Labor's BAM program by cross-matching the SSNs of the claimants against the NDNH. In fiscal year 2005, three states (Texas, Utah, and Virginia) participated in the pilot. According to Labor, initial results of the pilot show that overpayment detections increased 114 percent in Texas, 41 percent in Utah, and 73 percent in Virginia. The Texas Workforce Commission also reported that using the national cross-match in combination with the existing statewide cross-match helped detect 50 percent more cases of potential fraud in one quarter than it would have detected otherwise. In addition, on the basis of its NDNH pilot results, Labor reported in its fiscal year 2005 performance and accountability report that a substantial amount of additional overpayments could be detected using the database. Labor reported that it is moving ahead with full implementation of the NDNH cross-match with 5 states (Connecticut, Texas, Utah, Virginia, and Washington), and expects 29 states to use the NDNH by the end of fiscal year 2006.

In addition to its NDNH pilot, Labor is also pursuing the use of other data sources to improve UI program integrity. In particular, Labor continues to promote states' data sharing with other agencies, such as the Social Security Administration (SSA), to identify and prevent overpayments. According to Labor's fiscal year 2005 performance and accountability report, the department has funded states to exchange data with SSA on a real-time basis, giving states the ability to verify claimants' identity and prevent most overpayments due to fraudulent or mistaken use of SSNs. Labor's fiscal year 2007 budget request includes $10 million in funding to detect and prevent fraudulent UI benefit claims that use personal information stolen from workers. Labor estimates that the requested funds could generate savings of at least $77 million to the UI Trust Fund by preventing erroneous payments caused by the use of stolen identities.

Along with efforts to enhance states' use of data sharing to detect and prevent overpayments, Labor has taken other steps to enhance UI program integrity, including the development of a new core performance measure for overpayment detection at the state level. More specifically, Labor has announced that states will be given an additional incentive to prevent and detect overpayments by implementing core measures in states' performance budget plans based on the level of overpayments the states have detected. While Labor has established overpayment detection as one of its core measures, it has not yet specified the level of performance that states will be required to meet under this measure. In addition, Labor's fiscal year 2006 budget request contained a legislative proposal designed to give states the means to obtain funding for program integrity activities, including additional staff to enhance recoveries and prevent overpayments. Moreover, to reduce overpayments, Labor awarded Reemployment and Eligibility Assessments grants to 21 states during fiscal year 2005. The grants have been used to conduct in-person claimant interviews to assess claimants' continued eligibility for benefits and to ensure that individuals understand that they must stop claiming benefits upon their return to work.[8] Labor's fiscal year 2007 budget request includes $30 million in additional funding to continue this effort. Labor estimates that these funds could be used to conduct an additional 539,000 interviews and could save the UI Trust Fund as much as $151 million by reducing the average duration of UI benefits for claimants who are interviewed.

In addition to the initiatives contained in its budget request, Labor plans to submit a legislative proposal in the near future that includes several initiatives to further help states detect and recover overpayments.[9] Among other things, this proposal may include suggestions to allow the Department of the Treasury to garnish federal income tax refunds to recover UI overpayments as a means of improving overpayment recoveries. The proposal may also allow states to use a small percentage of recovered overpayments to fund their benefit payment control and program integrity activities as an incentive to focus their efforts on those activities. In addition, the proposal may seek to provide employers with a stronger incentive to inform the state when inappropriate UI claims are made. More specifically, the proposal could require states to charge employers a higher UI tax rate when claimants are

[8] These interviews would also promote use of reemployment services available in One-Stop Career Centers to assist claimants to become reemployed more quickly.

[9] According to Labor, this proposal will be similar to the 2005 legislative proposal (the Unemployment Compensation Program Integrity Act of 2005).

overpaid, if it is determined that the overpayment was the employer's fault (such as when an employer fails to provide wage information to the state in a timely manner). Such additional charges could lead to an increase in the UI tax rate for affected employers.

States Make Use of Federal Requirements to Help Speed Reemployment of UI Claimants, but Knowing More about Outcomes Could Enhance Program Performance

In our review of states' efforts to help UI claimants quickly return to work, we found that states most often make use of federal UI program requirements to help connect claimants with reemployment services at various points in their claims, usually beginning at the time their initial claim is filed. All federally approved state UI programs must include able-to-work and available-for-work requirements that claimants must meet in order to receive benefits. In many states, these requirements also serve to link claimants to reemployment opportunities and services. In addition, states provide targeted reemployment services to particular groups of UI claimants. The federal requirement of claimant profiling is typically the primary mechanism for targeting reemployment services to specific claimants. Despite states' efforts to design systems that link UI claimants to reemployment services, few data are available to gauge the extent to which their efforts are having the intended result. Moreover, Labor's fiscal year 2007 budget request does not include funding specifically designated for conducting evaluations of federally required efforts to target reemployment services.

States Use Compliance with Work Requirements and Target Services to Particular Groups of Claimants to Help Speed Reemployment

Although all UI claimants can access the range of reemployment services through the one-stop system at any time, UI program requirements often provide the context for states' efforts to link claimants to reemployment services. Specifically, all federally approved state UI programs require that claimants be able and available to work. To meet these conditions, 44 states require that UI claimants register with the state's labor exchange—that is, job-matching services provided through the Wagner-Peyser-funded Employment Service—in order to be eligible for UI benefits. In addition, 49 states impose a work search requirement as a condition for continuing UI eligibility, and claimants must document that they are meeting their state's work search requirement in a number of ways. Most commonly, claimants are required to keep a log of work search activities that may be subject to review, or they must certify that they are able and available to work through the process of filing for a continuing claim.

These work registration and work search requirements often serve to link claimants to reemployment services. The process of registering for work with the state's labor exchange, for example, may bring claimants into an Employment Service office or one-stop center where reemployment services are delivered.

Some states also use their processes for monitoring compliance with the work search requirement to direct claimants to reemployment services. Officials in 39 of the 49 states that require claimants to actively seek employment told us that telephone or in-person interviews with claimants may be used to monitor compliance with this requirement. In over two-thirds of these states, officials told us that some information on job search strategies or reemployment services is provided during the interview.

States also engage some claimants in reemployment services directly through programs that identify certain groups for more targeted assistance. States primarily target reemployment services to claimants identified through federally required claimant-profiling systems—a process that uses a statistical model or characteristics screen to identify claimants who are most likely to exhaust their UI benefits before finding work. While claimants identified and referred to services through profiling can access the services available to all job seekers through the one-stop system, participation in the services they are referred to—most often orientation and assessment services—is mandatory for profiled claimants. In addition, many officials told us that the services profiled claimants received depended on their individual needs following an assessment, the development of an individual plan, or the guidance of staff at a one-stop center. While failure to report to required reemployment services can result in benefits being denied, states vary in the conditions that prompt denying benefits.

Maryland, for example, targets reemployment services to profiled claimants through its Early Intervention program. This program, which began in 1994, offers an interactive, 2-day workshop, addressing self-assessment, job search resources, resume writing and interviewing skills, and other community resources available to

job seekers. Profiled claimants selected for the workshop who fail to attend are given one opportunity to reschedule; after that, their failure to participate is reported to the UI program and their benefits may be suspended. When claimants complete the workshop, they are registered with the Maryland Job Service, they receive an individual employment plan, and the workshop facilitator may refer them to additional services. Officials told us that although they currently do not have data to show the impact of this program, they have received very positive feedback about the quality and effectiveness of the workshops.

Some states have developed additional methods to target reemployment services to particular groups of UI claimants. For example, one-stop staff in Washington have the ability to identify various subgroups of claimants using a tracking device called the Claimant Progress Tool. Officials told us that one-stop staff typically use this tool to identify claimants who are about 100 days into their claim, and then contact them for targeted job search assistance and job referrals. This process was developed to help the state achieve a goal of reducing the portion of its UI benefits that unemployed workers claim. Georgia's state-funded Claimant Assistance Program identifies claimants who are seen to be ready for employment and requires them to participate in the same services required of profiled claimants. This program is designed to help the state achieve its goal of generating savings for the UI Trust Fund.

During fiscal years 2001 through 2005, states often made use of Labor's Reemployment Services Grants—totaling $35 million per year—to fund some of the targeted services. Officials in the majority of the states we interviewed told us their states had used the Reemployment Services Grant funds to hire staff to provide reemployment services to UI claimants. For example, Maryland state officials said they used their funds to hire staff for the Early Intervention program, enabling them to run more workshops in areas that needed them and to make further improvements in the program. Some states also used these grants to direct reemployment services to claimants beyond those who have been profiled and to support other enhancements in the provision of reemployment services to claimants. For example, Washington state officials told us they used funds from these grants to support the development of the Claimant Progress Tool. Beginning in fiscal year 2005, Labor began shifting its focus away from these grants that funded direct reemployment services for UI claimants toward the Reemployment and Eligibility Assessment Grants. These new grants focus states' efforts on providing face-to-face eligibility interviews with claimants as a way to ensure compliance with work search requirements. As part of these interviews, eligibility workers may refer claimants to reemployment services funded by Employment Services, the Workforce Investment Act (WIA), or the Trade Adjustment Assistance (TAA) program.

Little Information Exists to Assess whether States' Efforts Are Achieving the Intended Outcomes

Despite states' efforts to design systems that link UI claimants to reemployment services, little is known about the extent to which claimants receive reemployment services or about the outcomes they achieve. Although states must meet a number of federal reporting requirements for their UI and employment and training programs, including reporting on the outcomes of profiled claimants, none of these reports provide a complete picture of the services received or the outcomes obtained by UI claimants. Labor only recently began to require that states provide information on the reemployment outcomes of UI claimants, and the ongoing evaluations of claimant profiling are limited.

States must track and report annually on several performance measures considered key indicators of UI program performance, but these measures largely focus on benefit and tax accuracy, quality, and timeliness. In addition, states must also report to Labor on their claimant-profiling process, but information in these reports represent only a portion of all UI claimants the state has served, a proportion that can vary from place to place and from month to month depending on available resources.

UI claimants may access other federally funded reemployment assistance through the Wagner-Peyser Employment Service, WIA Adult or Dislocated Worker programs, and, if they are laid off because of trade, the Trade Adjustment Assistance program. To monitor the performance of these programs, Labor requires states to meet a number of reporting requirements, but these reports are submitted on a program-by-program basis, and none provide a complete picture of the services received or the outcomes obtained by all UI claimants.

Having data that show the degree to which reemployment services are reaching UI claimants is key to good program management and provides a first step toward understanding the impact of these programs. However, knowing how many claim-

ants may be accessing reemployment services and the type of outcomes they may be achieving has proven difficult for state and local officials. We found that only 14 states go beyond the federal reporting requirements to routinely track the extent to which UI claimants receive services from the broad array of federally funded programs that are designed to assist them, and only 6 states routinely monitor outcomes for UI claimants who receive reemployment services. States most often told us that tracking claimant services across multiple programs was made difficult by the fact that reemployment services and UI claimant data were maintained in separate data systems—systems that were either incompatible or difficult to link.

Labor has some initiatives that may begin to shed light on claimant outcomes, but these efforts may not go far enough. Labor recently modified its UI performance measures to require states to track a reemployment rate for their UI claimants—defined as the percentage of UI claimants who are reemployed within the quarter following their first UI payment. This change will help focus efforts on speeding reemployment and will improve the understanding of how many UI claimants are quickly reemployed nationwide, but it will not allow for an assessment of the outcomes of claimants who access reemployment services compared to those who do not. Furthermore, states must meet federal requirements to target reemployment services using the claimant-profiling process, but little is known about the effectiveness of their efforts. Labor funded an evaluation of the claimant profiling system in 8 states beginning in 1996, including an assessment of UI benefit duration, employment, and earnings. The current evaluation of the profiling process focuses exclusively on how well the models are able to predict whether a claimant will exhaust UI benefits, not on whether the process results in shorter benefit duration or better employment outcomes for claimants. Budget authority to conduct the current evaluation expires at the end of fiscal year 2006, and no additional funds have been requested in the fiscal year 2007 budget specifically to conduct further evaluations on profiling.

Labor is also developing a system to consolidate performance reporting for Labor's Employment and Training Administration (ETA) programs. This system—ETA's Management Information and Longitudinal Evaluation (EMILE) system—would consolidate reporting across a range of Labor programs including WIA, Employment Service, and TAA. Current plans do not include incorporating UI reporting into EMILE. Last year, we recommended that Labor work with states to explore the feasibility of collecting more comprehensive information on UI claimants' services and outcomes. Although Labor generally agreed with our findings, Labor commented that current and planned data collection efforts would provide sufficient information to policy makers. While Labor's new initiatives, in combination with current reporting requirements, will provide valuable information on the reemployment activities of some UI claimants, these efforts will not allow for a comprehensive, nationwide understanding of claimants' participation in the broad range of reemployment services designed to assist them. Furthermore, these efforts will not move states in the direction of having the data they need to better manage their systems.

Concluding Observations

UI's size and importance make it critical that the program is performing at a peak level. With annual overpayments reaching the billions, it will be important for federal and state stakeholders to take the necessary action to address this issue. Labor's current initiatives and its proposed action contained in the fiscal year 2007 budget request could help, but work remains. In the long run, program performance can be enhanced by avoiding improper payments rather than trying to detect and collect them. Labor's initiatives to help states detect and prevent overpayments represent a positive step toward improving UI program integrity. In particular, Labor's initiative to promote states' use of the NDNH database and its continued effort to encourage states' use of SSA's data for verifying the identity of claimants appear promising. However, to maximize the effectiveness of these initiatives, it is important for as many states as possible to participate. In addition, while Labor's development of a new core performance measure on payment accuracy has the potential to facilitate states' focus on detecting and preventing overpayments, it is premature to evaluate the effectiveness of this effort. Moreover, although Labor continues to fund grants for states to conduct in-person reemployment and eligibility assessments, more time is needed to fully assess how effective these initiatives will ultimately be. Finally, while Labor's June 2005 legislative proposal to charge employers for UI payments to ineligible individuals could result in UI tax rate increases for those employers, such a change merits further consideration.

To help claimants get the reemployment services they need, states have often designed their processes to make use of federal UI program requirements in linking claimants with services. However, knowing whether their efforts are actually result-

ing in better employment outcomes and reduced UI benefit payments has proven difficult for federal, state, and local officials. Findings from evaluations are limited, and most states lack much of this information, arguably critical for good program management—often because data reside in separate systems that cannot be easily linked. In the new environment created under the Workforce Investment Act, where claimants may be served by a range of programs that go beyond UI and ES, it becomes increasingly important to find new ways to link program data across a broader range of programs. Doing so is an essential step in understanding what's working and what's not. Labor's current and planned initiatives may help fill the information gap, but they fall short of providing a comprehensive understanding of services and outcomes for UI claimants.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other members of the subcommittee may have at this time.

Chairman HERGER. Thank you, Dr. Nilsen. Mr. Halley?

STATEMENT OF ROOSEVELT HALLEY, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF STATE WORKFORCE AGENCIES, COLUMBIA, SOUTH CAROLINA

Mr. HALLEY. Good morning, Chairman Herger, Ranking Member McDermott, and Members of the Subcommittee. On behalf of the National Association of State Workforce Agencies, I thank the Subcommittee for the opportunity to comment on the President's FY2007 budget as it relates to the UI system. Mr. Chairman, NASWA supports initiatives by the Federal Government to improve the administrative efficiency, integrity, and overall performance of our Nation's Federal-State UI system. However, Federal grants to States for the administration of UI programs are inadequate. Without sufficient Federal funding, NASWA believes proposals to improve the UI system will not have the desired positive effect on performance. NASWA submitted testimony recently to the Subcommittee on States' extensive use of technology to increase program efficiency. It highlighted improvements to customer service and barriers to full modernization due to Federal underfunding.

States are more efficient at operating their UI programs today than they have ever been. But further improvements in program integrity and productivity are increasingly difficult to attain. Additional UI system appropriations for administrative funding are necessary for further UI system improvement. The remainder of my statement focuses on selected proposals of the Administration's FY2007 budget. NASWA's full statement on the FY2007 budget has been submitted for the hearing record. With substantial balances in the Federal accounts of the UI trust fund, NASWA believes there are sufficient funds available to support States' UI operations without extending the Federal Unemployment Tax Act 0.2 percent surtax beyond 2007 as proposed by the Administration. NASWA supports the Administration's proposal that would authorize the U.S. Treasury Department to recover UI benefit overpayments and certain delinquent UI taxes from Federal income tax refunds. NASWA supports the Administration's proposal that would require employers to include a "start work" date on new hire reports to help identify persons who have gone back to work, but continue to claim benefits.

NASWA recommends modifying the Administration's proposal that would prohibit States from not charging employers for overpayments due to their inadequate or untimely response to requests for information. NASWA recommends requiring States to treat employers no longer as interested parties if they respond inadequately or untimely and to require charging these employers even if an appeal denies UI benefits to claimants. This modified proposal would provide employers a strong incentive to respond to State requests for information on UI separation issues. The Administration includes proposals that would permit States to use up to 5 percent of UI overpayment recoveries to augment their Benefit Payment Control administrative funding and up to 5 percent of State unemployment tax, or so-called SUTA dumping collections, to augment funds aimed at reducing employer tax evasion and fraud.

NASWA is concerned about the potential precedent this would authorize by allowing State-collected UI revenues to be used for purposes other than the payment of benefits. Despite this concern, NASWA would support these proposals if funds collected are limited to Benefit Payment Control and activities to combat employer evasion and fraud. NASWA believes the Administration's proposed minimum 15 percent penalty assessment on overpayments due to claimant fraud is too low. Many States already have implemented larger penalties for UI fraud. NASWA recommends modifying this proposal by raising the penalty to at least 25 percent and also applying it to employer fraud. We agree States should penalize individuals for wrongfully receiving UI benefits and also believe States should require an identical penalty of 25 percent on employer underpayments of taxes due to employer tax evasion and fraud. NASWA supports the Administration's request of $30 million to expand Reemployment and Eligibility Assessments. However, NASWA is concerned about the recent elimination of the $35 million reemployment service grants to the States in FY2006. This cut and continued underfunding of ES hamper States' ability to help unemployed workers return to work quickly. Mr. Chairman, we look forward to working with the Subcommittee on this vital Federal-State program.

[The prepared statement of Mr. Halley follows:]

Statement of Roosevelt Halley, President-Elect, National Association of State Workforce Agencies, Columbia, South Carolina

Mr. Chairman and Members of the Subcommittee thank you for the opportunity to comment on the President's FY 2007 Budget. The National Association of State Workforce Agencies (NASWA) respectfully submits this testimony for the record.

The mission of NASWA is to serve as an advocate for state workforce programs and policies, a liaison to federal workforce system partners, and a forum for the exchange of information and practices. Our organization was founded in 1937. Since 1973, it has been a private, non-profit corporation financed by annual dues from member state agencies. NASWA members are the administrators of the Unemployment Insurance (UI) and Employment Service (ES) programs, and other workforce investment programs.

NASWA supports initiatives by the Administration and Congress to improve the administrative efficiency, integrity and overall performance of our nation's UI system. This statement in large part is an endorsement of many of the Administration's UI proposals included as part of its FY 2007 Budget and reflects NASWA's longstanding and ongoing work with U.S. Department of Labor (USDOL) to improve the UI system. However, NASWA believes proposals to improve the UI system will not have their desired positive effect on performance without a sufficient commit-

ment by Congress and the Administration to appropriate necessary funding for the program's administration. NASWA believes improvements to the UI system and UI system administrative funding are inseparable and encourages the Subcommittee to consider both as it pursues improvements.

PROMOTING UI PAYMENTS AND TAX INTEGRITY

NASWA formed an eight-state (AL, CA, GA, IL, MI, NJ, OK, and TX) workgroup to review and work with the USDOL on its Unemployment Compensation Program Integrity Act of 2005. The NASWA workgroup agrees amendments to federal law that would help states reduce overpayments of UI benefits and increase collections of overpayments and taxes are needed. However, the workgroup is concerned with the precedent set by several of the proposals to permit use of state unemployment funds for administration in lieu of federal administrative grants. Spending state unemployment tax revenues on administrative costs, instead of benefits exclusively, would further undermine the federal commitment to funding UI administration.

USDOL's proposal would permit states to use up to five percent of UI overpayment recoveries to augment their benefit-payment-control administrative funding. USDOL also proposes permitting states to use up to five percent of State Unemployment Tax Act (SUTA) dumping collections to augment funds aimed at reducing employer tax evasion and fraud. NASWA recommends the use of funds collected under these programs be limited to benefit-payment-control and employer tax evasion and fraud activities. NASWA is concerned about the precedent these two proposals set by modifying the standard that state trust funds be used only for the payment of benefits.

USDOL's proposal to require states impose at least a 15 percent penalty on benefits individuals obtain by defrauding the UI system is problematic because some state laws do not permit collection of a penalty until the benefit overpayment is collected. The USDOL proposal would require penalties be collected first. The collected penalties would be used only for benefit payment control and tax enforcement activities. Further, NASWA believes the proposed 15 percent penalty is too low. Many states already have implemented larger penalties for UI fraud. NASWA recommends modifying this proposal by raising the penalty to at least 25 percent and also, applying it to employer fraud. We agree states should penalize individuals for wrongfully receiving UI benefits, but also believe states should require an identical penalty of 25 percent on employer underpayments of taxes because of employer tax evasion and fraud.

NASWA supports USDOL's proposal that would authorize the U.S. Treasury Department to recover UI benefit overpayments and certain delinquent UI taxes from federal income tax funds. NASWA also supports the USDOL proposal that would allow states to make individuals liable for the processing fee and give states discretion to the U.S. Treasury to recover the debt.

NASWA supports USDOL's proposal that would require employers to include a "start work" date on new hire reports to help identify persons who have gone back to work, but continue to claim benefits. NASWA believes this requirement will help states accurately identify when an individual has begun employment, but still is claiming UI benefits, and identify overpayments for recovery.

NASWA supports USDOL's request of $10 million to prevent and detect fraudulent unemployment benefit claims filed using personal information stolen from unsuspecting workers.

PROMOTING RE-EMPLOYMENT

NASWA supports USDOL's request of $30 million to expand re-employment and eligibility assessments (REAs) used to review UI beneficiaries' need for re-employment services and their continuing eligibility for benefits through in-person interviews in one-stop career centers. However, we must point out the disparity between this $30 million request by USDOL and recent elimination of the $35 million Re-Employment Services (RES) grants to states in FY 2006. The elimination of RES combined with a $30 million cut to the Employment Service (ES) program totals an eight-percent reduction to services used to help accelerate unemployed workers transition back to work. The Administration proposes an additional 4 percent cut to the ES program in FY 2007.

NASWA supports the proposed Government Performance and Results Act (GPRA) goals for reemployment and UI Performs Core reemployment measure to assess UI reemployment services and outcomes. The GPRA goal proposed for reemployment requires states to compile data on those individuals receiving UI benefits for this measure. The measurement indicates if a person who received UI benefits in one quarter has earned wages reported in the subsequent quarter. States would submit data for the most recent four quarters in March 2006 and these data would be used

to establish a baseline and set performance targets for FY 2007. USDOL also would use this GPRA outcome as a state-specific measure for UI Performs. This reemployment measure is one of the core measures states must meet or provide corrective action plans to meet or exceed the goal the following fiscal year.

NASWA is concerned USDOL's recent decision to dismantle America's Job Bank (AJB) system will lengthen the duration it takes employers to find qualified workers and job seekers to find jobs. AJB complements other resources available in the private sector. The Employment and Training Administration (ETA) has assured states it will try to resolve their concerns. NASWA plans to work with these states to assist them and ETA in resolving these concerns.

NASWA supports USDOL's proposal that would permit waivers of certain federal requirements allowing states to experiment with innovative projects aimed at early re-employment of UI beneficiaries. NASWA supports this proposal because it allows opportunities for state flexibility in providing re-employment services. We look forward to working with the USDOL on this concept.

OTHER UI PROPOSALS IN USDOL'S FY 2007 BUDGET

NASWA does not support USDOL's proposal that would permit states to allow collection agencies to keep up to 25 percent of the amount collected on "uncollectible" fraud overpayments or delinquent taxes. NASWA recommends this collection tool be available as an option under the recovered overpayments proposal and under the fraud penalty proposal if states have exhausted efficient state means to collect the outstanding debt.

NASWA recommends modification of USDOL's proposal that would prohibit states from non-charging benefit costs to employers if an overpayment is due to an employer's pattern of inadequate or untimely responses to requests for information made by the state. NASWA recommends modifying this proposal by requiring states to treat employers as no longer an "interested party" if they respond inadequately or untimely to separation notices and require charging of these employers even if an appeal denies UI benefits to a claimant. We believe this modified proposal provides an employer incentive to respond to state requests for information on UI separation issues. It would reduce state administrative collection costs by limiting overpayments and all employers would not have to share the costs born by employers who respond inadequately or untimely to state requests for information. NASWA also recommends additional state administrative funding to help implement this proposal.

NASWA supports USDOL's proposal that would permit states to use compensating balances and interest earned on clearing account balances to pay associated banking costs. States use a variety of other banking services, including the maintenance of lock boxes and aggressive clearance schedules, which can speed the transfer of tax deposits to the trust fund, but cost more than basic banking services. To pay the cost of these additional services, some states hold a balance in the clearing account to generate enough interest to pay the costs of the services. USDOL has said this is inconsistent with the "immediate deposit" and "withdrawal" requirements of federal UI law. These "compensating balance" arrangements permit states to pay for state-of-the-art banking services that speed the deposit of taxes in the trust fund that they would be unable to afford otherwise. As some states already use this practice, an amendment would authorize an ongoing and effective practice.

NASWA supports USDOL's proposal that would require state UI agencies to disclose information to child support enforcement agencies about UI claimants owing support to custodial parents and to deduct such obligations from UI benefits. We understand this proposal will clarify federal UI law.

USDOL's proposal would amend the Advisory Council on Unemployment Compensation (ACUC) provision to permit, rather than require, the Secretary of Labor to convene periodically a council. The proposal also would reduce council size to nine. NASWA believes another ACUC is not needed now and supports granting the Secretary of Labor the flexibility to convene a council when necessary. We look forward to working with the Secretary, and employer and worker groups, to improve this system on an ongoing basis.

NASWA supports USDOL's proposal to repeal a provision denying unemployment compensation to certain federal workers performing federal service under contract. Even though this is a federal program, as a general rule, we believe nearly all employees should be covered under UI as the states' do under state law.

THE FUTA 0.2 PERCENT SURTAX

In the U.S. Department of Treasury budget, the Administration proposed extending the Federal Unemployment Tax Act (FUTA) 0.2 percent surtax for five years beyond 2007. In the past, NASWA has testified in favor of repealing this surtax as

an unwarranted burden on employment. NASWA believes the revenue collected by this surtax currently is unjustifiable to meet the nearly nonexistent demand for federal loans to states with trust fund balances insufficient to cover benefits. Moreover, NASWA notes the National Governors Association not only supports the repeal of this surtax, but also supports substantially lowering the unnecessarily high balances in the loan account (Federal Unemployment Account) and using these funds to shore up other parts of the system, such as grants to states for administration of unemployment insurance, employment services, and labor market information, and information technology and performance investments.

UI ADMINISTRATIVE FUNDING CONCERNS

Secretary of Labor Elaine Chao testified recently before the House Labor, Health and Human Services and Education Appropriations Subcommittee and stressed her desire to improve the financial integrity of the UI system. NASWA supports this goal, but states are finding it increasingly difficult to accomplish. We believe grants to states for the administration of state UI programs are inadequate since USDOL's resource justification model (RJM) demonstrates states need more UI administrative funding than what is appropriated and allocated. Although it is true states are more efficient at operating their UI programs today than they were ten years ago, further improvements in program integrity and productivity are increasingly difficult to attain.

We are concerned future policies might impose financial penalties on states for failing to meet performance standards, further eroding states' ability to administer UI. Rising personnel and service costs without corresponding increases to federal appropriations are forcing states to cut staffing levels, reduce integrity efforts, delay technology upgrades, and seek other funding sources. With the federal account balances in the UI Trust Fund projected to be $3.4 billion for the Employment Security Administration Account (ESAA), $16.6 billion for the Extended Benefit Account (EUCA), and $14.2 billion for the loan account (FUA) at the end of FY 2007, NASWA believes there are sufficient funds to support UI administrative operations without imposing additional state taxes to supplement the lack of adequate federal administrative funding.

Mr. Chairman, thank you for the opportunity to testify today. NASWA looks forward to working with you and your colleagues and USDOL on this vital federal-state program.

Chairman HERGER. Thank you, Mr. HALLEY. Mr. Devereux to testify.

STATEMENT OF GREG DEVEREUX, EXECUTIVE DIRECTOR, COUNCIL 28, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, SEATTLE, WASHINGTON

Mr. DEVEREUX. Good morning, Chairman Herger, Ranking Member McDermott, and other Members of the Committee. For the record, I am Greg Devereux, the executive director of the Washington Federation of State Employees, Council 28 of AFSCME. I am testifying on behalf of AFSCME's 1.4 million members, including the many thousands in the employment security system across the State. In my State, we represent 2,400 of these workers. I appreciate being here and ask that my written statement be made part of the record.

Chairman HERGER. Without objection.

Mr. DEVEREUX. We believe the Labor Department's FY2007 budget is penny wise and pound foolish. It will further undermine the UI work test by impairing the ability of UI claimants to receive in person reemployment services and help finding employment. As you know, UI claimants must register for work with State ES offices. Like UI, the ES is State administered and financed with revenue from the Federal unemployment trust fund. The ES is a free Nation-wide public labor exchange, offering such services as job

search assistance, referral of workers to job openings, screening of job applicants for employers, career counseling, skills assessment, and resume writing assistance. State ES offices are a major provider of labor exchange and reemployment services for UI claimants. Nation wide, in 2004, 40 percent of the 14 million job seekers who registered with ES offices were UI claimants. In Washington State, it was 49 percent. Seventy-nine percent of them received staff assistance, and over half were referred to employment. Numerous analyses have documented the cost effectiveness of the ES labor exchange services. For example, in a 2002 paper, researcher Lou Jacobson found public labor exchange services spend only about $330 per job placement.

Reemployment services also speed up return to work. In 2000, DOL estimated that every dollar spent on reemployment services for UI claimants produces two dollars of trust fund savings. Despite this, DOL proposes a $34 million cut in State employment service grants after last year's $58 million cut. This would be very destructive to employment security. If absorbed entirely by staff reductions, at least 1,500 State workers would have to be laid off, and in-person services in many rural areas would have to be eliminated. However, the damage is actually much worse because the cuts come on top of decades of financial neglect. The FY2007 request is actually $88.6 million less than the 1985 appropriation. To match the 1985 appropriation in value, the Administration would have to ask for $1.4 billion. In addition, DOL proposes to end the employment service as part of a strategy to aggressively decentralize workforce programs. Its block grant plan and career advancement accounts treat the unique role of the ES in relation to the UI system almost as an afterthought. The Administration also plans to end the Nation's job bank service. America's job bank is now the largest electronic listing of job openings in the world and is an important tool for local ES and other workforce labor exchange activities in Washington State and elsewhere. It is invaluable.

Finally, I also want to mention our concern with the failure to provide adequate funding for State UI operations. Strengthening reemployment services and providing adequate administrative funding is a better solution to benefit overpayments and collecting delinquent employer taxes than DOL's approach. Most UI overpayments occur when someone works and collects UI at the same time. Reliance on automated UI filing and work certification makes such fraud far easier. Earlier in-person contact by ES staff would reduce overpayments while also providing workers with valuable job search assistance. In addition, we oppose using private collection agencies to recover overpayments and delinquent taxes. We are particularly concerned about the privacy of both worker and employer data and the reputation of this industry to engage in harassing, threatening, and illegal actions, even when the Fair Debt Collection Practices Act (P.L. 104–208) applies. I want to thank you again very much for giving me the opportunity to testify today. I would be pleased to answer any questions you might have. Thank you.

[The prepared statement of Mr. Devereux follows:]

Statement of Greg Devereux, Executive Director, Council 28, American Federation of State, County, and Municipal Employees, Seattle, Washington

Good morning, Mr. Chairman and members of the Subcommittee. My name is Greg Devereux, and I am Executive Director of Council 28 of the American Federation of State, County and Municipal Employees (AFSCME) in the State of Washington.

I am testifying today on behalf of the 1.4 million AFSCME members who work in state and local government, health care, and nonprofit organizations across the country, including many thousands in the employment security system. We appreciate the opportunity to present our views on the Department of Labor's (DOL) budget request for 2007.

My testimony today will focus primarily on the implications of the DOL budget on the reemployment of unemployment insurance (UI) claimants. In brief, we believe that the budget request will further undermine administration of the UI work test and impair the ability of unemployment insurance claimants to receive reemployment services and find employment as soon as possible.

As you know, the employment security system is the product of a political agreement struck among business, labor and the government in the 1930s. Employers would pay taxes into state and federal trust funds, jobless workers would receive unemployment benefits and meet a "work test" by looking for work, and the federal government would provide the states with the funds to operate the system.

Workers receiving state unemployment benefits are required to register for work with state Employment Service (ES) offices which are authorized under the Wagner-Peyser Act and financed with revenue from the Federal Unemployment Trust Fund (FUTA). While both programs are administered by the state employment security agencies, at various times state UI and ES employees have worked separately in the same or different locations. They also have been cross-trained to perform both functions so that they could be shifted from one responsibility to the other as economic conditions changed.

Two developments over the last 10 years have influenced the connections between the state UI and ES operations. With the shift to electronic and telephone claims for benefits, the states have centralized UI benefit processing functions and set up call centers, thus for the most part ending in-person filings and simultaneous in-person registration for work with the employment service. Second, the Workforce Investment Act (WIA) now requires that employment service operations be offered as part of local one-stop systems. In many states the ES is the backbone of these locally governed systems, thus adding a local mission and orientation to this state agency program.

The state ES offices are a major provider of labor exchange and reemployment services for UI claimants. Nationwide, in Program Year (PY) 2004, 40% of the 14 million job seekers registered with ES offices were unemployment insurance claimants. The number in Washington State was even higher: 49% of 381,582 registered jobseekers were UI claimants, and 79% of them received staff-assisted services while over half were referred to employment.

Numerous analyses have documented the cost effectiveness of the labor exchange services and their effectiveness in reducing outlays from the UI Trust Fund. According to a 2003 U.S. General Accounting Office report, in FY 2002 the ES was the employment and training program serving the largest number of workers (seven times the next largest number of participants) while ranking eighth in funding. Based simply on the number of people registered by the PY 2004 appropriation, the ES spent $56 federal dollars on each person served. In a 2002 paper entitled "Evaluation of Public Labor Exchange (PLX) Services in a One-Stop Environment: New Evidence from North Carolina," Lou Jacobson, a researcher at Westat, found that public labor exchange services spend about $330 per job placement. "What is particularly remarkable," he states, "is that virtually every rigorous analysis of PLXs (sic) indicates that they are highly cost effective."

Reemployment services also speed up return to work by UI claimants. In support of its FY 2001 budget request for $50 million for Wagner-Peyser Reemployment Services Grants for UI claimants, a DOL fact sheet noted that $1 spent on reemployment services would produce $2 of UI Trust Fund savings. This estimate was based on previous experiments and analyses which also demonstrated the advantages of close cooperation between UI and ES operations.

Yet despite this evidence, the Department of Labor proposes to cut spending for state employment service grants by $34 million in FY 2007. This reduction would come on top of last year's cut of $58 million, which included the elimination of the Wagner-Peyser reemployment services grants for UI claimants created in the FY 2001 budget. While DOL requests $30 million in UI funds for in-person reemploy-

ment and eligibility assessments of UI claimants, we anticipate that the emphasis of these grants will be on enforcement instead of reemployment services.

The two-year cuts to the Employment Service are very destructive. If absorbed entirely by reductions in staff, we estimate that, based on the average cost per employee, at least 1,500 state workers would have to be laid off with in-person services in many rural areas eliminated.

However, the damage is actually much worse because the cuts come on top of decades of financial neglect by the Congress and executive branch.

Below are funding levels for State Employment Service allotments since 1985. As you can see, the $688,769,000 requested for FY 2007 is actually $88.6 million *less than* the 1985 appropriation. To match the 1985 appropriation in value, the Administration's budget request would have to be *$1.4 billion* or more than twice as much.

Fiscal Year	*Allotment to States*	*Fiscal Year*	*Allotment to States*
1985	$777,398,000	1997	761,735,000
1986	758,135,000	1998	761,735,000
1987	755,200,000	1999	761,735,000
1988	738,029,000	2000	761,735,000
1989	763,752,000	2001	761,735,000 (plus $35 million for UI claimants)
1990	779,039,000	2002	786,608,000 (plus $35 million for UI claimants)
1991	805,107,000	2003	756,784,000 (plus $35 million for UI claimants)
1992	821,608,000	2004	752,302,000 (plus $35 million for UI claimants)
1993	810,960,000	2005	746,301,000 (plus $34 million for UI claimants)
1994	832,856,000	2006	715,883,000 (-0-)
1995	838,912,000	2007	688,769,000 (-0-)
1996	761,735,000		

With this steady decline in resources in real terms, it should come as little surprise that services also have declined even though technology has added many efficiencies to the ES. For example, in 1995 when the unemployment rate was 5.5%, the Employment Service registered 18.3 million job seekers. By 2004, when the unemployment rate again was 5.5%, it registered 14 million job seekers.

In addition, the Administration has made policy proposals to repeal the Wagner-Peyser Act and end the Employment Service as part of an aggressive strategy to decentralize workforce programs. Its original WIA reauthorization plan would have block granted the ES with the WIA adult and dislocated worker program and transfered responsibility for the UI work test to the local workforce system. This year's budget proposes ending both ES and WIA and replacing them with a block grant to governors who would have to use 75% of the funds for job training and education vouchers, called "career advancement accounts". While both proposals would retain some funding for state labor exchange services, the amount would continue to decline and few, if any, requirements would exist.

The cumulative effect of these proposals is to eliminate federal leadership and accountability and to weaken the core elements of the political agreement that has supported the UI/ES system over the years. The unique role of the Employment Service in relation to the unemployment insurance system is almost an afterthought in these "reform" plans.

Effective administration of the UI work test requires close cooperation between state UI and ES staff and adequate resources to ensure that UI claimants look for work and receive the assistance they need. Such cooperation will be even harder to achieve if administration of the work test is transferred from the state agency to locally administered programs which have to meet separate and locally oriented performance standards.

Furthermore, repealing the Wagner-Peyser Act would end existing requirements that UI claimants receive reemployment services. This requirement is especially important as a companion to the worker profiling and reemployment service system for UI claimants that Congress approved in 1993. Under this program, UI claimants referred to reemployment services by UI agencies must participate as a condition of continuing eligibility for UI benefits. However, these services will not necessarily be available under the career advancement accounts proposal.

The Administration also intends to end America's Job Bank (AJB) which is financed through the Employment Service. Without AJB, there would be no effective mechanism to comply with the Wagner-Peyser Act's longstanding requirement to "maintain a system of clearing labor between the States". AJB is now the largest electronic listing of job openings in the world and has links to the job banks of all

the states and the web sites of private placement agencies and job postings of numerous corporations.

AJB is a critical tool in supporting ES operations and other workforce labor exchange activities in Washington State and nationally. It played a critical role in the aftermath of Hurricanes Katrina and Rita in creating the Hurricane Recovery Job Connection Website when Louisiana's systems shut down entirely. DOL has suggested that the widespread development of internet sites such as Monster.com would be available, but we can think of no effective way private agencies and websites could even begin to replace the value provided by AJB. For example, it is not clear how requirements for federal contractors to list their job openings and for veterans to receive hiring preferences could be implemented without this universally available labor exchange tool.

While my statement has focused on the implications of DOL's budget on reemployment services for UI claimants, I also want to address our concern with the failure to provide adequate funding for state UI operations. These functions include determining eligibility for and paying UI benefits to jobless workers, adjudicating claims, and collecting employer taxes.

Appropriations for state UI operations have not been adjusted for inflation, including personnel and service costs, since 1995. While efficiencies have been achieved during that time, this situation, if allowed to continue, will lead to staff layoffs, reduced services to claimants and reduced integrity efforts.

DOL has made a number of integrity proposals to recover benefit overpayments and improve tax collections. However, they are limited and rely in part on reinvesting recovered benefit overpayments and employer tax penalties in these administrative functions.

In addition to having limited financial impact, the reinvestment approach would break down the historical structure of the UI system under which the federal government is responsible for administrative financing and state trust fund resources are used only for paying UI benefits. For this reason we oppose this policy.

DOL's integrity proposals also do not fundamentally address the deterioration in UI administrative funding, which has reduced state recovery activities, and in ES funding, which has hampered state enforcement of the UI work test. Most UI overpayments occur when someone works and collects UI at the same time. Funding cuts have forced states to rely on internet or automated UI filing and certification of work which makes such fraud far easier. Early, in-person contact by employment service staff would reduce overpayments in these cases. While the Administration's funding request for periodic eligibility reviews may be helpful, it is not the same as a sustained commitment to rebuilding the system and providing an adequate level of reemployment services.

AFSCME also strongly opposes using state benefit trust fund money to pay private collection agencies to recover benefit overpayments. We believe it violates the merit system requirement of the unemployment insurance program. The civil service requirement was first enacted in the 1930s to protect the program from financial and political abuse much like the kind we increasingly are seeing today in government contracting in a variety of contexts. We also are concerned about the privacy of data for both workers and employers and the reputation of this industry to engage in harassing, threatening and illegal actions even when the Fair Debt Collection Practices Act applies.

AFSCME believes the chronic financial neglect of the employment security system must be addressed. Our support for proposals to increase administrative funding and convert it to mandatory funding is longstanding. A mandatory financing structure would allow program activities to more accurately reflect increases in employers and fluctuations in UI claims. The Administration's request is a very poor substitute for the federal government fulfilling its responsibility to provide the necessary administrative funds. In the short term, Congress should at least follow the recommendation of the National Association of State Workforce Agencies and increase UI funding to $3.023 billion for UI administration, which is $283 million more than DOL has requested.

In closing, Mr. Chairman, I want to thank you again for giving me the opportunity to testify today. I would be pleased to answer any questions you may have.

Chairman HERGER. Thank you, Mr. Devereux. Dr. Brough to testify.

STATEMENT OF WAYNE BROUGH, PH.D., ADJUNCT SCHOLAR, AMERICAN INSTITUTE FOR FULL EMPLOYMENT

Dr. BROUGH. Thank you, Mr. Chairman and Members of the Committee. Thank you for the opportunity to testify today. My name is Wayne Brough. I am an adjunct scholar with the American Institute for Full Employment. The American Institute for Full Employment is a nonprofit public policy research and development center founded in 1994, with offices in Klamath Falls, Oregon, and Washington, D.C. The institute was founded with the goal of full employment, universal access to jobs with career potential for all who can work so they can avoid the many poverties of unemployment. The institute conducts leading research, studies best practices, and develops practical solutions in the areas of UI, workforce development, retirement income, and public assistance. Today, we encourage careful assessment of two issues. First is identifying and addressing areas where tax dollars may be wasted in the current program. The second is identifying and improving opportunities to help people find work while saving taxpayer dollars.

On the first issue, State employment agencies, operating under DOL oversight, overpaid claimants by $3.4 billion 2004. This is 9.9 percent of all UI payments. Now not only does this waste scarce tax dollars, but a portion of these overpayments are passed on to workers through lower wages. In total, the effect is the overpayments affect employers, honest workers, and the overall productivity of the economy. I think the problem arises because of the focus on swift payments as a top priority of the agencies. This, I think, is a holdover from a time when the DOL placed more emphasis on timeliness than on efficacy of the programs or the stewardship of public funds. The DOL budget request includes efforts to prevent overpayments as well as collect past overpayments. These are worthy goals, and we encourage the DOL to improve this program.

With respect to the second point, the helping unemployed find work more quickly and effectively, our research has shown that people operating the UI system are capable of improving the job search process. In Arizona, we found face-to-face eligibility interviews did accelerate reemployment. The program saved $10 in benefits for every dollar spent on interviews. However, the program was cut because of inadequate funding. The 2007 budget request includes $30 million to expand the reemployment eligibility assessments. We applaud this effort because we know that this approach helps people get back to work, and it saves money. In another example, for 10 years, Oregon has experimented with subsidized wage program for low-skilled UI claimants. The program was designed to help those likely to experience a long spell of unemployment to find work rapidly through subsidized jobs. The program was found to save more dollars than it cost while employing the most disadvantaged UI claimants and allowing them to find work.

Reforming the system to promote faster rates of reemployment provide significant benefits to the workers and to the economy. Typical claimants receive less than half of their prior wage from UI and spent 3 months unemployed. Most have little savings, and these are depleted fairly rapidly. More than one-third exhaust their benefits before finding a job. Allowing States to experiment with

work-oriented programs can alleviate the burden on claimants while promoting faster reemployment. We know worker-oriented programs help people and save tax money. This should be a thrust of future DOL efforts. Finally, we would like to comment on career advancement accounts. We found most people collecting UI would like to be reemployed promptly and at a good job. Providing the tools to find good work is more important than simply providing a check and saying we don't have high hopes of allowing you to find new employment. Integrating employment services and WIA funding and services provide the flexibility to each UI claimant to get the exact combination of support services that will provide the most benefits. This will improve cost effectiveness, as the unemployed weigh the cost and benefits of various options. Programs to assist the unemployed can be performed with improved outcomes and at lower cost. The key to achieving both of these benefits is to have a strong work orientation to the program, and we urge Congress to incorporate a pro-work attitude in its budget decisions. Thank you, and I would be glad to answer any questions.

[The prepared statement of Dr. Brough follows:]

Statement of Wayne Brough, Ph.D., Adjunct Scholar, American Institute for Full Employment

Mr. Chairman and Members of the Committee, I am Wayne Brough, adjunct scholar with the American Institute of Full Employment. I am here today on behalf of the American Institute for Full Employment, a nonprofit public policy research and development center founded in 1994, with offices in Klamath Falls, Oregon and Washington, D.C. The Institute was founded with the goal of Full Employment—universal access to jobs with career potential for all who can work, so they can avoid the many poverties of unemployment. The Institute conducts leading research, studies best practices, and develops practical solutions in the areas of unemployment insurance, workforce development, retirement income, and public assistance.

The Institute applauds the Department of Labor for recognizing needed changes in the administration of programs to assist the unemployed. We encourage careful consideration of two issues: how tax money is being wasted, and the opportunity to help people find work while saving tax money.

State unemployment insurance agencies, operating under DOL oversight, overpaid claimants $3.4 billion in 2004, the latest year for which data are available.[1] Overpayments amounted to 9.9 percent of all UI payments. Employers across the country are taxed to fund these overpayments. A number of economic studies have concluded that some or all of these taxes are actually passed on to workers through lower wages, so the overpayments problem affects employers and honest workers alike.[2] The problem arises, we believe, from an attitude that swift payments must be the top priority of the agencies, an attitude adopted in years past when payment timeliness was of greater concern to the Department of Labor than program effectiveness or stewardship of public funds. The department's budget request includes efforts to prevent overpayments, as well as to collect past overpayments, which are worthy goals.

Our research has found that the people who operate the UI system are capable of helping the unemployed find work more quickly and effectively. We learned that in Arizona, face-to-face eligibility review interviews helped accelerate reemployment.[3] The program saved about ten dollars in benefits for every dollar spent on the interviews. However, the program was discontinued because of inadequate funding. As you know, money saved from benefits payments cannot be used to fund UI

[1] U.S. Department of Labor, "UI Benefit Accuracy Measurement Report for CY 2004," downloaded from http://workforcesecurity.doleta.gov/unemploy/bam/2004/bam-anrep.asp on April 28, 2006.

[2] Anderson, Patricia and Bruce D. Meyer, "The Effects of Firm Specific Taxes and Government Mandates with an Application to the U.S. Unemployment Insurance Program," *Journal of Public Economics,* Vol. 65 (1997), pp. 119–145.

[3] Arizona Department of Economic Security, "Reemployment Services Performance Report," December 23, 2002.

administration. Thus we have a program that helped the unemployed and saved money, but was terminated. We applaud the budget proposal's inclusion of $30 million to expand Re-employment and Eligibility Assessments. We know that this approach helps people get back to work and it saves money.

In Oregon, for 10 years, that state experimented with a subsidized wage program for low-skilled UI recipients.[4] The program helped people who were likely to experience a long spell of unemployment to find work rapidly through subsidized jobs. The program was funded by a state diversion tax and was found to save more dollars than it cost—while helping the most disadvantaged UI recipients get work.

Reforming the current system to promote a faster rate of re-employment would provide significant benefits to workers and the economy. Typically, claimants receive less than half of their prior wage from UI and spend over three months unemployed. Most of these workers have very little in savings, which are depleted rapidly. More than one-third of claimants exhaust their benefits before getting a job. Providing states the flexibility to experiment can alleviate the burdens imposed on claimants and promote greater re-employment. The Arizona model proved successful, and other states, such as Oregon, have developed more effective programs as well. Yet the current system discourages such experimentation in favor of a system that has changed little over time. We know that work-oriented programs help people and save tax money. This needs to be the thrust of future DOL efforts.

Finally, let us comment on the proposal for Career Advancement Accounts. We applaud this change. We have found that most people collecting UI would like to get back to work promptly, at a good job. Providing them with the tools to find good work is more powerful than simply handing them a check and saying that we don't have high hopes for them finding work. Integrating Employment Service and Workforce Investment Act funding and services has the potential to help each UI claimant get the exact combination of support services that will provide that person the most benefit. It will improve cost effectiveness as the unemployed weigh the costs and potential benefits of various service options.

The programs that assist unemployed people can be performed with improved outcomes and at lower cost. The key to achieving both benefits is to have a strong work orientation in the program. We urge Congress to incorporate a pro-work attitude into its budget decisions.

Chairman HERGER. Thank you, Dr. Brough. Mr. Rosen to testify.

STATEMENT OF HOWARD ROSEN, VISITING FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. ROSEN. Thank you very much, Mr. Chairman and Members of the Committee. I am also grateful for the opportunity to testify today on the Administration's budget request for UC. Before I begin my comments, I would like to respond to some of the earlier comments that were made that are very timely. This morning, the BLS announced that the productivity and the economy grew by 3.2 percent in the first quarter of 2006. I once time asked a Secretary of Labor did we have a productivity problem in this country? He said to me, "Yes, you can never have enough productivity." Productivity is a great thing. But we have to remember that there is also a cost to productivity because, in the short term, employers may need fewer workers. Although we applaud the increase in productivity that is going on in the economy, it also puts pressure on the labor market.

The Chairman also mentioned this morning that we have had an incredible rate of employment growth of about 2 million jobs per year, close to 2 million jobs per year. We now have data that dissect that number because that number is really just a net change

[4] William B. Conerly and John Courtney, "Final Report on the JOBS Plus Program," American Institute for Full Employment, March 2001.

in employment, and we can actually see how many jobs are actually created and how many are terminated. Snce I know that Members of Congress love numbers, let me just tell you that every day in this economy, we create 50,000 new jobs. But at the same time, 45,000 people are terminated in their jobs. Now the net is still positive, which is wonderful, and we need to do what we can to celebrate that. But we can't forget the fact that it is a net number and that actually people are losing their jobs even though we are creating jobs in the economy. The Administration's budget seems to focus almost exclusively on recovering UI payments made in error. Although I think it is important to address waste, fraud, and abuse in the program, I think the Administration's proposal make actually make it harder for eligible workers to receive assistance they so desperately need.

At the same time, the Administration is proposing to reduce funding for ES, which could actually reduce in a decline in resources, making it more difficult for States to monitor compliance with UI eligibility requirements. In fact, I could argue that the declines in employment service spending over the last couple of years may actually be contributing to the increase in the amount of fraud going on in the system. The Administration's budget request ignores the program's serious long-term problems. Our Nation's UI system is seriously out of date with recent developments in the U.S. economy. Number one, yes, the unemployment rate has fallen. But the duration of unemployment has risen, which suggests that unemployment is becoming more permanent rather than temporary. Unemployment is increasingly due to structural, not cyclical factors. Recessions are getting shorter, and the time it takes for employment to recover is getting longer after each recession. State unemployment rates are converging, suggesting that unemployment is becoming due to national factors as opposed to State or regional factors. In this current day of technological change and globalization, no region or industry is immune from the labor market pressures. There is, as I have already suggested, considerable turnover in the U.S. labor market. On average, 30 million workers, or about one-quarter of the workforce, either lose their job, take a new job, or both each year. That is an incredible amount of turnover. That means one out of four people will change their jobs in any given year. Contrary to the conventional wisdom, much of this turnover is taking place in the service sector, not manufacturing.

Looking at our current program, only a small fraction of unemployed workers actually receive UI. Approximately one-third of UI recipients exhaust their benefits before finding a new job. The current benefit level is $262, which is below the poverty rate for a family of three. It only replaces about one-third of previous wages, well below the initial goal of the program of one-half. The automatic triggers for the extended benefit program are broken, making the program obsolete. My written statement goes into some detail about some reform proposals. I just want to highlight five right now. One, we need to expand the insurance risk pool by increasing the Federal role in financing and distributing UI benefits. Number two, we need to make the system more progressive by increasing the maximum taxable wage base and reducing the FUTA tax rate. Now we could actually remove the 0.2 surtax if we just kept the

tax base up with inflation. The tax base has not been changed in over 20 years, and adjusting it would allow us to significantly reduce the tax rate. Improve the linkage to reemployment. This has been mentioned already a couple of times before. We actually have some experience with that in another Federal program called the Trade Adjustment Assistance (TAA) Program, where we have recently introduced wage insurance and a health care tax credit. Given the DOL's enthusiasm about linking to more reemployment programs, it is actually curious to me that they have been unimpressive in their implementation of these two new proposals. Number four, we need to improve the levels of the UI and make them relate to local market conditions, and we need to fix the triggers of the extended benefit program. Thank you very much.

[The prepared statement of Mr. Rosen follows:]

Statement of Howard Rosen, Visiting Fellow, Institute for International Economics

I am grateful for the opportunity to testify before the Subcommittee on the Administration's budget request for Unemployment Compensation. Unemployment Insurance (UI) is the centerpiece of our efforts to assist workers who lose their jobs at no fault of their own.

In addition to providing income support to workers facing significant financial burden, recent research finds that the existence of an adequate unemployment insurance program can reduce worker anxiety and encourage more labor market flexibility, both of which are required in order to meet the challenges of technological change and globalization.

The Administration's budget request focuses on recovering UI payments to workers made in error. Although it is important to address waste, fraud and abuse in the program, the Administration's proposals may actually make it harder for eligible workers to receive the assistance they so desperately need. At the same time, the Administration's proposal to eliminate funding for Employment Services and create a new block grant, results in a decline of resources, thereby making it more difficult for states to monitor compliance with UI eligibility requirements.

The Administration's budget request ignores the program's serious long-term problems. Our nation's UI program is seriously out of date with recent developments in the U.S. labor market.

There have been no major changes in the basic structure of Unemployment Insurance since it was established 70 years ago, despite significant changes in U.S. labor market conditions.

- *Currently, only a small percentage of unemployed workers receive assistance under the program and the assistance is modest at best.*
- *There are vast differences in eligibility, benefit levels and tax rates between state unemployment insurance programs.*
- *The program no longer meets its initial goal of providing counter-cyclical stimulus during periods of economic slowdowns.*

Changes in the U.S. labor market

The U.S. labor market has undergone a significant transformation since unemployment insurance was established 70 years ago.

- *Although the unemployment rate has recently been low and falling, the duration of unemployment has been rising,* suggesting that unemployed tends to be more permanent than temporary.
- *Unemployment is increasing due to structural rather than cyclical factors.* With the exception of the early 1980s, recessions have become shorter, but the length of time it takes for employment to recover from the economic downturns has significantly increased.
- *State unemployment rates are converging, suggesting that unemployment is due to national rather than state or regional factors.* During the late 1970s and the 1980s a disproportionate share of the nation's unemployment was concentrated in the Northeast and Midwest—regions with a high concentration of traditional industries, like autos, textiles and apparel and steel. One consequence of globalization is that no region or industry is now immune from increased do-

mestic and foreign competition. Although there clearly remain differences in local labor market conditions, current pressures on the U.S. labor market are becoming more national in character. Local labor market conditions primarily affect the costs associated with job loss and the prospects for re-employment, they do not necessarily protect workers from job loss.

There is considerable turnover in U.S. employment.[1] Between 1994 and 2004, 30 percent, or approximately 30 million workers either lost their job, took a new job, or both, each year. Contrary to conventional wisdom, a disproportionate amount of this turnover occurred in the service sector, as opposed to the manufacturing sector.

Between 1995 and 2004, approximately 18.3 million new jobs were created and 16.6 jobs were terminated on average *each year.*[2] Job losses exceeded job gains by 20 percent in the manufacturing sector. The average annual number of job losses in the five service industries, i.e. transportation, communication and utilities, wholesale and retail trade, finance, insurance and real estate, and services, was 12½ million, almost 7 times the number of manufacturing job losses.

The Current Unemployment Insurance Program

The original unemployment insurance program was designed to offset involuntary income losses during cyclical periods of temporary unemployment. By contrast, *current labor market conditions suggest that workers face short-term transitional unemployment—as they move from job to job—and long-term structural unemployment. The existing unemployment insurance system provides inadequate assistance in both cases.* Those workers who voluntarily leave one job in order to take another job are ineligible for unemployment insurance and assistance is inadequate for those workers who experience long-term unemployment.

Underlining these macroeconomic changes to the U.S. labor market has been *a shift from traditional employer-based full-time employment to contingent, part-time and/or self-employed.* The shift to non-traditional forms of employment raises additional problems for unemployment insurance. *The current system is not able to cover contingent employment, self-employment, and part-time and low-wage employment.*

As a form of social insurance, UI has some important insurance principles built into it. Premiums are paid in advance through employer taxes of wages earned. Individual eligibility requires earnings (employment) above a state-specified minimum, and entry into unemployment must be through involuntary job loss (no voluntary quits or firings). With the covered earnings requirement, eligible workers are those with some labor force attachment, and continued receipt of benefits requires being able, available and actively seeking work.

Coverage

Coverage is the only part of unemployment insurance that has been meaningfully reformed since the program was established. Over the years, various changes have widened the net of coverage to include almost all wage and salary workers, with the exception of agricultural and household workers. Self-employed workers remain not covered under the program.

Under current law, workers must have worked 20 weeks in a calendar year, earning at least $1,500 in 2 quarters, in order to qualify for the minimum level of assistance under the program. Workers must also have had just cause for losing their jobs. Most state programs provide assistance only to those workers who lost their jobs through no fault of their own. Almost all states disqualify workers from receiving UI benefits due to voluntary job loss and refusal to take suitable work and discharge due to misconduct.

The percent of the total civilian workforce covered by unemployment insurance has been trending upward and currently stands at 74 percent of the total workforce. Recent problems with coverage may be due to an increase in the number of self-employed workers.

The percent of total unemployed workers receiving assistance, the recipiency rate, has also declined in recent years. Only a little more than a third of unemployed workers actually receive unemployment insurance.[3]

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[1] The Bureau of Labor Statistics and the Census Bureau have recently begun publishing establishment data on employment creation and termination.

[2] By contrast, analyses based on changes in net employment would suggest that the economy created 17 million jobs over the 10-year period.

[3] Research funded by the Department of Labor suggests that the recent decline in the recipiency rate is likely due to changes in the industrial composition of employment and the way unemployment is measured. Others argue that the low level of assistance may discourage workers from participating in the program.

Duration of Benefits

Individual states set their own minimum and maximum benefits amounts, as well as the number of weeks workers can receive assistance. Initially, the range of UI duration was 12 to 20 weeks. *Currently, all states except two have a maximum duration of 26 weeks.*[4]

Over the last 30 years, the average duration for receiving unemployment insurance has ranged from a low of 13.2 weeks in 1989 to a high of 17.5 weeks in 1983 and has hovered around 15 weeks for most of the period.

The percent of beneficiaries who have exhausted their benefits, e.g. have remained unemployed beyond the period for which they received unemployment insurance, has ranged from a low of 26.7 in 1978 and 1979 to a high of 43.4 in 2003. *On average, approximately one-third of UI recipients exhaust their benefits before finding new jobs.*

Benefit Levels

Almost all states set their maximum weekly benefits somewhere between $200 and $500, with the largest concentration of states falling between $300 and $400. (See Table 1.) Puerto Rico has the lowest maximum weekly benefit ($133). States with the highest maximum weekly benefits include Massachusetts ($528 to $778), Minnesota ($515), New Jersey ($503), Rhode Island ($477 to $596) and Washington ($496). The average weekly benefit in 2004 ranged from $106.50 in Puerto Rico to $351.35 in Massachusetts. The average weekly benefit for the entire country was $262.50.

Table 1—State Maximum Weekly Benefits

Maximum Weekly Benefit	Number of States
below $200	1
$200 to $300	12
$300 to $400	26
$400 to $500	10
above $500	4

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook

Table 2 presents the distribution of 2004 replacement ratios, the ratio of the average weekly benefit to average wages. The District of Columbia has the lowest replacement rate, less than a quarter of its average wage. Hawaii's UI program comes the closest to replacing almost half of the state's average weekly wage. Thirty-eight states have an average replacement rate of between one-third and one-half of their average weekly wages. The states with the lowest replacement ratios include Puerto Rico, Arizona, Alaska, Alabama, New York, Connecticut, Delaware, California, Missouri, Tennessee, Virginia, Mississippi, Maryland and Louisiana. *The average replacement rate for the United States as a whole between 1975 and 2004 was 0.36 percent, far from the initial goal of 0.5 percent.*

Table 2—Distribution of the Replacement Ratio

	Number of States
Less than 0.25	1
0.25 to 0.35	20
0.35 to 0.40	18
0.40 to 0.50	14

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook

A recent Congressional Budget Office report found that Unemployment Insurance constituted an important source of income for unemployment workers and their families. (See Box 1.)

[4] Washington and Massachusetts have a maximum duration of 30 weeks.

Box 1

Summary of Conclusions

Family Income of Unemployment Insurance Recipients

- UI benefits played a significant role in maintaining the family income of recipients who experienced a long-term spell of unemployment in 2001 or early 2002—particularly those who did not have other wage earners in their family. Before becoming unemployed, recipients' average family income was about $4,800 per month.[5] When recipients lost their job, that income—excluding UI benefits—dropped by almost 60 percent. With UI benefits included, the income loss was about 40 percent.
- For sole earners in a family, the income loss was greater: almost 90 percent excluding UI benefits, or 65 percent including them. For such one-earner families, UI benefits represented two-thirds of their total income, compared with an average of about 20 percent for families with more than one worker.
- Former UI recipients who did not find work soon after their benefits ended—people for whom federal extensions of UI benefits are intended—continued to incur substantial income losses. For the 40 percent of long-term UI recipients who were not working three months after their benefits ended, average family income was about half of what it had been before they began receiving unemployment insurance. By comparison, for long-term UI recipients who were working three months after their benefits ended, income loss was less than 10 percent.

U.S. Congress, Congressional Budget Office, "Family Income of Unemployment Insurance Recipients," Washington, DC: 2005

Extended Benefit Programs

From the outset, unemployment insurance has not been flexible enough to respond to the cyclical nature of unemployment. More than 40 percent of unemployed workers exhaust their benefits before finding new jobs during recessions. To address this shortcoming, Congress enacted a temporary extension of unemployment insurance during the 1958 recession. In 1970, Congress enacted a permanent Extended Benefit (EB) program with automatic triggers to provide assistance in a more orderly fashion. High rates of regular UI exhaustion, problems with the automatic triggers and political pressures have resulted in the need for subsequent Congressional action to respond to heightened levels and pro-longed duration of unemployment associated with periods of economic slowdown.

Increases in the duration of unemployment during recessions have been the primary impetus for extending traditional unemployment insurance beyond its base period. In each economic slowdown since the 1950s, the average duration of unemployment has continued to rise after the economy has begun rebounding.

Extended benefits programs were designed to provide a counter-cyclical stimulus to the economy. In order to achieve this goal, one would have expected the amount of spending on unemployment insurance to be inversely related to the economy's well being, i.e. outlays on unemployment insurance would be higher during economic slowdowns and lower during economic recoveries. This does not seem to have been the case.

Most extended benefits were paid during the 1970s, when the extended benefit program was established, and during the 1980s, when the economy experienced a deep recession. (See Table 3.) There was a dramatic falloff in the amount of extended benefits paid during the subsequent 15 years. One explanation for this fall may be that the nature of recent economic slowdowns has changed, making the mechanisms that were initially designed to trigger extended benefits work less automatically.

[5] This testimony is based on Lori Kletzer and Howard Rosen, "Extreme Makeover: Reforming Unemployment Insurance to Better Meet the Needs of a 21 Century Workforce," draft, 2006. Howard Rosen also serves as Executive Director of the Trade Adjustment Assistance Coalition, a non-profit organization that advocates on behalf of workers, farmers, fishermen, firms and communities which face dislocations as a result of increased imports and international shifts in production.

Table 3—Federal-States Extended Benefit Program

	Total Benefits Paid (in billions)	Number of first payments (in millions)	Average weekly benefit amount
1972–1979	$8.6	13.0	$69
1980s	$7.5	7.0	$115
1990s	$0.8	0.7	$120
2000–2004	$0.7	0.2	$262

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook

Inflexibility in the "automatic" triggers has made the program obsolete. As a result, Congress has occasionally extended unemployment insurance. (See Table 4.) *Far more benefits have been paid under these temporary programs than under the standard extended benefit program, reflecting a major weakness in the standard extended benefit program.*

Table 4—Temporary Extended Benefit Programs

		Total Benefits Paid (in billions)	Number of First Payments (in millions)
1982–1985	Federal Supplemental Compensation Program	$9.6	7.7
1991–1994	Emergency Unemployment Compensation Program	$27.7	9.1
2002–2004	Temporary Extended Unemployment Compensation Program	$23.2	7.8

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook

The standard extended benefit program has accounted for a smaller share of assistance provided unemployed workers, while emergency extensions of unemployment insurance enacted by Congress have become more important. *The nation's unemployment insurance program has become less automatic and more dependent on Congressional action in response to prolonged periods of economic slowdown.*

The degree to which extended benefits actually stimulate the economy during periods of slowdown is also questionable. The amount of extended benefits paid during the Temporary Extended Unemployment program between 2002 and 2004 was approximately $23 billion, less than 3 percent of the change in personal consumption over that period. It is difficult to imagine how the existing unemployment insurance program, with its current benefit levels and duration, could provide serious stimulus to a $10+ trillion economy.

Financing Unemployment Insurance

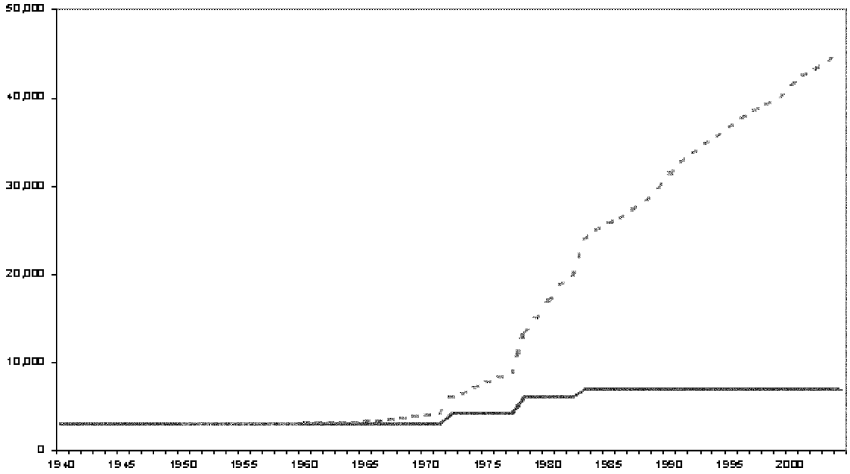
Unemployment insurance is financed by payroll taxes administered by federal and state governments. Revenue from the federal payroll tax is used to finance the costs incurred by both federal and state governments in administering the program. States are required to raise the necessary revenue to finance benefits paid to its unemployed. Federal and state governments share the costs of financing benefits under the automatic extended benefit program. Temporary extended unemployment insurance programs enacted by Congress have typically been financed by federal budgetary expenditures without any specific revenue offset.

The federal tax to finance UI, established by the Federal Unemployment Tax Act (FUTA) is currently 6.2 percent on first $7,000 of annual salary by covered employers on behalf of covered employees. Employers must pay the tax on behalf of employees who are paid at least $1,500 during a calendar quarter. Employers in states with approved unemployment insurance programs—which currently include all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands—receive a 5.4 percent credit, making the effective tax rate 0.8 percent. In 1976, Congress passed a temporary 0.2 percent surtax to replenish the unemployment insurance trust fund. The surtax remains in place and is scheduled to expire on December 31, 2007.

The taxable wage base has not been adjusted on a regular basis, thereby seriously eroding its real value. (see Figure 4.) The last time the federal taxable wage base

was increased was in 1983, when it was set at $7,000. *Had the taxable wage base been adjusted for inflation over the last 65 years, it would currently be approximately $45,000.* At that level, the net federal tax rate, i.e. the tax rate minus the credit, would only have to be 0.125 percent in order to generate the same amount of revenue that is currently being collected. Although it is unrealistic to expect an adjustment of the taxable wage base of this magnitude anytime soon, any increase in the wage base to make up for the erosion in its real value over the last 2 decades could provide additional funding for providing assistance to workers in need as well as enable the federal government to reduce the FUTA tax rate.

Figure 4
Federal Taxable Wage Base
Inflation adjusted



Actual

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook and authors' estimates.

Currently, federal taxes only finance 17 percent of the unemployment insurance program. The remaining 83 percent is financed through state taxes. Thirty-one states set their taxable wage base below $10,000, of which 11 states set their taxable wage base at $7,000, the same as the federal taxable wage base. Ten states set their taxable wage base above $20,000, approximately 3 times greater than the taxable wage base set by the federal government.

There is substantial variance in tax rates set by states. (See Table 5.) Forty-one states have an average UI tax rate between 1 and 3 percent of payroll. Average UI tax rates in the Virgin Islands, South Dakota and New Mexico are below 1 percent. By contrast, the Virgin Islands and New Mexico have relatively high taxable wage bases. Nine programs—California, Pennsylvania, New York, Illinois, Michigan, Massachusetts, Puerto Rico, Rhode Island and Connecticut—have the highest UI tax rates. The weighted average tax rate for the 53 states and territories is 2.8 percent.

Table 5—Average State UI Tax Rates

Average tax rate as a percent of taxable wages	Number of States
Less than 1.00	3
1.00 to 1.99	22
2.00 to 2.99	19
Above 3.00	9

Source: Employment and Training Administration, U.S. Department of Labor, Financial Handbook.

The average tax rate for the nation was a little less than 2 percent in 1975, before rising and finally peaking at 3.25 percent in 1984. The average tax rate declined over the next 17 years, dropping to 1.7 percent in 2001, before rebounding slightly between 2002 and 2004.[6]

Critique of Existing Unemployment Insurance Program

Although the vast majority of American workers are currently covered by unemployment insurance, those groups of workers still not covered by the program, including self-employed workers, some agricultural and domestic workers, people who provide services for relatives, many health care providers, student interns, immigrant farm workers and all kinds of seasonal workers, are gaining prominence in the U.S. labor market.

The percent of unemployed workers actually receiving assistance under unemployment insurance has been falling, at that the same time that coverage has been expanding.

Employers are required to pay federal and state unemployment insurance tax on behalf of workers employed for at least 20 calendar weeks or who receive at least $1,500 or more during any calendar quarter. Coverage is determined by a worker's relationship with a single employer, not by the employee's own work experience. For example, a worker who changes jobs during a calendar year may not be covered by unemployment insurance, even though he or she may have worked more than 20 weeks during the year. This may not have been a problem 40 or 50 years ago, when worker turnover was low. Currently workers change jobs more frequently. In addition, workers are more likely to have multiple employers due to company reorganizations.

Unemployment insurance does not cover workers who voluntary quit their jobs, regardless of the reason or those workers entering or re-entering the labor market. As a result, *workers who voluntarily leave their jobs in anticipation of a plant closing, women who decided to postpone returning to work after childbirth, and workers who leave their jobs in order to relocate with a spouse are all currently ineligibility for unemployment insurance program.*

As a result, the current unemployment insurance program provides assistance to only a small share of the unemployed.

Program eligibility is only one hurdle for the unemployed: in most states, *the level of assistance is extremely low.* The current average weekly assistance under each of the state programs is $262.50—*almost 10 percent less than the weekly equivalent of the poverty rate for a family of 3 set by the U.S. Government.*[7]

There is no evidence that higher benefit levels result in higher unemployment rates.

Assistance under the program is limited to 26 weeks in almost all states. With the recent increase in the d*uration* of unemployment, *the maximum period workers can receive unemployment insurance has declined from twice to a little more than 1½ times the average duration of unemployment.*

The current unemployment insurance system is extremely regulated and rigid. Changes in coverage, eligibility and benefits must be legislated by individual states and must be consistent with federally mandated standards. This makes it *extremely difficult for individual state programs to easily respond to changes in local labor market conditions and crisis situations.*

The Extended Benefit triggers are no longer automatic, as they were initially intended to be, thus undermining the overall effectiveness of the program, and making it virtually obsolete.

Inadequacies in the extended benefit program have resulted in a need for Congress to periodically enact legislation to temporarily extend unemployment insurance benefits, thereby politicizing unemployment insurance. These temporary programs have proven to be clumsy, typically being enacted after millions have already exhausted their unemployment insurance. In addition, the sunset provisions are arbitrarily set and usually fall before employment has picked up.

The current UI system has only a limited relationship with re-employment. Workers receiving unemployment insurance are required to show that they are seeking employment by documenting job inquiries and interviews. There is no requirement

[6] In general, movements in the average total UI tax rates tend to reflect the business cycle, i.e. the rate tends to reach a trough during economic slowdowns and reach a peak during economic recoveries. This is most likely due to changes in the amount of taxable wages, which tends to be cyclical, rather than to actual changes in the tax rate legislated by each state.

[7] Bureau of the Census, U.S. Department of Commerce, "Incomes, Earnings and Poverty from the 2004 American Community Survey," Government Printing Office: Washington DC, August 2005. According to the report, the poverty rate in 2004 for a family of three, with one child under the age of 18 was $14,974.

on workers to undertake training. Even if workers wanted to enroll in training, limitation in federal funding would prevent them in doing so.[8]

The current federal-state structure undermines the program's ability to pool risk, protecting any one state from incurring more than its share of costs associated with unemployment. The current program produces the exact opposite outcome, i.e. those states with less unemployed workers have lower costs and those states with more unemployed workers face higher costs.

Individual states have been forced to revise their tax rates and minimum taxable wage bases in order to finance their unemployment insurance programs. By contrast, the federal government has not revised its tax rate or taxable wage base in more than 20 years. Adjusting for inflation alone, as many states have done, would have resulted in increasing the federal taxable wage base five-fold.

Extreme Makeover for Unemployment Insurance

Recent calls for special unemployment insurance programs to assist the victims of hurricanes Katrina and Rita are the latest evidence that the current program is not flexible or adequate enough to our workers' needs in a timely fashion. Strict eligibility requirements and limited resources have restricted the ability of existing programs to provide meaningful assistance to people in need.

In general, U.S. labor market programs have been designed to fight "the last battle," thereby limiting their ability to respond to new and changing labor market conditions. For example, Unemployment Insurance was established in 1935 in response to prolonged and large-scale unemployment that was associated with the Great Depression, labor market conditions which have not occurred since then. Instead, over the last few decades, the labor market has been characterized by more limited periods of unemployment, experienced more widely throughout the economy. *Fewer people may be experiencing unemployment, but for those who are, it is quite costly.*

In recent years the U.S. labor market has come under increased pressure from intensified domestic and international competition. This pressure has changed the nature of job turnover in the United States. *Workers no longer just change jobs but often also change occupations throughout their working lives.*

The following are some recommendations for reforming the current Unemployment Insurance program:

1. *Increase the federal role in unemployment insurance*

The federal-state structure of unemployment insurance is a relic of its 1935 establishment, and a Depression-era concern over the constitutionality of plans for the federal government to levy taxes for unemployment assistance. Although referred to as a partnership, states currently bear the overwhelming responsibility of financing and administering the unemployment insurance system. Changes in the labor market suggest that, at least substantively, *unemployment insurance would better meet its stated objectives if the federal government played a more prominent role in this partnership.*

At one extreme, transforming unemployment insurance into a federal program would significantly reduce the current administrative burden being placed the states. There would be a single tax rate and maximum taxable wage base for the entire country. Like Social Security, the federal government would collect all unemployment insurance taxes. All workers, regardless of where they lived and worked, would be treated equally under this new federal program, thereby removing all the bureaucratic discrimination that currently exists. Workers would continue to apply for assistance at local offices and local officials would monitor eligibility requirements. The federal government would make payments directly to workers, removing the middle step of transferring funds to State agencies. These changes would result in substantial cost savings.

The convergence of state unemployment rates suggests that unemployment is becoming a more national phenomenon, rather than a state or regional phenomenon. This provides another reason for moving toward a single national unemployment insurance system.

As a federal program, it would much easier for the government to extend assistance during periods of prolonged economic slowdown, as well as provide assistance during periods of national emergency, like natural disasters and economic disruptions resulting from terrorist attacks.

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[8] States are required to maintain an unemployment insurance system that meets federal standards in order to receive the offsetting FUTA tax credit. The provision of training and other employment services, like job search assistance, is left almost entirely up to the states, for which they receive some federal funding. As a result, the availability and quality of employment services varies by state.

Most importantly, making unemployment insurance a single federal program would create a national risk pool, and thereby bring the program closer to achieving its original objective of being an insurance program.

Reinventing UI as a federal program would have the following benefits:

- Bring unemployment insurance closer to serving as a true insurance program
- Remove the implicit discrimination by state in the amount of assistance
- Reduce administrative burden of tax collection and program administration
- Enable the program to be more flexible in responding to changes in national labor market conditions
- Make more resources available to workers undergoing a costly transition

Opponents of this option argue that strengthening the federal role in unemployment insurance it will further increase the size of the federal government. The current system may help reduce the size of the federal government, but it is contributing to increasing the size of state governments.

Regional variation in earnings/assistance could be maintained, with the federal role establishing a minimum percentage of wages replaced.

2. *Increase the maximum taxable wage base and reduce the FUTA tax rate*

Increasing tax taxable wage base would make the unemployment insurance payroll tax more progressive. By increasing the taxable wage base to $50,000, which is closer to the taxable wage base currently in place under Social Security, the tax rate could be significantly reduced yet still generate the same amount of revenue that is currently collected. A large reduction in the tax rate could result in significant job growth.

3. *Improve the linkage to re-employment by expanding assistance to include recent innovations in labor market policies, i.e. "wage insurance" and a health care tax credit*

In 2002 the Trade Adjustment Assistance (TAA) program was expanded to include "wage insurance" and a Health Care Tax Credit (HCTC). Under wage insurance, unemployed workers who find a job that pays less than their previous job are eligible to receive half of the difference between their new and old wages for up to 2 years, subject to a cap of $10,000. Wage insurance is specifically designed to encourage people to return to work sooner than they might have otherwise. In addition, it is hoped that the new employer will provide on-the-job training, which has proven to be the most effective form of training. Wage insurance is also a less expensive form of assistance than unemployment insurance. Under the refundable Health Care Tax Credit, eligible workers can receive 65 percent of the cost of their health insurance premium for up to 2 years. According to recipients, both programs have already proven to meet pressing needs of workers and their families.

4. *Enable individuals, and employers on behalf of individuals, to voluntarily contribute to unemployment insurance and receive coverage*

One of the difficulties in achieving universal coverage is that many of those workers who are currently not covered do not have traditional relationships with employers. In order to address this problem, individuals would be able to voluntarily contribute to the unemployment insurance program, as is currently the case under Social Security. With voluntary contributions, more workers would be eligible for assistance. Workers who leave their jobs voluntarily could receive assistance, as could the self-employed.

It is easier to collect taxes and cover these workers than it is to provide them with assistance. Most importantly, there are problems with measuring "job loss" for many of these workers. It would also be difficult to determine the amount of assistance they should receive. One way to address these problems would be to encourage individuals to establish saving programs to help offset income losses.

5. *Tailor benefits to work experience and local labor market conditions*

Benefit levels would be set according to a formula based on work experience, i.e. number of contributions to the trust fund, wage history, local labor market conditions and reason for separation. In order to cover low-wage, part-time and part-year workers, eligibility would be based on hours worked and earnings levels, rather than exclusively on earnings levels. Workers losing their jobs in regions with poor labor market conditions might receive a higher level of assistance, and/or get assistance for longer periods of time. Workers leaving their jobs voluntarily might be eligible for less assistance than those workers who lose their jobs because of downsizing or plant-closings.

6. *Explore consolidating tax collection and benefit payment with Social Security in order to seriously reduce administrative costs*

Federal and state governments currently maintain duplicate payment systems to administer Social Security and Unemployment Insurance. Both the federal and state governments collect taxes for Unemployment Insurance. Federal and state revenues are placed in a trust fund and the federal government transfers the funds back to the states. This cumbersome process could be replaced by having the federal government collect the tax and make payments, as is currently the practice under Social Security.

The FUTA tax could be withheld from wages together with the Social Security tax.[9] Employers and employees could both pay the FUTA tax, as is currently the practice with Social Security. The current practice of "experience rating," which serves as a factor in calculating the employer's tax rate, would continue.

7. *Create a 401(k)-like saving program for workers, which they could use to supplement unemployment insurance.* Employers and the government could match individual contributions.

Encourage workers to establish a fund to help offset costs associated with unemployment and job change. Workers could make contributions to a fund, matched dollar-for-dollar by their employers and the federal government. Contributions would be tax deductible and any interest generated by the fund would be exempt from tax. Individuals would manage their own funds. Distributions from the fund to pay cover the costs for worker training, job search, job relocation and other expenses associated with unemployment and job change would be tax free. Self-employed, part-time and temporary workers could withdrawal funds to offset drops in income. All other distributions would be taxed as income. All funds remaining at age 57 would automatically become part of the worker's retirement savings.[10]

Conclusion

Unemployment Insurance provides needed assistance to workers and their families during times of great financial hardship associated with job loss.

The Administration's budget request for FY 2007 focuses on recouping payments considered to be made in error. While addressing waste, fraud and abuse in the program, the Administration's proposals may actually increase the administrative burden placed on states, as well as on workers, thereby making it more difficult for them to receive the assistance they so desperately need in a timely fashion.

The Administration's budget request ignores the program's serious long-term problems. Our nation's Unemployment Insurance program is seriously out of date with recent developments in the U.S. labor market.

American workers are currently facing considerable pressure due to continued technological change and intensified competition resulting from globalization. Despite significant changes in U.S. labor market conditions there have been no major changes in the basic structure of Unemployment Insurance since it was established 70 years ago. Reform of the nation's Unemployment Insurance programs is necessary in order to make it relevant to the labor market of the 21st century.

Chairman HERGER. Thank you, Mr. Rosen. Dr. Kane to testify.

STATEMENT OF TIM KANE, PH.D., DIRECTOR, CENTER FOR INTERNATIONAL TRADE AND ECONOMICS, HERITAGE FOUNDATION

Dr. KANE. Thanks very much, Mr. Chairman and Members, for this opportunity to testify. I am actually speaking on behalf of myself, not the Heritage Foundation, where I work. I have learned a lot there, but this is my own testimony. In fact, it is my first time, first opportunity to testify before Congress. My wife reminded me if I don't behave, it may be my last. I really do appreciate this. But

[9] Despite concern over future liquidity of its trust fund, the SSI program has served millions of Americans extremely well since its creation.

[10] For a more detailed description of this proposal see Feldstein, Martin, "Rethinking Social Insurance," 2005, American Economic Review, Volume 95 Number 1, American Economic Association, March.

because this is my first opportunity, I take what I say in these 5 minutes very seriously. It may be my last opportunity to have an influence on public policy. To set the context, I want to begin by emphasizing the strength of the U.S. economy. As an economist, having looked at this recession and recovery period, I think I share Mr. Greenspan and others' feelings that we live in an amazing economy. With an unemployment rate of 4.7 percent, lower than the last 3 decades, as you mentioned, Mr. Chairman, with the growth rate coming out at 4.8 percent, it is a real puzzle why there is so much concern and fear. I know there are some other explanations, but I think there have been plenty of folks in the policymaking community who are fanning the flames of fear right now of a bad economy when we have a good economy. That leads to repercussions and hostility sometimes to illegal immigrants or immigrants of any color, from any nation, any creed, and I think that is an unhealthy environment.

We need to carefully consider creating fear where there shouldn't be fear, where there should be hope and promise. On the notion of turnover that was already emphasized this morning, the UI Program has a tremendous impact on that turnover, and I would like to emphasize job turnover. Industrial turnover is a good thing. We don't all want to be back in ancient times building pyramids. We want to have an economy where people move into new sectors. Job loss, job turnover, job gain—those are right, and we shouldn't characterize every time a person leaves a job as a termination because, mostly, those are voluntary. Mostly, in this economy, people choose to have, in this day and age, shorter work tenures rather than longer. It is not forced by duress. It is not forced by employers. With the nature of the strong economy in mind, let me turn briefly to the goals of the UI Program. The goal originally was to help people transition to another job, to actually help lower the unemployment rate. But what has happened—through international research and through national research—because we do have State diversity, we know that programs that provide more labor protectionism, longer replacement periods for income and higher replacement rates actually lead to higher unemployment rates. If you all want to get the lowest unemployment rate possible in this country, you might consider scrapping the program altogether or turning it back to the private sector. When we question why we have such a low savings rate in this country, you may think also that we have one of the highest insurance rates. Why would Americans need to save if they are already insured against everything by a paternalistic government?

When you start thinking about ways to reform the system, consider allowing the States to reform it on their own, not to impose on them ways that you think is best. Let me propose one thing in particular because I won't have the opportunity to go through my entire written testimony. It often puzzles me why we have a strict 26-week limit on the UI program. I don't particularly understand why you pay someone when they have only been unemployed 3 weeks or 4 weeks. Why not start the program at 5 weeks or 8 weeks, when you know someone is in duress, and that would give you an opportunity to maybe pay them longer or maybe pay them more? This is perhaps exactly the thing that you should consider

freeing the reins on the States to experiment with, rather than having one strict 26-week system. Because Nobel Prize economist Gary Becker has pointed out, the bulk of the payments go to those first 4 weeks, when people aren't in duress. I think your concern rightly is the folks that are still unemployed a half year into an unemployment spell.

Let me close in the brief time I have with a few questions. One is just based on personal experience as an employer. I know that when we think smoking is bad, we tax cigarettes. We tax smokers. But when we think unemployment is a bad thing, why is the Congress taxing employers? It was very unnerving when I hired my first worker, and I was instantly hit with a tax to pay for unemployment when I was actually trying to be part of the solution, not part of the problem. I think that concludes my testimony, and I do appreciate the honor, sir, and would be happy to answer questions afterward.

[The prepared statement of Mr. Kane follows:]

Statement of Tim Kane, Ph.D., Director, Center for International Trade and Economics, Heritage Foundation

Mr. Chairman and other distinguished Members, I am honored to testify before you today.[1] In my testimony, I would like to (1) emphasize the strong employment health of the current U.S. economy; (2) describe new research showing that overly generous unemployment insurance programs lead to higher levels of unemployment and slower economic growth due to the dynamic nature of labor markets; and (3) propose steps for reforming U.S. law on unemployment insurance.

The Nature of American Prosperity in this Decade

As obvious is this may seem, every analysis of economic policy at the federal level in the United States must begin with a recognition of its comprehensive, record-setting strength. By almost every indicator, the American economy is prosperous.

- More Working Americans than Ever. In the latest Employment Situation report from the Labor Department, it is reported that there are 150.65 million Americans in the labor force, and 143.64 million employed, both record highs.
- Very Low Unemployment. The rate of unemployment is just 4.7 percent nationally. In most introductory economics courses, this is considered a rate that is below the natural rate of unemployment, and a sign of possible overheating. By any measure, it is a low rate, far below the average of the 1990s, which itself was a healthy decade economically.
- Growth in Output and Productivity continues to surge. The high growth rates in GDP every quarter since that attacks of 9/11 are a very powerful symbol of the resilience of the American economy. But a more important measure, as you know, is the high GDP per capita Americans enjoy. By comparison, U.S. GDP per capita is 20% or higher that equivalent income levels in nearly every other

[1] The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work. The Heritage Foundation is the most broadly supported think tank in the United States. During 2005, it had more than 275,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2005 income came from the following sources:
Individuals; 63%
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Investment Income; 9%
Publication Sales and Other; 3%
The top five corporate givers provided The Heritage Foundation with 2% of its 2005 income. The Heritage Foundation's books are audited annually by the national accounting firm of Deloitte & Touche. A list of major donors is available from The Heritage Foundation upon request.
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country in the world, particularly the advanced industrial economies of Europe, as well as Japan.

What are the Goals of Unemployment Insurance?

Established in 1935 with the Social Security Act of 1935, and financed by a tax on worker's wages according to the Federal Unemployment Tax Act of 1939 (FUTA), the general goal of UI is to alleviate economic hardship caused by involuntary unemployment.

The program is a complex blend of state and federal authority, funded at the federal level with a 6.2 percent tax (though all but 0.8 percent is refunded) on the initial $7000 of each worker's wages, primarily used for administration. The state tax (SUTA) varies; some states use a high rate and low base (New York's is 4.2 percent on the first $8500), and others use a low rate and high base (Utah's is 0.5 percent on the first $22,000). States collect roughly $20 billion per year in tax revenues, while the federal government collects roughly $7 billion. During most years, total benefits paid out are $20 billion, but during the recent recessionary years, regular benefits paid amounted to over $40 billion per year.

Specific goals of the program are to (1) provide income support, (2) help increase the job-search opportunities of UI recipients. The trade-offs of UI are (1) lengthening the duration of individual unemployment spells, (2) decreasing aggregate labor force utilization in the macro economy, which restricts aggregate supply and growth. Research over the years has found that the program is not effectively meeting its intended objectives to diminish unemployment levels or to enhance employment prospects. That should weigh heavily on the minds of policy-makers when they consider the budget for the program.

If the goal is to minimize the unemployment rate, then UI is counter-productive. If the goal is to alleviate natural job-loss transitions, then it may be working well. But policy-makers should still question why only about half of qualifying citizens use the program, and what the equity considerations are. I think that offhand there are two very clear policy lessons from this basic data.

1. UI payments should made only to citizens in employment duress. That means that a qualifying test should be utilized, and screening should be done carefully.
2. More importantly, in my mind, Congress should restrict UI payment to citizens who have been jobless for more than 4 weeks. This could potentially allow the program to be extended by many months, while focusing payments on those truly in need.

Labor Protectionism and Unemployment

The Summer 1997 issue of the *Journal of Economic Perspectives* published two articles discussing labor rigidity in Europe. Horst Siebert emphasized that the concert of rigid labor institutions in Europe was clearly driving higher unemployment rates there, emphasizing the tightening of policies during 1960s and 1970s. While he observed differences among European states, he concluded by focusing on one common feature: "Job protection rules can be considered to be at the core of continental Europe's policy toward the unemployment problem: protecting those who have a job is reducing the incentives to create new jobs." A contrasting opinion was provided in Stephen Nickell's econometric overview, which reported, "there is no evidence in our data that high labor standards overall have any impact on unemployment whatever."

Table 1 presents unemployment rate averages by decade for ten countries reported by BLS.

Table 1. Unemployment Rates on the rise

	1960–1979	1980–2004	Change
USA	5.5	6.2	0.8
Japan	1.5	3.3	1.7
Netherlands	4.6	6.5	1.9
Canada	5.7	8.5	2.8
Sweden	1.9	5.1	3.2
UK	3.6	8.3	4.7
Australia	2.9	7.7	4.8
Italy	3.5	8.3	4.8
Germany	1.4	7.2	5.9
France	2.8	9.8	7.0

Source: Author calculations using U.S. BLS data.

To summarize, the old caricature that "America is richer but less humane to its lower classes" can be squared with some data up to 1980, when per capita GDP was higher in America but unemployment was too. However, post-1980 it is clear that America has continued its productivity leadership (with higher income distribution generally), while European countries suffer high unemployment rates. The "humane" policies of labor protectionism appear to have backfired, creating a less humane social arrangement.

Nickell (1997) emphasized the diversity of European unemployment rate experiences ("from 1.8 percent in Switzerland to 19.7 percent in Spain") and policies. Nickell's approach is a good one—he assembles macroeconomic performance data for 20 OECD countries, measured over two periods (1983—88 and 1989—94), and assembles an impressive array of labor policy measures, which he uses as explanatory variables. Nickell says at one point that "roughly speaking, labor market institutions were the same" in the 1960s and 1990s. He concludes that unemployment rates are dependent on some policies (e.g., generous unemployment benefits, high taxes, high minimum wages, and weak universal education), but not the conventional culprit: labor market rigidity.

Nickell's assessment has changed in less than ten years, however, as expressed in his recent paper with Luca Nonziata and Wolfgang Ochel (2005). The authors find that "changes in labor market institutions" and rigidities since 1960 have indeed occurred, and these are the root causes, with employment protection accounting for 19 percent of the rise of unemployment. I think it is fair to say that the consensus view of economists today has evolved along the same lines.

A deep new data set published by the World Bank in 2003 and published in the *Quarterly Journal of Economics* (Djankov *et al.* 2004) makes a definitive case that the "Regulation of Labor" (the title of the paper) can be harmful to macroeconomic outcomes. The Djankov labor data cover 85 countries over dozens of labor categories, including the size of the minimum wage, strike laws, protections from dismissal, generosity of social benefits, and so on. The data are coded so that a maximum score of 1 represents the most rigid labor rule, while zero represents perfect flexibility. Importantly, this very deep data set represents laws during a single year, 1997, which precludes some uses that would be available with a time series.

Nevertheless, Djankov *et al.* (2004) find that an increase in the employment laws index is associated with an increase in black market activity, a reduction in labor force participation, and an increase in unemployment rates (averaged over the decade). The econometric tests are not robust and report an R^2 of 0.13, with the labor regulation variable significant at the 5 percent level.

I am hopeful that the excellent new data sets in place will be improved in years ahead and that, with greater knowledge of how institutions and outcomes relate to one another, countries will be even better armed to lower the barriers to riches.

For our discussion of Unemployment Insurance, the point to emphasize is that higher replacement rates and durations of UI are related to longer unemployment spells and higher unemployment rates.

One Model of Unemployment Insurance Reform

Now I would like to share with you the results of rough analysis of a reform proposal of the U.S. Unemployment Insurance (UI) system by the Heritage Foundation. This research was done out of personal interest, and has not been peer-reviewed, but I would like to share some of the insights with the Members on this occasion.

The basic reform considered is a conversion of UI tax payments toward personal employment insurance savings accounts (PESA) that can be drawn down in the event of an unemployment spell. This reform holds the promise of creating incentives that will limit rather than encourage the duration of unemployment spells. Upon retirement, accrued funds will be paid to the individual.

Cash paid into the system would not flow out as insurance to others, but would instead build up individual accounts. If the individual PESA becomes exhausted during an unemployment spell, benefits could still be drawn out in the form of a non-recourse loan from the PESA trust fund (aggregate pool of PESA savings). The system itself would need additional inflow revenues to maintain solvency, making it more expensive than the current UI system. The feasibility of the reform rests entirely on the sensitivity of behavior to different incentives, which current economic studies are unable to specify with much accuracy.

Executive Summary of our Model

We created a model for reform of the U.S. Unemployment Insurance (UI) which would create personal employment insurance savings accounts (PESA) that can be drawn down in the event of an unemployment spell—with the key distinction that PESAs are personal property. Unutilized PESA savings are paid to the individual

upon retirement. The goal is to change incentives for utilizing UI, which economists widely believe extends the duration of unemployment spells.

Results from our multiple agent model:

- A PESA would provide positive retirement savings for about 94 percent of workers, even if existing UI usage behaviors do not change. The additional cost of transitioning to the program amounts to $88.8 billion for the first 50 years of the program. The typical PESA at retirement would amount to $20,000 per worker.
- Our best approximation of incentive effects on UI usage imply the costs will be much lower—$21.5 billion for the first 50 years of the program. Further, up to 97 percent of workers would retire with positive PESA savings. The typical PESA savings at retirement stays at $20,000 per worker.

When we allow for incentive changes induced by a PESA, we assume the duration of benefit usage is cut in half, lowering overall unemployment and raising aggregate supply and economic output. However, with PESAs, people are also more likely to use their benefits more frequently.

Design of the Model

The model considers a set of simulated agents over their work life, and runs them through the current program and its established parameters. We then modify the incentive parameters to simulate reform options. A representative agent is defined by work-life characteristics including an annual income vector, and a weekly unemployment spell vector. Dollars are expressed in 2003 terms, so funds available upon retirement do not include the effect of inflation, nor do benefit levels and tax payments.

The model uses a representative state since each of the 50 states uses different parameters for maximum and minimum weekly benefits, taxable wage base, tax rate, and so forth. The model uses the following parameters:

$10,750;	Taxable wage base (for benefits, not administrative)
2.1%;	Tax rate (for benefits)
50.0%;	Replacement rate (% of total wages paid as benefit)[2]
$400;	Maximum weekly benefit
3.0%;	Real rate of return on PESA savings
3.0%;	Interest rate charged on PESA loans

[2] The average replacement rate of covered employees is roughly 37.5% (weekly total wages divided by weekly average benefit), but 50% is the typical legal replacement rate before placing a maximum weekly benefit that averages roughly $400.

Reform Option 1 introduces PESAs, which we assume cuts UI durations in half, but also increases utilization by half.

Many research studies confirm that a 10 percent increase in the replacement ratio (percent of employment income replace) results in an increase in UI duration "between 1.0 week and 1.8 weeks."[3] One labor textbook notes that a consensus estimate is that 25% reduction reduces average duration by 3–4 weeks. The theoretical question is how much would UI durations fall if replacement ratios were essentially zero? Under a PESA, the recipient would not have benefits as income, but would instead be drawing down wealth. The mind-set of "free" money from the government would be replaced the ideal personalized incentive to preserve wealth. The introduction of PESAs would act like a 100 percent reduction in replacement ratio, resulting in a 10-week reduction in UI durations under conservative assumptions, or a two-thirds decline from the typical UI duration of 15–16 weeks. We used an even more conservative assumption that all UI durations would be reduced by half, not by two-third (or ten weeks).

However, the introduction of PESAs may also incent more participation. We know that more than half of eligible people do not utilize UI benefits currently. Take-up may increase if PESAs were implemented, for a variety of reasons. There would be less stigma (personal and social), eligibility hurdles would probably be lowered, bureaucratic access to funds might be simplified, and so on. Ultimately, it would be a rational decision for an unemployed worker to draw down a PESA before all other forms of saving during an unemployment spell. When faced with unemployment, why take money out of your mutual fund before taking it out of your PESA? We assume these factors would increase PESA usage rates by 50 percent.

[3] From Tom Stengle (July 1998), U.S. Department of Labor, "Dynamic Models of Unemployment Inusrance Receipt," page 22.

Simulation using a Single Representative Agent

This model assumes a single representative agent, who is on UI once for 4 months at age 32.[4] His lifetime income profile is based on Department of Labor (DOL) income average data for each age group.

The agent draws unemployment benefits from his PESA for each of the 16 weeks, which replaces 50 percent of his total wages at that time. His PESA fund builds up to a positive balance of $3,960 by the time when the unemployment spell begins, then it falls to a negative balance of $1,825 by the end of the unemployment spell, which is treated as a non-recourse loan. The net cost to the government of the agent's UI spell is $5,785. Further PESA payments initially go towards paying off the loan, then begin building up as positive savings. Upon retirement at age 66, the agent's savings are a positive balance of $9,154. If the PESA is seeded with $100, the individual spends 9 fewer months under the loan deficit, and the final PESA savings are $9,497.

When we allow for incentive changes induced by a PESA, the agent is more likely to resume work faster, and also is likely to draw down his PESA more often. This is ambiguous to model using a single representative agent, but we assume a second UI spell—later in life at age 42, and briefer (one month). We also cut the first spell by half (two rather than four months). Under these assumptions, and the $100 seeding, the PESA never goes into deficit during the first spell, and ends with positive savings of $13,000.

If we further assume that the first month of any unemployment spell was not eligible for PESA draw down, the PESA would grow to $21,000 upon retirement.

Simulation using Multiple Agents

Fifteen representative agents—representing three income profiles weighted by five benefit usage patterns—are the basis of this model. The following table illustrates various cases, run without changing behavior, seeding each PESA with $200.

Table 1. PESA Savings at Retirement in 2003 dollars (without behavioral change)

Income Profiles	Number of Lifetime UI Spells (Percent of insured covered employment)				
	0	**1**	**2**	**3**	**4+**
(Yearly Average)	**(61.1%)**	**(24.9%)**	**(7.9%)**	**(3.5%)**	**(2.6%)**
Low Income ($14,296)	$21,941	$19,514	$10,837	$5,768	$(4,979)
Average Income ($25,168)	$24,344	$19,324	$4,758	$(3,238)	$(18,983)
Higher Income ($39,649)	$26,074	$16,254	$246	$(11,960)	$(34,362)

This multiple-agent model implies that even under current usage parameters, a PESA would provide positive retirement savings for about 94 percent of workers. The PESA system would generate an additional cost above what the existing UI system costs today, mainly by paying out individual PESAs upon retirement. In the first run of this model without changing behavioral assumptions, the "overhang" of the PESA fund amounts to $88.8 billion for the first 50 years of the program.

A second version of the model includes assumptions about behavioral change among the workforce, presented in Table 2. In this case, up to 97 percent of workers would retire with positive PESA savings, and the overhang amounts to just $21.5 billion.

[4] Empirically, 2.42 percent of the workforce is on UI in the typical month. A typical insured unemployment spell lasts 15–16 weeks. With 49 working years (18 to 66), there are 588 working months.

Table 2. PESA Savings at Retirement with behavioral change

Income Profiles	Number of Lifetime UI Spells (Percent of insured covered employment)				
	1	**2**	**3**	**4**	**5+**
(Yearly Average)	(61.1%)	(24.9%)	(7.9%)	(3.5%)	(2.6%)
Low Income ($14,296)	**$19,554**	**$15,706**	**$10,663**	**$9,608**	**$5,471**
Average Income ($25,168)	$20,085	$13,575	$5,642	$3,047	$(1,879)
Higher Income ($39,649)	$20,705	$10,856	$120	$(3,019)	$(13,064)

Those few workers who had negative PESA balances upon retirement would *not* have to pay back PESA loans, just as UI recipients today are not expected to settle their UI account with the government.

There is one major limitation to the current model: agents are all in the labor force, and this is not a realistic assumption. A future run of the model will include more realistic agents who are out of the labor force during different periods of time, and also agents who are unemployed and neither adding to or drawing from their PESA.

For discussion, the introduction of the PESA system would be scrutinized immediately for any changes in unemployment behavior or financial effects. Long-range incentives can be very difficult to introduce, especially if the term is four or five decades. Therefore, the incentive to maintain a positive PESA balance may be enhanced if some percentage of positive PESA balances were paid out periodically. For example, if annual PESA "dividends" were 10%, paid out every year on December 1st, then the poorer workers in our model would get check for $37.20 in the very first year.

Conclusion

Again, let me thank you for the honor of testifying today. America can retain its economic leadership in the world by continuing successful free market policies of the last two centuries. Labor freedom is one of the most important freedoms of all, and a more effective UI program will help balance economic justice with higher growth.

Chairman HERGER. Thank you, Dr. Kane. The gentleman from Washington to inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Let me start with Mr. Halley and Mr. Devereux. Mr. Devereux and Mr. Halley, we just heard testimony from the department, from Ms. Chao's operation, that the ES Program is redundant, and it serves little purpose. Can you respond to that suggestion? I mean, what specific services are provided? Why have the two programs? It sounded there for a moment like we had two programs doing absolutely the same thing, just in different offices, the way it was described by Mr. Mason. Would you explain, is there any reason for having the two different programs?

Mr. HALLEY. Thank you, Congressman. Let me respond to that from the State of South Carolina perspective. Whereas we do have an employment service and we do have the WIA in 12 workforce investment areas, the employment service is a State-wide labor exchange agency. It has a State-wide job bank, which the workforce investment areas do not have. Fortunately, in the State of South Carolina, the workforce investment areas, the One-Stop Careers are located, in 98 percent of the cases, within the Employment Security Commission. Let me assure you that the integration of serv-

ice is very obvious when you walk into one of our One-Stops in terms of the services that are provided from the employment service to the—which are basically core services and, in addition, to the intensive services. But in terms of partners that operate out of that One-Stop, it is an integrated process that we exercise. I also have to reference the fact that in the State of South Carolina, the Wagner-Peyser budget to provide labor exchange activities is $10 million. We served over 400,000 people last program year. We placed 65,000 people in employment. The WIA budget in the State of South Carolina is $45 million. They served a little over 200 people in this agency as far as people graduating, actually graduating from an institution. I think that the Wagner-Peyser, the employment service, the labor exchange service is essential. I think that you have to have a State-wide labor exchange program in place, which is the Wagner-Peyser State-wide labor exchange program, in order to give the applicants, I think, the right to apply and the convenience of looking for jobs on a State-wide basis.

Mr. MCDERMOTT. Mr. Devereux?

Mr. DEVEREUX. I would echo some of those comments. I think it is incredibly important to have a State-wide system where UI and ES is tied together in a very coordinated fashion. The One-Stop programs under WIA are governed by local boards and have a very different set of priorities than the ES system. I think it is far more important to have that State-wide coordinated system under the employment——

Mr. MCDERMOTT. The one that is locally controlled has to do with what the jobs that they are looking in the local area, and so they design what they are doing locally?

Mr. DEVEREUX. That is correct. Correct.

Mr. MCDERMOTT. The other one is a State-wide system?

Mr. DEVEREUX. State-wide integrated system.

Mr. MCDERMOTT. It is not correct then, in your view, to say that if you combine these systems you will get more for less, and we can save $2 billion, as the President's budget tries?

Mr. DEVEREUX. That is my belief, yes.

Mr. MCDERMOTT. Also your——

Mr. HALLEY. I agree with that, Congressman.

Mr. MCDERMOTT. That would be your organizational assessment from a national board that you sit on and you are here representing? Or you are just speaking for South Carolina at the moment?

Mr. HALLEY. I am speaking from South Carolina. As an administrator of the Employment Service Program for the State of South Carolina.

Mr. MCDERMOTT. Is there any State that has yet received a waiver to let some outside agency decide who is eligible for UI?

Mr. HALLEY. I am not familiar with any.

Mr. DEVEREUX. I am not either.

Mr. MCDERMOTT. You don't know whether this bill that has these new waivers in it would give States that option of letting some—I know about this from workers' compensation, where workers' comp has now been, in some States, put out to private agencies to decide if somebody is able to go back to work on a physical basis.

I wondered if this kind of thing had happened at the administrative level. But you know nothing about anything like that?

Mr. HALLEY. I have no concept of that, Congressman.

Mr. MCDERMOTT. Mr. Rosen, we hear a lot of good numbers here. We are getting 175,000 new jobs a month. My remembrance from a previous Administration was that it took at least 250,000 jobs a month simply to keep up with the new people coming into the employment base. Now I see your head going "yes," and I see Mr. Kane's head going "no." I would like to hear some discussion about the wagging heads here.

Mr. ROSEN. Well, I was saying yes because I think you have identified an important issue. But you know, it is conventional wisdom that somewhere around 200,000, 250,000 a month is the number we are looking for. It is curious. The markets wait—you know, bated breath—for that number to come out, and then we are told that the markets respond to that number, if it is above or below, and then we know how healthy the economy is. Well, one of the factors is that we actually are not, our labor force is not growing as fast as it was before because of demographic factors. In terms of bringing people into the market, that number is less important. As I pointed out before, I wish that the Government would stop reporting that number because I think it is incredibly misleading. That really what we want to know is not the net number, but the total. Because it is possible, let us say, for example, during a recession, we will have job creation, some—it will be a lot lower than usual—and very high job termination. But during recoveries, we will have higher job creation, but we could also have higher job termination. But just the net might be positive. The net is, I think, a very misleading number. Only a couple of years ago has the BLS and the Bureau of Census begun collecting data from establishments on actual numbers of people who are employed and jobs that are terminated. We have the ability now to start looking at those numbers, and that is what we really need to look at in terms of really understanding the health of the economy.

Dr. KANE. I would agree with some of that. I am sorry.

Chairman HERGER. On my time. The time has expired. But, Dr. Kane, why don't you answer the question also?

Dr. KANE. Yes, sir. I will be brief. I think the conventional wisdom has varied quite a bit. But if it were as high as 250,000 a month, that would be about 3 million workers a year. If you assume half are employed, that is 6 million people you are adding a year. That is way too high. I think a study done by the Federal Reserve in Atlanta pointed out that because of the demographic changes, it is about 100,000 a month now. If you get 175,000 job creation a month, you are way above what you need to replace. The best measure is the unemployment rate. That is where you see utilization of labor, and it is incredibly strong right now.

Mr. MCDERMOTT. Even when you are considering a number of people who have given up looking?

Dr. KANE. Yes, sir. There is this theory of discouragement, which is, frankly, a real canard.

Mr. MCDERMOTT. You don't believe that happens?

Dr. KANE. It is not that I don't believe it. It is that the data say it is not true. This story was put out, and I think it was a good

story in the 1991 recession. The Labor Department—I had nothing to do with it. I would love to take credit—they responded, and they started to ask people why they were not looking for work. One of the choices is if they are discouraged, and they take great care to find that out. We know since 1992 how many discouraged workers there are, and there is not a growth of them in this last recession. We have the same amount of discouraged workers today as we did in some of the best years in the 1990s. You go back to that unemployment rate. It is a great statistic, and 4.7 percent, you are not going to find a way to explain that away.

Chairman HERGER. I thank you.

Mr. MCDERMOTT. Thank you for extending my time a little.

Chairman HERGER. A lot.

[Laughter.]

Mr. MCDERMOTT. It is all in the eye of the beholder.

Chairman HERGER. Right. Dr. Nilsen, what do you know about the effect of profiling programs which were created in the 1990s with the intent of better targeting services to people most likely to exhaust unemployment benefits before finding a new job? Should we be surprised that after this many years, we still have such limited data on the effect of worker profiling efforts?

Dr. NILSEN. Mr. Chairman, it is unfortunate that we don't have a lot of good information on the effectiveness of profiling. I know it was started in the 1990s based on some research that said if we identify those people most likely to exhaust their benefits and focus assistance on them, we should get shorter durations of unemployment for those. There hasn't been good research funded by Labor to look at this program to see if, in fact, it is operating the way it was conceived to operate. As I covered in my statement, the current research right now that Labor is funding is just seeing how good the models are on predicting exhaustion. They are not looking at how good the assistance is to shorten the duration of unemployment. Right now, I agree with your statement. We don't know enough about how successful this profiling experiment has been. I know in Washington State, where Mr. McDermott is from, they have a program that also targets people who are more or less the most job ready and says let us help you get into the workforce, get back to work quicker. Those are the kinds of things that I think also should be tried. But we need the research to show that these efforts are effective. Right now, we don't know enough about profiling. We don't know how much each State profiles its unemployment recipients. We don't know what proportion are being provided assistance. I would hope that the Labor Department would fund more research. When we looked at its research budget over time or the last 5 years, this is all of the Employment and Training Administration programs. The research budget has gone down from about $86 million to in 2007 they are requesting about $17 million. That has got to be spread not only for UI research, but for all the research on the programs. If I just might add something to Mr. McDermott's question from before? Looking at the UI system and its relation to the workforce investment system, this is a big, broad system. When Mr. Bishop was talking about the amount of training in the workforce investment system, we did a study that said 40 percent of the dollars are spent on training. That 60 percent that

is left over is not administrative funding. That is helping people get jobs. Many more people are placed in jobs as a result of that assistance than the training. Basically, the training is people in training are barely 10 percent of the people going through the system, and we have seen many examples across the country in our work of systems that are integrated with ES and the workforce system. That is the model. That is the way it should be. It is not that way everywhere, as Mr. Bishop pointed out.

Mr. MCDERMOTT. It is in Washington.

Chairman HERGER. Thank you, Dr. Nilsen. Mr. Halley, could you please give us an update on how many States are using the authority Congress provided in the SUTA Dumping Prevention Act of 2004 to compare unemployment rolls with the NDNH? Do you have any sense of the savings to the State unemployment trust fund due to State use of this new authority?

Mr. HALLEY. Thank you, Mr. Chairman. To the best of my knowledge, I have no concept as to the number of States involved in the North Carolina model. In terms of savings, there have been projected savings. But in terms of actual savings that have occurred, I cannot tell you.

Chairman HERGER. Okay. Thank you. The gentleman from California, Mr. Becerra, to inquire.

Mr. BECERRA. Thank you, Mr. Chairman. Thank you all for your testimony. If I could begin with is it Mr. Halley or——

Mr. HALLEY. Halley. Like the Halley Comet.

Mr. BECERRA. Halley. Let me ask you something and also to Mr. Devereux, as folks who work in the system. Were you consulted by the DOL on these proposals to consolidate some of these employment service programs and combine them so we could have some savings?

Mr. HALLEY. No, I was not. The State was not. The State of South Carolina was not.

Mr. BECERRA. You are the president-elect of the——

Mr. HALLEY. National Association of State Workforce Agencies.

Mr. BECERRA. You would represent all those various State agencies that deal with workforce employment and the efforts that are being done by the various States?

Mr. HALLEY. Yes.

Mr. BECERRA. Okay. Mr. Devereux?

Mr. DEVEREUX. I represent 2,400 members who are in employment security. I, myself, was not consulted. They may have been. I am not sure whether they were or not.

Mr. BECERRA. Mr. Halley, I think you mentioned that you know of some programs that had to be eliminated that were having some success in reemploying individuals because of lack of funding?

Mr. HALLEY. Basically, I did not mention. I think that is one of the other panelists.

Mr. BECERRA. Oh, okay. I am sorry. Thank you. I apologize for that. Let me ask a question of Mr. Rosen. You talked about the employment figures and job creation/job loss. My sense is that over the last several years, we have seen a lot of jobs lost in manufacturing and a lot of jobs gained in the service sector. A lot of jobs lost that had benefits attached to them, a lot of jobs gained that come without benefits. A lot of jobs lost that had large or lengthy

security attached to them, a lot of jobs gained that are very insecure. Tell me if my gut and some of the data which I have seen reflects what I have just said.

Mr. ROSEN. What you said is exactly the conventional wisdom, and it is the story that we are being fed by the press constantly. But, in fact, if you look at this new database that I have mentioned, it actually suggests—I mean, you are correct that there are large numbers of manufacturing job losses and very few job creation in manufacturing. Therefore, the net in manufacturing is negative. The contrast is true in services, which is that the job creation is high. But there is also a lot of job termination in services.

Mr. BECERRA. ower paying jobs in the service area.

Mr. ROSEN. Correct. Correct.

Mr. BECERRA. We are not talking about just computer jobs service area.

Mr. ROSEN. Correct.

Mr. BECERRA. We are talking a lot about the hospitality industry.

Mr. ROSEN. Finance industry.

Mr. BECERRA. Yes.

Mr. ROSEN. Okay. The net may be greater in services than it is in manufacturing. But in fact, when you correct for the size of those two sectors—i.e., service is now 80 percent of the workforce, and manufacturing is less than 20 percent—in fact, the relative size of job termination in services is much greater than it is in manufacturing because manufacturing is a small base in the economy.

Mr. BECERRA. Which I think, to some degree, to Dr. Kane's point, I think addresses why so many Americans still feel so insecure. Because while they may be working, it is no longer the same job that their parents had, where they knew for 40 years they would be there, and they would have a pension at the end of the time that they were there. They had their benefits. Like my father, who was a laborer all of his life, he at least knew through his union job that he was going to have some health benefits for his family. He has a small pension through his work and also through Social Security. I think most people today are saying I better work very hard because I don't know how long I will keep this job, and I don't have any benefits that will be attached to it. I am sorry. Did you want to——

Mr. ROSEN. Mr. Congressman, could I just add that in addition to your point about the fact that these new jobs may not have benefits associated with it, they also are putting a strain on our UI system because many of these people are not covered.

Mr. BECERRA. That is right.

Mr. ROSEN. That is why we are seeing a decline in the number of people who are unemployed actually getting assistance. That is why we need to rethink our system to try to cover some of those people.

Mr. BECERRA. In the remaining time I have, I would like to engage the two of you, and Dr. Kane as well, on this issue. Because, Dr. Kane, I know a lot of folks who have come to me and said, "I am working at a job that, if I could, I would leave. But I don't have anything else that I can turn to. I am working part time, but I

would love desperately to work full time." A lot of part timers—my understanding is somewhere around 4 million or so Americans are working part time, and they are considered part of that full-time employment number that reduces the unemployment rate, but are barely making ends meet. I know a lot of folks who are discouraged and have not had success. These are folks who have some skills. The 4 or 5 million people that we consider discouraged are no longer even counted in the unemployment rate. I am surprised that you say it is a fiction that there are these folks out there because my understanding is there are a lot of folks who have tried very hard. There are lot of folks who are working part time but are considered part of the full-time employment number, and that reduces the unemployment rate. Just, I know I am running out of time, but any quick comments. First let me turn to Dr. Kane, since I have already asked Mr. Rosen for some comment.

Dr. KANE. Thank you, sir. No, I think you are right that there is—I don't mean to say that it is a fiction that there are discouraged workers that have skills that can't find work. My point is that they are not in greater number than they have been. It is pretty much a permanent feature of an economy that goes through change. If we want to have change and higher productive jobs in the future, that is part of the process. The issue today is does the UI help or does it protract that experience? I think you and both want to solve it. I would caution that we don't know all of the answers, and State experimentation is the best way to get there. On the part-time issue, I think you are right as well. I have looked at the data on that. There are more part-time workers. Some don't want to be. But a greater proportion are voluntarily part time. Mothers, for example—is a great story—that want to stay involved, and our economy now lets them on a part-time basis, professional women. I would also just briefly challenge, I don't think the loss of manufacturing, which is about 14 million workers now in an economy—that is only 10 percent—the loss of those jobs, they are not replaced by bad jobs. Most of us, over 80 percent, are in the service sector. I would suspect every person in this room is in the service sector. Many of those jobs have benefits. If we look at the average data, pay and benefits on average is higher today than it was last year and the year before and in the 1950s, when there was all this supposed security. I do think it is fiction that we are losing benefits and that we are losing job security.

Mr. BECERRA. But my understanding is that real wages, what you take home and what you can use to buy with that money, has actually gone down?

Dr. KANE. Yes, sir.

Mr. BECERRA. Your pay may have gone up, but relative to inflation, the cost of everything you have to buy, it has gone down.

Dr. KANE. It is higher today. Cash payment earnings are higher today than during the dot-com boom. It has maybe gone down in the last year or two. But that points out again to the real rise that we have seen is in benefits. To your point, things like health, things like fringe benefits of other kinds. Those are even higher than they were.

Chairman HERGER. The gentleman's time has expired. The gentleman from Pennsylvania, Mr. English, to inquire.

Mr. ENGLISH. I want to thank the Chairman, and I want to thank the panelists for their contributions to our debates. I particularly want to thank you, Mr. Rosen, for raising the issue of wage insurance. I realize at a time when we are talking about retrenching at the Federal level, it may be unfashionable to talk about something that might prove to be an increment to the safety net. But at the same time, we are at a moment where it is very difficult for us, particularly in a district like mine, to rationalize some of our trade policies and recognize that some of the job displacement that is occurring may lead to higher incomes. But at the same time, there are many people who are losing their jobs and are facing a great deal of uncertainty. On that point, I know there is always a concern about the cost of entitlements. If we were to consider a system of wage insurance added to the current unemployment benefit system, what would it cost? Relative to the potential benefits in the economy that would accrue from our continued commitment to a rules-based globalization, are there potential savings as well from putting in this kind of a system?

Mr. ROSEN. Well, thank you very much, Congressman. Actually, wage insurance is the extension of the discussion that we have been having here. The discussion about the difficulty people have in finding new jobs, the problem with training and those kinds of things. If I could just very quickly, just to say what wage insurance is? Under TAA, this program has just been implemented by your leadership. That if a worker takes a new job which pays less than the previous job, the Government will subsidize 50 percent of the difference up to 2 years with a cap of $10,000. Right now, it is structured for older workers, but there is no reason why it would have to be limited just to older workers. What is the reason for wage insurance? Number one, it is to encourage people to take jobs quicker. That would get them off the UI rolls quicker. Also, it would also have them go into work, and hopefully, the new employer would provide on-the-job training. We don't know a lot about the effectiveness of training. But the one thing we do know is that on-the-job training is always more effective than classroom training. If we can encourage more on-the-job training, that is a good thing. Now, to answer your question directly—I am sorry for the introduction—the estimates are somewhere between $4 billion and $6 billion to cover all dislocated workers. That is not everyone on UI. That is just—I shouldn't say just—it is the number of people that are permanently displaced from their jobs because those are the people that are most seriously in need. In fact, as you suggest, getting these people back to work quicker would save money on the UI rolls and would also, you know, help the macro economy. In all sense, I mean, it is a kind of a positive all around. As I mentioned in my opening statement, it is, therefore, curious to me that the Labor Department has been rather slow in implementing this program under the TAA program because of all of the benefits to it, both to the fiscal budget and also to the economy as a whole. We are hoping that that will change relatively soon.

Mr. ENGLISH. Dr. Kane, I think Heritage brings in sometimes, you know, a very formidable experience on these issues and also a solid track record of questioning entitlements. Looking at wage insurance as something that would be potentially part of a bigger pic-

ture of rationalizing some of existing entitlements, saving money in some places, and also committing us to continued involvement in the global economy, from a Heritage perspective, what questions should we be asking about a new entitlement like this?

Dr. KANE. I appreciate the opportunity, sir. I have to say I am not very steeped in wage insurance, but I am little suspicious of it. I like the idea of thinking creatively about ways to address some of the concerns that we have with the loss of manufacturing jobs. But off the top, I think it sounds a little bit like it gets in the way of the free market. If someone goes to a job or if they can't compensate for the past job, I don't know if the Federal Government has a role there. I do like some of the ideas that I have heard out of the Republican Party to build skills at a very fundamental level by bringing choice into education, you know, at a very intro. But that is not really what you want.

Mr. ENGLISH. Yes. Is there a scruple you would have against this that you wouldn't also apply to, say, UI?

Dr. KANE. Well, I think I presented some strong scruples earlier to UI.

Mr. ENGLISH. Ready to give it up. People will get back to work quicker.

Dr. KANE. That is one way to think about it. I would want to encourage the States to experiment with radical freedom on how they do UI and wage insurance, which should be part of that. Let me say that.

Mr. ENGLISH. Well, and let me say I would encourage Heritage, coming at this again with a lot of expertise, to maybe team up with the Institute for International Economics because certainly you end up in the same place on a lot of trade issues, and this might be, granted, an interventionist approach, but one that I think is worth reviewing. Mr. Chairman, I realize actually wage insurance is more in the jurisdiction of the Trade Subcommittee. But I am grateful that, as always, you have given us a forum to consider the bigger picture, and I thank you for it.

Chairman HERGER. I thank the gentleman from Pennsylvania. On that note, I might mention we have been talking about some reductions here, several of you have. These reductions really are not under our jurisdiction. They are really under the jurisdiction of the Education and Workforce Committee. But Dr. Brough, could you tell us more about your research that has found that people who operate the UI system are capable of helping the unemployed find work more quickly and effectively? What States are doing the best job of that?

Dr. BROUGH. Just briefly, the work that I am referring to there is actually done by a colleague of mine, Bill Connelly, who has done work looking in Arizona, in particular, where you did have these interviews. What they did find was, you know, a $10 savings for every dollar put into this system. As I mentioned in the testimony, Oregon is another State that has done these things. I think, looking at the system as a whole, getting that kind of experimentation at the State level and allowing them to come up with a package that meets the individual claimant's needs is probably the best way to move forward. I think we do have a study that Dr. Connelly did

that I would be glad to forward to the Committee that talks about some of those things.

Chairman HERGER. I would appreciate you doing that, if you would? Do you know specifically what those States do to help laid-off workers more quickly?

Dr. BROUGH. Off the top of my head, I am not. Again, it is research that he did, and I will be able to pull that together for you.

Chairman HERGER. I appreciate that. Thank you very much. Again, I would like to thank all of our witnesses this morning for your testimony and ask that you also answer any additional questions for the record that may be sent in writing. As we continue to look at ways to improve the Nation's unemployment system, the information you provided today will be very helpful. With that, the Committee stands adjourned.

[Whereupon, at 11:48 a.m., the hearing was adjourned.]

[Questions submitted from Chairman Herger to Mr. Bishop, Dr. Nilsen, Mr. Halley and Dr. Kane, and their responses follow:]

Questions from Chairman Wally Herger to Mr. Mason Bishop

Question: Written testimony submitted by UWC, a trade association representing employers, suggests that states provide employers with "charge notices"—a list of all employees collecting unemployment benefits based on work with that employer—no less frequently than quarterly. Some states, like California, provide these notices to employers only annually, limiting the ability of employers to contest benefit payments to individuals who may not have worked for them, or who were fired for cause and may not be due unemployment benefits. Have you examined this issue, and whether states that provide more frequent charge notices in effect better prevent overpayments by allowing employers time to contest improper payments in time to do something about it?

Answer: The Department of Labor (DOL) has not conducted specific studies to determine whether more frequent notices prevent overpayments. However, we agree that these notices allow employers to know about claims that have been filed and allow them to respond and alert state unemployment insurance (VI) agencies about potential problems or potential fraud. Most state VI agencies issue a notice of claim immediately to the last employer when a claim is filed, and many states also immediately issue a notice of claim to each employer whose wages are used to establish the monetary determination for the VI claim—i.e., those employers for whom the individual worked during the recent 1-year period, or the base period, which is used to determine the monetary entitlement and the weekly benefit amount. This notice of claim serves as a systematic internal control to help prevent and detect fraud. Most states also then issue quarterly "charge notices," which also serve as an internal control or check and balance in the system to prevent fraud and abuse. Only five states issue a charge notice to employers less frequently than quarterly; however, all of these states advise employers of their possible liability at the time a claim is being processed.

Question: Please explain why DOL estimates that only about half of the estimated $3 billion overpayments in the unemployment program are potentially recoverable. Is this percentage similar to potential overpayment recoveries in other Federal programs?

Answer: Operational overpayments (those that the states can reasonably be expected to detect and recover) tend to be about one-half of the total estimated overpayments. Certain types of overpayments are excluded from the definition of operational overpayments because it is not cost effective for the state VI agencies to pursue them, they are not detectible through normal operations, or they are deemed not recoverable under state law. Examples of excluded overpayments are those caused by improper work search, failure to register with the employment service, and issues related to the monetary determination process.

Because of the unique nature of the VI program, which is a Federal-State partnership, it is difficult to make an "apples to apples" comparison of overpayment recoveries in other Federal benefit programs.

Question: Several witnesses express concern about DOL's decision to end "America's Job Bank." Please provide the Committee with additional information that would explain DOL's decision to suggest such action.

Answer: America's Job Bank (AJB) was the first national electronic job board on the Internet and served an important role when it was first developed in 1995. During the past 2 years, the U.S. Department of Labor's Employment and Training Administration (ETA) has extensively reviewed and evaluated the ongoing viability of maintaining a national job site. Due to a number of factors, the benefits of AJB no longer outweigh the costs of operating and maintaining this national system and it will cease to be operational on June 30, 2007. The 2007 Budget requests no funds to support AJB.

Numerous factors were weighed in coming to the decision to end AJB, most of which fell into two broad categories: 1) changes in the broader environment AJB is operating in, and 2) the costs associated with running the system.

1) Changes in the Operating Environment: Since the launch of AJB, the number of private-sector Internet-based job boards (Career Builder, Monster, Yahoo! Hot Jobs, and so forth.) has proliferated. This development calls into question the need for a Federal government-sponsored job board.

- The numerous private-sector electronic labor exchange systems are continuously improving and most, if not all, of these sites offer free services to job seekers. Current trends in the industry suggest that some level of free service will also be offered to businesses/employers in the future.
- Most of the employers who currently use AJB also use other job boards simultaneously to advertise their openings.
- As Internet technology and technical resources have become widespread and the costs associated with them have declined, states and local areas that used to depend on AJB for their Internet self-service labor exchange presence have built and operate job banks of their own that are not based on AJB.

2) The Cost of Operating AJE: The cost of operating AJB has been as high as $27 million per year, with a current operating budget for systems maintenance of $12 million per year. Even with this sizable investment, AJB has not been able to keep up with private sector job boards or industry standards regarding up-to-date technology. Additionally, the technology platform on which AJB is built is outdated. Therefore, the cost to maintain AJB and constantly upgrade the foundational technology and make improvements to the site is no longer justifiable given that AJB duplicates what is already available in the private sector.

Question: One of the DOL proposals would to require states to impose at least a 15 percent penalty on improper payments due to fraud. Savings from that penalty would be deposited in a special fund, which in turn could only be used to further program integrity activities. Overall, this proposal is estimated to save $314 million over 5 years. How much of that $314 million in savings is from the initial penalty, and how much from your estimate of the secondary effect of states' performing more program integrity activities using those penalty savings?

Answer: The entire $314 million estimated savings is derived from additional integrity activities funded by the penalty. We estimate that collections from the penalty will be $116 million over 5 years and assume that the entire amount will be spent.

Question: Why is it taking so long for all states to start using data in the National Directory of New Hires to help ensure unemployment benefits are paid to the right people?

Answer: In early 2005, DOL and the Department of Health and Human Services (HHS) conducted a pilot test with three states to determine the procedures and technical specifications/requirements that would be used for the National Directory of New Hires (NDNH) data matching. The pilot was completed successfully and after some modifications by HHS, the NDNH was accessible to all states by October 2005. In order to begin matching data against the NDNH, states must execute a Computer Matching Act (CMA) agreement with HHS, modify their automated systems to meet the HHS CMA system security requirements, and implement data transmission protocols. These automated systems changes are time consuming, and the programming and implementation are subject to state priorities. This has

caused delays in implementation. Currently, 14 of the 27 states with signed CMA agreements are matching state data against one or more of the NDNH databases. The remaining 13 states, as well as several states with agreements pending, have indicated to DOL that they intend to begin matching in 2006. DOL provided funds requested by 37 states in 2005 to implement the NDNH data matching. DOL will continue to monitor state implementation. In addition, DOL is issuing guidance promoting the use of the NDNH and disseminating information about the pilot and the benefits of accelerating implementation.

Question: Some other witnesses expressed concerns about mixing administrative and benefit funds, as the DOL budget proposals would do. For example, allowing states to use a share of recoveries of improper unemployment benefit payments to support administrative costs has drawn the objection of state agencies and employers. Do you agree these are valid concerns? If so, are there ways to address such concerns within the context of the DOL budget proposals?

Answer: We are aware that some UI stakeholders have this concern regarding our integrity proposals. While we understand the historic origins of this concern, we believe that addressing the integrity of the VI system is critical at this juncture. There is precedent permitting limited amounts of state unemployment funds to be used for administration. Under the Reed Act—in place for 50 years—states have received funds that must be used for the payment of UI benefit payments unless the state legislature authorizes use for administrative purposes. Our proposal follows this approach—recovered moneys must be used for the payment ofUI unless the state legislature authorizes use of up to 5% for UI integrity activities. In the context of our proposals, it is important to remember that these proposed provisions are optional on the part of states—they simply provide another source of funds states can use to improve prevention, detection, and collection of overpayments and reduce SUT A dumping if they so choose. (SUTA stands for state unemployment tax act.) As does the Reed Act, our approach gives state legislatures the flexibility to determine the best use of the funds. Under the integrity proposal, state legislatures will decide whether those funds can best be spent for benefits or for improper payment reduction, because the legislature will be interested in assuring that use for administrative purposes really is promoting trust fund solvency by saving the state's unemployment fund money.

Question: The DOL FY 2007 budget request for the Trade Adjustment Assistance program is $938.6 million. This is down almost $28 million from last year. Please explain why.

Answer: The Department's FY 2007 request for TAA is $938.6 million. Of that amount, $259.6 million is requested for training, job search and relocation allowances, and administration and represents an increase of about $200,000 over FY 2006. The Department estimates that it will need $654 million in Trade Readjustment Allowance (TRA) benefits in FY 2007, one million less than in FY 2006. The reduction in the Department's request is a result of our estimate for the funding level expected to be needed for the Alternative TAA pilot program, also known as Wage Insurance. In FY 2006, the Department estimated that it would need $52 million. The Department's estimate for FY 2007 for Wage Insurance is $25 million, $27 million below FY 2006. It is important to note that this is not a reduction in services; rather, it is our best projection of the funds needed by those who access the program. It is also important to note that if our projections of Trade Readjustment Allowances or Wage Insurance are too low, the appropriators have provided a ready means for the T AA program to obtain additional resources without the need for a supplemental appropriation. The appropriators have provided authority for another DOL account (the Advances to the Unemployment Trust Fund and Other Funds account) to provide non-repayable advances to TAA.

Question: DOL collects a wide variety of detailed weekly, monthly, quarterly, and annual information related to performance in the unemployment program. What does this data tell us? How has state performance improved since this detailed information has been collected? How wil DOL budget proposals ensure that state unemployment program performance improves?

Answer: DOL collects both macro- and micro-level data that can be used to measure the performance of the UI program at both the state and national levels. The data tell us how quickly and accurately payments are made to beneficiaries, how quickly and accurately employer tax accounts are established and, generally, how well states operate their UI programs. State performance has varied over the years

as states have implemented new technologies and methodologies for processing claims and dealt with fluctuations in claims workloads.

Data have been collected for many years—payment and benefit timeliness since the 1970s and payment accuracy since the late 1980s. Except for a brief period of improvement during the mid-1990s, the rate of payment timeliness has been relatively stable at about 89%. When first measured, the overpayment rate was 10.05%. The overpayment rate then leveled off at about 8.5% for several years. Since 2002, overpayments have exceeded 9%. We anticipate that enactment of our proposed UC Integrity Act will help lower these numbers.

DOL is committed to promoting proper and efficient administration of state UI programs. Additional budget requests are targeted to specific needs. For example, the Administration's Fiscal Year 2007 budget request includes funding to prevent overpayments caused by identity theft and funding for states to review the continued eligibility of beneficiaries and provide job search assistance in person.

Questions from Chairman Wally Herger to Dr. Sigurd Nilsen

Question: What are your views on DOL's proposal to enhance unemployment program integrity, particularly with respect to allowing the Department of Treasury to garnish Federal tax refunds to recover unemployment insurance overpayments?

Answer: Our work has highlighted the value of using this tool to help Federal and state-administered benefit programs recover overpayments. For example, in prior reports,[1] we noted that the Social Security Administration (SSA) uses the tax refund offset as a means of improving overpayment collection in the Supplemental Security Income (SSI) program, which has yielded hundreds of million of dollars in recoveries. Similarly, SSA uses the tax refund offset to collect overpayments in the Disability Insurance (DI) program. Other programs, such as the Department of Agriculture's Food Stamp Program also use this tool for recovering overpayments. Thus, it would seem that using this tool to recover UI overpayments would be appropriate to consider.

Question: What are your views about the effectiveness of the National Directory of New Hires match pilot that DOL is conducting?

Answer: We have not performed an independent assessment of DOL's National Directory of New Hires (NDNH) pilot, and thus cannot comment on the effectiveness of this initiative. However, our prior work has shown that use of the NDNH can help Federal agencies verify eligibility for individuals in means tested programs. For example, SSA uses the NDNH to verify the employment status and income of SSI recipients, and it estimated that access to this database has saved almost $800 million over 5 years. More recently, we also recommended that SSA obtain authority to match its DI program with the NDNH to help the agency more effectively verify beneficiaries' income.

Question: What are your views on DOL's FY 2007 budget request for $10 million in additional funding for identity theft prevention activities, and $30 million for more reemployment and eligibility assessments?

Answer: Because we have not performed a study of these proposals, it is difficult to comment on their merit. However, in a prior report, we noted that states were vulnerable to fraud and overpayments resulting from individuals who use Social Security numbers that do not exist or belong to deceased individuals.[2] DOL estimates that $313 million in overpayments are caused by identity theft each year. In its fiscal year 2005 Performance and Accountability report, DOL notes that is has funded states to provide them with the ability to exchange data with SSA on a realtime basis. The Department believes that this will help the states prevent many, if not most, overpayments due to fraudulent or mistaken use of Social Security numbers. On March 5, 2004, DOL and SSA signed a memorandum of understanding formalizing the data exchange agreement. DOL estimates that the $10 million in additional funding for identity theft prevention activities in its fiscal year 2007 budget request will result in $77 million in savings by preventing erroneous payments

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[1] GAO, *Supplemental Security Income: Action Needed on Long-Standing Problems Affecting Program Integrity,* GAO/HEHS–98–158 (Washington, D.C.: Sept. 14, 1998) and GAO, *Supplemental Security Income: Progress Made in Detecting and Recovering Overpayments, but Management Attention Should Continue,* GAO–02–849 (Washington, D.C.: Sept. 16, 2002).

[2] GAO, *Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments,* GAO–02–697 (Washington, D.C.: July 12, 2002).

caused by the use of stolen identities. However, we have no basis to assess the accuracy of this estimate.

With respect to the Reemployment and Eligibility Assessments grants, it is too soon to know whether these will be effective in helping to improve efforts to connect claimants with reemployment services, or in reducing UI duration or improving employment outcomes. DOL is conducting an evaluation of these grants and initial results should be available in March of 2007. DOL has estimated that the $30 million requested in its fiscal year 2007 budget could be used to conduct an additional 539,000 interviews and could save the UI Trust Fund as much as $151 million by reducing the average duration of UI benefits for claimants who are interviewed. However, it would be important to know how much is actually saved.

Question: An April 2006 GAO report on improper payments includes information indicating that unemployment overpayments are rising. Do you have any explanation for why this is happening?

Answer: Although we have not performed an independent analysis of this trend, DOL attributes the rise in overpayment error rates to an increase in payments to claimants who improperly continue to claim benefits despite having returned to work. While use of the NDNH would help states determine when UI beneficiaries are reemployed, it appears that all states are not yet using it to its full potential.

Question: Are there any penalties or rewards for states that meet certain overpayment prevention goals for program improvement? If not, do you think an incentive or penalty-based approach would help motivate states to improve their unemployment payment accuracy?

Answer: Our prior work on unemployment insurance program integrity[3] concluded that DOL could enhance states' emphasis on payment accuracy by using its performance measurement system to encourage states to focus on payment accuracy. We also recommended that DOL revise its performance measures to ensure increased emphasis on this activity. In response, DOL has established a new core performance measure for overpayment detection at the state level. DOL believes that this measure will provide states with an added incentive to prevent and detect overpayments by implementing core measures in states' performance budget plans based on the level of overpayments the states have detected. While DOL has established overpayment detection as one of its core measures, it has not yet specified the level of performance that states will be required to meet under this measure. In addition to establishing performance measures that ensure increased emphasis on payment accuracy, we also recommended that DOL use the annual administrative funding process or other funding mechanisms to develop incentives and sanctions that will encourage state compliance with payment accuracy performance measures. DOL's current legislative proposal[4] contains a provision that would allow states to retain a small proportion of recovered overpayments to reduce fraud and errors by enhancing states' benefit payment control activities. However, the proposal does not provide for sanctions for states that do not meet the specified level of performance.

Question: Has any research been done to explain why average durations on unemployment benefits have been rising in the past decade, even when unemployment rates have remained low?

Answer: We did not review the research literature on the trend in the duration of unemployment benefits, and its interaction with unemployment rates, for our recent report (GAO–06–341). As you are aware, we used data from a nationally representative sample of workers born between 1957 and 1964 and spanning the years 1979 through 2002. We used the data to help build a model that allowed us to simulate, for example, how changes in characteristics of UI eligible workers—such as UI receipt—affected the likelihood of unemployment duration. We did not conduct a trend analysis. Nevertheless, in explaining the associations in our report, we discuss some research related to this question, such as: Karen E. Needels and Walter Nicholson, An Analysis of Unemployment Durations Since the 1990–1992 Recession, UI Occasional Paper 99–6, prepared for the Department of Labor, 1999 and Bruce D. Meyer, "Unemployment Insurance and Unemployment Spells," Econometrica, vol. 58, no. 4 (1990), p.771. Notably, in the former, the researchers point out that while labor markets appeared to be quite healthy in the post-1992 period, the lengths of unemployment spells were longer than have usually been associated with such low unemployment rates. Further, they note several factors related to the labor market

[3] Ibid.

[4] On May 3, 2006, DOL submitted a bill entitled the "Unemployment Compensation Program Integrity Act of 2006".

which appear to be the most likely explanations for the observed increase in average UI durations: (1) increases in the fraction of claimants in demographic groups who are likely to experience long unemployment spells (older workers, females, African Americans) and (2) changes in the industrial composition of the labor force, most notably the decline in manufacturing jobs.

Questions from Chairman Wally Herger to Mr. Roosevelt Halley

Question: Please provide the Committee with information about which states supplement Federal funding for unemployment administrative funding with state general funds.

[Answer continues on next page.]

STATE SOURCES USED TO SUPPLEMENT THE FEDERAL UI BUDGET (2005)

STATE	GENERAL FUNDS	PENALTY & INTEREST	ADMINISTRATIVE TAX	OTHER FUNDS	TOTAL SOURCES
ALABAMA	-	2,209,374	1,649,026	-	3,858,400
ALASKA	712,106	-	-	255,394	255,394
ARIZONA	-	50,700	-	-	50,700
ARKANSAS	-	678,247	-	-	678,247
CALIFORNIA	-	44,038,000	-	-	44,038,000
COLORADO	-	1,638,835	1,388,938	-	3,027,773
CONNECTICUT	-	1,033,211	-	1,003,700	2,036,911
DELAWARE	-	-	-	-	-
DISTRICT OF COLUMBIA	-	494,885	-	2,486,125	2,981,010
FLORIDA	-	-	-	-	-
GEORGIA	311,046	-	7,001,831	-	7,001,831
HAWAII	-	643,958	-	-	643,958
IDAHO	33,754	14,423	3,458,501	-	3,472,924
ILLINOIS	-	-	-	-	-
INDIANA	-	1,973,200	-	-	1,973,200
IOWA	3,085,495	700,000	-	-	700,000
KANSAS	62,729	526,368	-	615,000	1,141,368
KENTUCKY	-	1,837,900	-	-	1,837,900
LOUISIANA	-	3,925,711	5,000,000	38,019,463	46,945,174
MAINE	-	297,625	-	-	297,625
MARYLAND	-	490,887	-	-	490,887
MASSACHUSETTS	-	577,494	-	-	577,494
MICHIGAN	-	1,500,000	-	-	1,500,000
MINNESOTA	-	-	7,100,000	-	7,100,000
MISSISSIPPI	-	-	-	-	-
MISSOURI	-	2,239,139	-	-	2,239,139
MONTANA	-	429,243	650,353	14,998	1,094,594
NEBRASKA	-	-	-	-	-
NEVADA	-	3,578,269	448,272	-	4,026,541
NEW HAMPSHIRE	-	-	-	-	-
NEW JERSEY	-	-	-	-	-
NEW MEXICO	-	-	-	-	-
NEW YORK	-	8,688,098	-	-	8,688,098
NORTH CAROLINA	-	-	-	-	-
NORTH DAKOTA	-	-	-	-	-
OHIO	3,560,970	1,016,792	-	10,498,598	11,515,390
OKLAHOMA	-	-	-	-	-
OREGON	-	-	-	1,324,272	1,324,272
PENNSYLVANIA	4,000,000	-	-	-	-
RHODE ISLAND	-	192,259	-	-	192,259
SOUTH CAROLINA	-	-	2,496,315	-	2,496,315
SOUTH DAKOTA	-	-	-	-	-
TENNESSEE	-	80,926	-	-	80,926
TEXAS	-	-	-	-	-
UTAH	-	-	-	-	-
VERMONT	-	30,103	-	-	30,103
VIRGINIA	-	-	-	-	-
WASHINGTON	-	2,190,253	1,694,561	-	3,884,814
WEST VIRGINIA	-	2,729	-	-	2,729
WISCONSIN	-	2,301,763	1,915,584	-	4,217,347
WYOMING	-	-	1,175,000	-	1,175,000
TOTAL	11,766,100	83,380,392	33,978,381	54,217,550	171,576,323

Question: What does NASWA view as the positives and negatives of the use of "corrective action plans" that states put in place to help them meet DOL performance goals in the unemployment benefits program?

Answer:

- Positives—NASWA members believe corrective action plans are beneficial for identifying problems and solutions within state UI programs. They serve to bring problems to the forefront for resolution. Emphasis and focus are applied to specific areas that need attention. States develop strategic approaches and timelines to measure improvement in deficient areas. Focusing efforts on improving performance where performance is below minimum criteria helps promote proper and efficient administration.

- Negatives—Many deficiencies identified through corrective action plans result from Federal underfunding. Underfunding leads to understaffing, and it impedes corrective actions. States also have out-of-date and inefficient computer systems. Given these problems, corrective action planning can become a paper exercise. At times states are compelled to reduce staffing or other resources in areas that show acceptable levels of performance in order to raise performance in areas identified for improvement by corrective action plans. This creates a "roller coaster" performance cycle without addressing the fundamental performance issues. In like manner, states also may not invest as much effort in improving performance levels in areas that do not fall below the minimum required level, but could be improved. Finally, some performance issues are beyond the control of state UI programs. General economic conditions and the number of job openings affect reemployment prospects of individuals receiving UI benefits. Corrective action plans have little effect on these exogenous factors.

Question: The Department of Labor has developed goals to promote reemployment of people receiving unemployment benefits and has a number of unemployment program performance goals. What happens under current law if a state fails to meet those standards?

Answer: States are required by law to administer state UI programs in a proper and efficient manner. U.S. Department of Labor (USDOL) regional offices monitor state performance on a quarterly basis and attempt to work with the states in identifying and addressing potentially negative trends before they become problems. However, if a state fails to meet USDOL-set standards for reemployment of workers receiving unemployment compensation, a corrective action plan would be submitted by the state and updated quarterly. Consistent failure to meet standards would lead to a conformity or compliance hearing, which could result in sanctions, including the loss of administrative funding. A major concern with a sanction that includes a reduction in funding is it becomes more difficult for states to achieve the performance standards. NASWA members believe monetary penalties for failure to meet performance standards tend to be counter-productive. Scarce resources are primary reasons for failure to meet standards in the first place. Depriving a state of funds is more likely to exacerbate the problem, not correct it. NASWA suggests a better alternative would be additional funds provided to states with appropriate monitoring, support, technical assistance and oversight. In fiscal year 2007 testimony to the House Committee on Appropriations, NASWA requested an additional $283 million for UI administration and $100 million for updating computer systems above the Administration's request.

Question: Your testimony mentions the use of the Government Performance and Results Act and UI Performs Core measures to assess unemployment program reemployment services and outcomes. The Department of Labor is in the process of establishing a baseline and setting performance targets for reemployment in FY 2007. What new or effective approaches are states taking to help unemployed workers find new jobs? What can Congress do to help in this effort?

Answer: Many states have enjoyed success in reducing UI benefit duration and expediting reemployment through enhanced Reemployment Eligibility Assistance (REA) and employment services. While unemployment insurance administrators encourage its claimants to find work, the responsibility and expertise in reemployment services lies with staff of One-Stop Career Centers and the Employment Service (ES). The goal of REA focuses on early intervention (e.g., between the eighth and twelfth week of an active UI claim) to shorten the benefit period for UI recipients. Virtually all of the strategies for increasing reemployment of UI recipients involve the use of additional personnel to provide more intensive services in the form of labor exchange services and training if necessary. Few states afford to provide these services on their own; likewise, reemployment services are staff intensive and extremely difficult to maintain without adequate funding. For many states, funding for ES is the primary state support for assisting UI claimants with their work test requirements outlined in federal legislation. NASWA members believe additional funding is necessary to support the efforts of states and allow for expansion of those efforts. As less funding is appropriated for ES activities, the ability to be successful in reemployment of UI recipients probably will diminish. In fiscal year 2007 testimony to the House Committee on Appropriations, NASWA requested the federal government restore the fiscal year 2005 appropriations levels for labor exchange services of $781 million for the ES and $35 million for Reemployment Services (RES) for UI claimants.

Question from Chairman Wally Herger to Dr. Tim Kane

Question: The Department of Labor proposes allowing states to operate waiver programs to test various new approaches to improve unemployment benefits and how they help workers. Could you envision one or more states operating a savings-based unemployment benefit system like the one you outlined in your testimony? Is that the only way to test how individuals actually respond to such a system? Do any other countries operate such a system, offering lessons for us in how workers react when faced with these new choices?

[Answer not received at time of printing.]

[Submissions for the record follow.]

Statement of Greg Devereux, Washington State Federation of Employees, Olympia, Washington

Despite efforts to fill in the gap with other sources of funds, the decline in employment service funding since the mid 1980s has had a significant impact on the services that the Spokane, Washington employment service office can provide workers and employers.

In the early 1980s, the Spokane office had 25 employment specialists who provided placement services to unemployed workers that included job search assistance and referral to job openings. The number of staff has declined by 75 percent to only five employees. In addition, the number of veterans employment specialists who work exclusively with unemployed veterans has declined from five to two.

The establishment of the computer center in the employment office self-help area has created some efficiencies since many jobseekers are adept at using the electronic job bank. However, most people need some in-person assistance to learn how to perform online job searches. Workers with limited education who have lost their jobs, when employers such as Columbia Lighting have moved their operations to other countries, are in particular need of help. Many are not computer literate and have to be taught not only how to search the database of job listings but also how to submit job applications online since many employers want jobseekers to submit their job applications electronically. Unless they can master these skills, these workers cannot reach a whole group of employers.

With only five employment specialists, the office has been forced to depend in part on volunteers from the AARP to help in the computer center, but this help is of uneven quality and not always reliable. In addition, some staff from other programs, such as the TAA program, now spends part of their time away from their primary work working in the self-help area.

The Spokane employment service office has an effective reemployment program that provides early intervention with unemployment insurance claimants within their first few weeks of filing a claim. Claimants receive referrals to job openings and training in how to write their resumes and in interview techniques. They also receive help with other services such as skills assessments and the use of the electronic job bank.

These services are likely to be eliminated beginning in July when the $35 million in federal state reemployment grants end.

The Spokane office also provides work search verification for the unemployment insurance program. To the extent they are able, when the staff calls claimants into the office for verification, they also provide job search assistance, skills analysis and other services the claimants might need. The availability and quality of these services will be affected by a continued contraction in resources.

Services to employers have deteriorated considerably. In the mid 1980s, the office had industry specialists who had expertise in particular sectors, such as industrial, clerical, and construction occupations. These employer specialists developed and maintained ongoing relationships with employers for the purpose of serving their needs and also building their listings of employment opportunities. This in-person proactive approach to working with employers has been abandoned entirely. Now employers simply call and register jobs with whoever takes the phone call. In addition, some discussion has occurred about charging employers modest fees in order to support services for them.

While the Administration has claimed that private agencies can replicate the work of the local employment offices, the primary private agencies in Spokane are temporary service agencies that largely provide temporary placement to low paying

jobs with no benefits. This is a very different orientation than the local employment service office that attempts to find ways to upgrade workers skills and find good jobs with benefits, especially for the many workers who have been displaced by off shoring and other economic dislocations.

Statement of Eric J. Oxfeld, Strategic Services on Unemployment and Workers' Compensation

Thank you for the opportunity to comment on the unemployment compensation aspects of the Department of Labor (DOL) proposed Fiscal Year 2007 budget. Because there are integrally related unemployment compensation aspects of the *Treasury* proposed budget, this statement addresses both agencies' proposals. UWC applauds the increased attention to UI payment and tax accuracy ("integrity") in the DOL and Treasury proposed budgets. The improper payment rate for the UI system is a shocking 9.9%, according to the latest statistics from the DOL Benefit Accuracy Measurement (BAM) report. Addressing this problem should be a priority for federal and state officials, as well as employers. Unfortunately many of the specific strategies in the form proposed by DOL and Treasury raise significant policy concerns.

U***WC cannot support,*** and urges Congress not to approve, the following proposals:

1. Mandate that states penalize an employer for a response the state deems "late" or "incomplete" after sending a separation notice.
2. Increase the Federal Unemployment Tax Act (FUTA) through a 5-year extension of the "temporary" surtax.
3. Finance administrative costs for integrity activities with state unemployment tax revenue, which federal law has always required be dedicated to financing benefits.
4. Use a "bounty hunter" contingency fee method of reimbursing contractors hired to recover improper benefit payments or tax underpayments states deem "uncollectible."
5. Mandate that states impose a fraud penalty of at least 15%.

UWC ***supports*** the proposal to recover improper payments out of federal income tax refunds. We also support the DOL request for Congress to appropriate an additional $10 million to combat UI identity theft and $30 million to expand re-employment and eligibility review initiatives.

We are ***reviewing*** three additional proposals. Although we have not finalized our position, we see merit in the Treasury proposal allowing a professional employer organization (PEO) to remit FUTA for its clients, when the PEO is certified by the Treasury as meeting stringent financial standards, along the lines of H.R. 4985. We are also reviewing the DOL proposal mandating that employers report start work dates on their new hire reports. We understand the value of obtaining this information but must also weigh the economic and practical burden of re-designing established employer reporting systems to capture this information. Finally, we are awaiting additional information needed to evaluate the DOL proposal to facilitate a claimant's return to work by allowing state waivers of unspecified federal requirements (for demonstration projects).

UWC—The Voice Of Business On Unemployment And Workers' Compensation

UWC is the only national association exclusively devoted to providing legislative/regulatory representation for the business community in connection with unemployment insurance (UI) and workers' compensation (WC) public policy. UWC's members include employers, national and state business associations, third party claims and tax administrators, accounting and law firms, and other service providers, all of whom support and advocate sound, cost-effective UI and WC programs. UWC members, and their clients, policyholders and members, collectively represent a major share of the business community in the United States. UWC is intimately acquainted with unemployment insurance law and best practices. In addition to UWC's advocacy efforts on behalf of business, we manage the National Foundation for Unemployment Compensation & Workers' Compensation, which conducts educational activities such as the annual National UI Issues Conference, as well as reference materials on UI, including the annual Highlights of State Unemployment Compensation Laws book, the annual *RESEARCH BULLETIN: Fiscal Data for State Unemployment Insurance Systems,* and the Employer's Unemployment Compensation Cost Control Handbook.

Analysis of UI proposals in the Administration's FY 2007 proposed budget

UWC strongly supports the state UI program, through which employers provide benefits for a temporary period of time to insured workers with a strong attachment to work who become temporarily and involuntarily jobless when their employer no longer has suitable work available. We advocate greater efforts by states to prevent and recover improper payments, and it is very refreshing that DOL has given greater emphasis to payment *accuracy*. However, many of the specific strategies embodied in the Administration proposals raise significant policy concerns for employers.

Of greatest concern are (1) the DOL proposal to prohibit non-charging for improper payments attributed, even unfairly, to an employer's fault and (2) the Treasury proposal to extend the FUTA surtax.

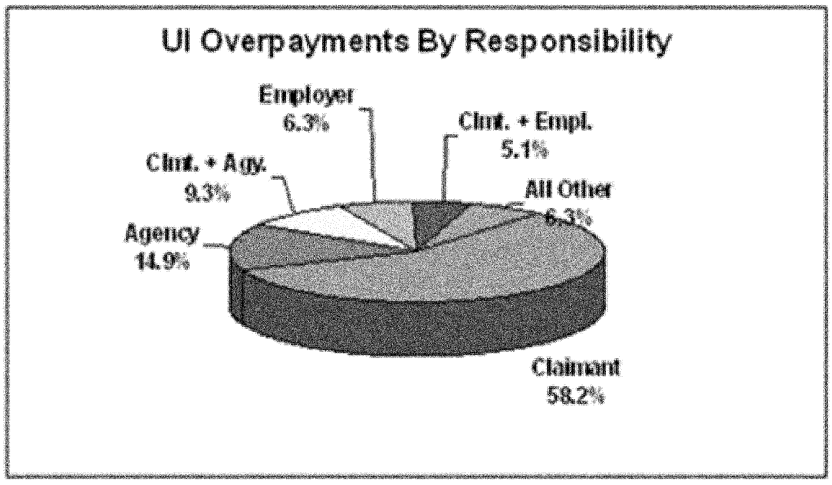
Non-charging proposal

UWC opposes the federal mandate in the form proposed last year, which requires state UI laws to charge an employer's unemployment tax account for erroneous UI payments due to the "fault" of the employer or its agent. Employer fault was defined in last year's UI integrity proposal as "failure to respond timely and in good faith to a state request for information" relating to a UI claim. However, what is timely or complete or a good faith response was not defined.

This proposal will significantly increase payroll taxes for employers who have done nothing wrong. For example, there is no assurance that an employer will not be charged even though it did not receive the notice in time to respond before the deadline or the state subjectively determines that the employer's response was "incomplete."

Employers support procedures for processing unemployment claims promptly, but it is also important that speedy benefit delivery should not result in *erroneous* payments. Claimants may be adversely affected by the requirement to repay improperly paid benefits, and these amounts are rarely fully recovered because, the claimant has often spent the money by the time the error is discovered. Improper payments also reduce state unemployment trust fund balances and therefore result in higher taxes for employers. And they add to the workload of state workforce agencies.

When a claim for unemployment benefits is filed, most states conduct an initial review and make an initial determination relying solely on information supplied by the claimant and the employer's response to the state "separation notice" advising them that the claim was filed. DOL rules require that states begin paying benefits, even if the employer protests the determination and asks for a re-determination or a hearing. When an initial determination favoring the claimant is overturned, benefits already paid are not charged to the employer's unemployment tax account. This practice is appropriate and represents a very small cost to the system. Only a minuscule amount of non-charging results from reversals where the employer did not provide timely or complete information at the initial proceeding. DOL's own figures show that improper payments are *rarely the fault of the employer*. The DOL Benefit Accuracy Measurement (BAM) report shows that claimants are responsible for 73% of overpayments, administrative agencies are responsible for 24% of overpayments, and employer error is responsible for only 11% of overpayments. (These figures add up to more than 100% because they include overpayments where there is dual responsibility.) DOL estimated that its proposal will save less than .1% of all benefits paid (an average of just $22.7 million a year).



Employers *already* have strong financial incentive to file timely and complete responses to state separation notices. The odds of prevailing on a contested claim are much reduced if the employer must overturn an initial determination favoring the claimant. Furthermore, employers who do not submit timely information for the initial determination will incur considerable business cost if they must participate in a formal hearing or an appeal. Hearings are costly for the employer, because it must send members of its staff to participate, including witnesses and the claimant's the supervisor, as well as a hearing representative. The lost productivity and time away from work required to prepare for and participate in a hearing are very expensive.

The proposed mandate against non-charging is also objectionable because it creates an unworkable and unfair *federal* standard governing *state* charging requirements. Unemployment taxes, benefits, and eligibility are areas of regulation traditionally left to the states in designing and administering their UI programs. *Federal* law is ill-equipped to address non-charging for failure to respond to a separation notice, because there are many inextricably related issues which the DOL proposal does not address.

As noted, prompt payment is a critical objective for a program designed to provide insurance against loss of work. Federal regulations hold state UI administrators to stringent performance standards governing prompt payment. To comply with these standards, many states provide short—and often completely unrealistic—timeframes for employers to respond to separation notices. In these states, the DOL proposal will significantly, and unfairly, increase unemployment tax costs for responsible employers because of circumstances that beyond their control. The deadlines vary by state, and usually are 10 days or less, including weekends and holidays. Typically these deadlines run from the date when the state mails out the notice, rather than the date when the employer actually *receives* it.

The brief time allowed for a response often does not allow for the vagaries in mail delivery or state practices which contribute to the delay in the employer's actual receipt of the notice. For example, it is not unusual for the state to mail the separation notice to the address provided by the claimant rather than to the address of record provided by the employer. This practice causes a delay in delivery to employers who have multiple locations or have designated a third party representative to receive their notices. Furthermore, in some states the form and envelope do not have an "attention line" or sufficient room to display the full name and address. At least 5 or 6 lines may actually be needed for a proper address (in fact, many state UI agencies themselves have addresses containing this many lines). When the state mails the notice to a wrong or incomplete address, it is likely to be lost in the mail or received at the main employer address, where it may be indistinguishable from the rest of the mail from that state. Delivery is delayed until the envelope can be opened and routed to the appropriate location. The employer thus receives the claim form well past the due date. Many companies experience this problem, and the states have traditionally ruled against them when they appeal the timeliness of their responses.

Many employers now third party agents to assist with UI claims. However, some states do not allow employers to designate a third party administrator as the recipient of state notices to their clients. This situation further delays response to the notice.

Due process must be applied to employers as well as claimants. Due process requires that states give an employer a reasonable amount of time to learn of a claim, investigate it, and respond when appropriate. Charging an employer's tax account when the employer was not given sufficient time to respond is a denial of due process. A deadline for response which allows the employer less than 10 calendar days after the notice is mailed out before the response is due often puts the employer in a Catch 22 situation.

If federal law mandates that states amend their laws to prohibit non-charging for failure to submit a timely or complete response, then fairness dictates that it also must require states to provide adequate time to submit their response. Any federal legislation prohibiting non-charging for failure to submit timely and complete responses should also pre-empt state laws that have taken a different approach in trying to encourage prompt submissions. Some states now assess monetary civil penalties against an employer for failure to respond to a separation notice. Such penalties are unfair. An employer may have legitimate reasons not to respond to a UI separation notice. The circumstances surrounding the separation from employment claim may entail a potential risk of separate litigation over employment law issues related to the reasons for separation. An employer which is at risk of litigation in another legal venue may not wish to provide the claimant's legal representative with an opportunity for discovery prior to the case going to court. In many states, the law and facts are construed in favor of the claimant. Consequently, the employer may not contest a UI claim because it wishes to avoid a potential legal problem down the road. In such cases, benefits are then charged to the employer's account. If federal policymakers are going to address the consequences of not responding to separation notices, it is unfair to allow states to enforce laws imposing monetary penalties, too.

States are actively debating how to encourage prompt response to separation notices. Federal mandates may make sense where the need for uniformity among the states is compelling, but no such need has been demonstrated for federal law to require that states charge benefits to the employer's tax account for failing to respond to separation notices.

It is true that the DOL proposal recognizes that charging is not appropriate in all circumstances. The DOL proposal includes an exemption for "good faith" error. But "good faith" is not defined, and what is considered either "good faith" or an employer's "fault" in one state may not be the same in others. Even greater variability is likely with respect to what is considered "sufficient" information to avoid being charged for an "incomplete" response. What is "sufficient" is a very complex issue. A determination of what is complete will not only vary among the states, it will vary from claim to claim and from adjudicator to adjudicator within a state. Furthermore, employers will be burdened with fifty different definitions, thereby making compliance and avoidance of punitive charging nearly impossible.

FUTA surtax extension proposal

UWC opposes the 5 year extension of the FUTA surtax. Over 10 years, extending the FUTA surtax will cost employers more than $17 **b**illion extra yet will make just a $710 **m**illion dent in the federal budget deficit.

The FUTA surtax directly punishes employers $14 for each worker, every year, and the indirect costs are even greater. At a time when the Treasury has asked Congress to extend expiring tax cuts to continue promoting a healthy economy and employment growth, this payroll tax increase makes no sense.

Congress originally imposed the FUTA surtax in 1976 to retire a deficit created by a temporary *ad hoc* supplemental extended unemployment program. Business accepted it, subject to agreement that the surtax would expire when the debt was repaid. The debt was retired in 1987. Nevertheless, the surtax has already been extended four times.

FUTA revenue may be expended for only three purposes: the administration of the state unemployment insurance (UI) and employment services program, the federal share of Extended Benefits (EB), and interest-bearing loans to states which temporarily deplete their unemployment trust accounts. Yet the FUTA trust fund is already over funded. Over the past 24 years, less than 57% of FUTA revenue has been used for administration and EB, and there is no need for more revenue just to provide loans.

There is no UI policy reason to extend the surtax, but there are strong policy reasons to let the surtax expire. The accumulation of unneeded FUTA revenue by ex-

tending the surtax will create significant problems for the UI system. FUTA balances over a statutory ceiling are automatically distributed to the state accounts used to pay basic UI benefits. Extending the surtax will cause the federal accounts to hit the ceiling and trigger a large distribution to the state unemployment funds. The expectation of federal funding for basic unemployment benefits will discourage state fiscal discipline in financing their UI programs. It also weakens the positive effect of using experience rated state unemployment taxes to finance UI benefits. Consequently, employers will have less incentive to avoid lay-offs and to protest improper claims.

Raising the FUTA ceiling would prevent a distribution to the states—but that also is poor public policy. The accumulation of unneeded funds will make the Unemployment Trust Fund an inviting target for proponents of new federal spending programs. For example, former HHS Secretary Donna Shalala once referred to the Unemployment Trust Fund as "unused pots of money" that could be re-programmed to transform UI into paid family leave ("Baby UI"). It will also make it more difficult for states still in debt from the last recession to raise the money needed to restore solvency.

The reason for the FUTA surtax expired almost 20 years ago. The Department of Labor got it right in 2002 when it proposed "reducing employers' federal unemployment taxes." The cost to employers will add up over time—not to mention the indirect cost of weakening experience rating, encouraging states to depend on federal financing for basic UI benefits, and accumulating paper balances which will be used to justify expanded government spending in the future. All these adverse consequences in exchange for a negligible impact on the federal budget makes extending the FUTA surtax too high a price. Congress should allow the surtax to expire on schedule at the end of 2007.

Other DOL integrity proposals

UWC agrees that additional financial resources are needed to enhance state efforts to prevent and recover overpayments and underpaid taxes. Because state budget dollars for UI administration are very limited, integrity often gets little emphasis. However, the specific financing mechanism proposed by DOL raises significant policy concerns. Allowing states to retain a portion of recovered overpayments or underpaid taxes creates an exception to the federal law known as the "withdrawal standard." This standard prohibits the expenditure of payroll taxes deposited in state unemployment trust funds for any purpose other than payment of unemployment *benefits*. This stricture provides a firewall against the use of benefits funds for various other purposes, including system administration. Maintaining the withdrawal standard, including the firewall between funding for benefits and administration, is important, because paying for administrative costs using benefits revenue will ultimately lead to higher state payroll taxes for employers. State unemployment payroll tax rates are closely—and automatically—tied to unemployment trust fund balances. Expenditures to cover administrative costs will reduce these balances and trigger higher tax rates, with virtually no accountability on the part of state or federal elected officials.

Although the DOL proposals seemingly do not create the risk of payroll tax increases because they have the potential to recover that presumably would have been lost to the system, they open the door to additional proposals to expend state unemployment revenue on other administrative functions, all of which arguably will also improve trust fund solvency. For example, hiring more hearing officers and adjudicators, who have more training and are paid higher salaries, is likely to result in fewer errors on claim determinations and appeals. Establishing more "job clubs" may result in more disqualifications of claimants who were not able to work or available for work. Maintaining more unemployment offices may foster more referrals of claimants to suitable work. Automating communications between agencies and employers will unquestionably result in fewer improper payments. Greater enforcement of work search requirements will also produce significant reductions in improper payments. All of these functions are administrative, and all would benefit from more money. Opening the firewall to allow funding for overpayment recovery efforts will undoubtedly trigger a myriad of other ideas which "require" reaching into the state trust funds.

Moreover, reaching into the state benefits trust funds to pay for *any* administrative expenses is totally unnecessary. The FUTA tax paid by employers is levied for the specific purpose of financing state UI administration, and it produces far more revenue than is needed for this purpose, even after allowing for "beefed up" state efforts to increase recoveries of overpayments. Since 1981, the federal government has returned less than 57% of FUTA revenue to the states for program administration and the state share of extended benefits, the sole purposes allowed by law for

expenditure of FUTA revenue. There is more than enough revenue in the FUTA accounts in the Unemployment Trust Fund to finance additional integrity activities, even if the "temporary" surtax is allowed to expire at the end of 2007. If Congress agrees that the return on these proposals will more than offset the cost—and we believe that is the case, at least initially—then it should allow states to tap FUTA revenue already paid by employers for UI administration rather than looking to alternative *state* funding sources.

A net gain from the collection agency proposal is more speculative. State UI agencies should be expected to use the resources of their own office in performing their public duty—including recoveries of overpayments and delinquent taxes—and they should be provided sufficient financial resources to accomplish this purpose. Because federal grants for UI administration are chronically inadequate, there will be strong temptation for states to write off as much as possible as "uncollectible" and thereby obtain supplemental financial resources. If this dynamic occurs, the use of collection agencies will appear to pay off, while actually doing little to increase real net recoveries.

The collection agency proposal also raises another public policy issue because a contingency fee is used to pay for the collection services. Contingency fee agreements were not meant for state governments—they were designed to increase access to courts for individuals without the resources to pay an hourly attorney fee. Delegating state authority to collection agencies on a contingency fee basis can lead to government enforcement activity on the basis of profitability, not public interest. State UI administrators serve to protect the public interest—not enrich private collection agencies. And there is a danger that contracts will be granted to firms that contributed to a political campaign, creating an appearance of impropriety.

Our policy opposing federal standards also compels us to oppose the proposed mandate that states impose a 15% fine on overpayments due to fraud. UWC advocates that states impose such fines, but there is no compelling need for federal uniformity. Unnecessary federal standards, even those favoring employer interests, will create precedent for additional unnecessary federal standards that will hurt employers, workers and the UI system. Furthermore, as a practical matter, the 15% fraud penalty may be counter-productive. Many states are reluctant to impose fraud penalties, and the greater the penalty, the more likely the state will not find that fraud occurred.

Better ways to improve UI integrity

We would like to suggest other ways to improve system integrity that were not included in the DOL integrity proposal. This is not a complete list of our suggestions, but these proposals will have a measurable positive impact:

- Administrative financing reform

The root cause of many of the systemic problems in the UI system which are responsible for the high error rate is the chronic under funding of the state workforce agencies which administer the UI program. UWC has gone on record on many occasions, including hearings before this subcommittee, regarding the need for permanent administrative financing reform to assure that workers receive necessary services, states receive adequate funds for administration, and employers are not taxed excessively. The problem is not inadequate revenue. As noted above, employers pay far more in FUTA than Congress appropriates for state administration. The problem arises primarily because federal appropriations are chronically inadequate because federal budget rules create incentive for the federal government to hold onto FUTA receipts and maintain an excessive FUTA tax rate. Past proposals for administrative financing reform, designed to return a greater share of FUTA revenue to the states, have not advanced in Congress but the problem is no less acute than it was previously. We urge Congress to step up to the plate and assure that states receive adequate administrative funding. But rather than just "throwing money at the problem" and trusting the states to spend it wisely, we would like to explore a "pay for performance" approach that will provide supplementary administrative funding for states that demonstrate they meet reasonable administrative standards and goals.

- More frequent charge reporting and automation

States should send employers their charge notices at least quarterly, and distribute them promptly at the end of the reporting period covered. These notices, similar to credit card statements, list all benefits charged against an employer's unemployment tax account. Employers check these notices for errors and often detect mistakes in time to stop payment of additional benefits to claimants who were not eligible. However, 6 states, including California, send these notices only once a year. By the time the employer has a chance to alert the state to an improper payment,

there is virtually no chance of stopping future erroneous payments or recovering past overpayments. DOL should encourage these states to send quarterly notices, and Congress should provide funding for the states to make the adjustment.

In addition, efforts should be expedited to develop automated systems for sending employers separation notices, charge notices, and similar communications. The states have established more efficient procedures for claimants to submit claims—e.g., by phone and by Internet—but automation of employer communications in most states has lagged far behind. The paper forms sent through the mail and the few "one size fits all" web applications do not lend themselves to the breadth of today's employers, many of which operate in multiple states and have centralized in-house UI management programs or outsource this function to authorized agents. Such a system could be established nationwide and used on a voluntary basis, giving the employer the opportunity to provide separation information at the time of discharge and not have to worry about receiving notice in the mail at a later time and missing deadlines or providing "incomplete" information. Such a system could also retain separation information to be used for benefit charge issues in subsequent separations that might involve base period wages. The potential for reducing fraud and administrative overpayments is tremendous. Again, federal funding to design and implement the system would be helpful.

Conclusion

UI overpayments are a serious problem. The root cause is tied directly to inadequate administrative funding that results from the hopelessly broken administrative financing mechanism for the state workforce agencies. The Administration proposals are a sincere and well-intentioned effort to focus attention on payment and tax accuracy but generally fall short of what's needed for an effective solution. A few, such as the recovery of overpayments out of tax refunds, have merit and should be enacted as soon as possible. Unfortunately, many of the others are misguided in various respects and should be rejected or modified.

Of greatest concern is the proposed federal standard requiring states to amend their laws to prohibit non-charging of benefits paid because of employer fault. This proposal will not result in a material reduction in overpayments. Few overpayments result from an employer's failure to provide timely and complete information. Often, the employer cannot respond any sooner because the principal reason for the late or incomplete response is that the state does not provide a realistic deadline or procedures which make it possible to submit timely and complete information. In some cases, the employer has legitimate reasons for choosing not to respond or not providing more detail. State systems, deadlines and procedures for responding to separation notices and adjudication of UI disputes vary widely. Employer cooperation in the UI claims process is essential, but a federal standard requiring that benefits be charged to the employer's account for failure to make timely or complete submissions will not only be ineffective, it will compound existing procedural problems and make the UI system more costly and frustrating for responsible employers.

Instead of charging benefits to the employer, the federal government should foster expedited development of more efficient processes to automate communications between states and employers. States should change their notification procedures to improve the timeliness of employer receipt of charge notices—and now is the best time to act on these changes because many states are in the process of re-engineering their UI systems. In addition, states should send charge notices to employers at least quarterly.

More funding for integrity functions and automation is urgently needed. The DOL proposals move in the right direction, but the proposed funding source, driven by federal budget rules, is objectionable. It is not appropriate to tap payroll taxes contributed to finance *benefit* costs or impose additional payroll taxes at the federal or state level when more than enough FUTA revenue is available. The principal purpose of FUTA revenue, by law, is administrative financing. Breaking down the firewall between benefits and administrative taxes is a mistake that will increase payroll taxes on employers. Proposals to allow use of recovered overpayments for enhanced benefit payment controls and collections, and enhanced IT upgrades, should be financed out of existing FUTA revenue, not additional taxes.

There is no compelling reason for uniformity of state laws imposing penalties for overpayments and some doubt as to whether a minimum 15% fraud penalty will be effective. We therefore do not support a federal mandate for this purpose. Federal mandates, even when helpful to employers, will simply invite additional federal mandates that ultimately will make the UI program more costly.

Of equal concern, there is absolutely no sound reason to raise payroll taxes on employers by extending the FUTA surtax past the end of 2007. The FUTA tax rate should be established based on UI program needs, not federal budget rules. The ac-

cumulation of unnecessary FUTA revenue is detrimental to a sound unemployment insurance system.

We appreciate your inclusion of these comments in the hearings record. We would be pleased to answer any questions or provide additional information. Please feel free to contact me by telephone or by email.

STATEMENT OF CLIENTS, PERSONS, OR ORGANIZATIONS ON WHOSE BEHALF THE STATEMENT IS SUBMITTED

This statement is submitted on behalf of UWC—Strategic Services on Unemployment & Workers' Compensation (UWC). UWC is a 501(c)(6) association incorporated under the laws of Wisconsin. UWC offices are located in the District of Columbia.

Statement of William Samuel, American Federation of Labor and Congress of Industrial Organizations (AFL–CIO)

On behalf of the more than 9 million working men and women of the AFL–CIO, I appreciate the opportunity to submit written testimony on the Bush Administration's FY 2007 budget request for the Department of Labor (DOL), with special emphasis on the Unemployment Insurance (UI) system, the Employment Service (ES), and the workforce development (job training) system.

On February 6, 2006 the Bush Administration released its FY 2007 budget request for DOL programs, and on May 3, 2006 the Administration submitted legislative language—called the "Unemployment Compensation Program Integrity Act of 2006"—to implement several of its budget proposals. Notwithstanding the modest title of this legislation, the Bush Administration is proposing nothing less than a radical restructuring of the U.S. employment security system.

The most far-reaching and harmful of the Administration's proposals would allow the entire balance of state UI trust funds to be diverted to purposes other than paying UI benefits—and specifically to pay for tax subsidies for low-wage employers, personal reemployment accounts (PRAs) to induce displaced workers to forego job training, and wage supplements to induce displaced workers to take lower-paying jobs with subsidized low-wage employers.

The Administration's sweeping agenda poses serious questions for the future of the U.S. employment security system. Bush Administration policies and proposals are taking us in the direction of lower-quality jobs with lower wages and reduced benefits; a shift in the mission of our economic security system from helping workers find good jobs towards inducing them to accept "rapid reemployment" at lower-quality jobs; and under-funding and neglect of the federal programs that help displaced workers find and qualify for good jobs. We propose a very different agenda that puts a priority on helping displaced workers find reemployment at good jobs with good wages and good benefits.

Four Principles for Reform

We believe the urgent task of reforming and improving our economic security system should be guided by the following four principles:

1. Reform should improve the effectiveness of our employment security system in preventing economic hardship for workers who lose their jobs;
2. Reform should improve the effectiveness of our economic security system in helping displaced workers find reemployment at good jobs with good wages and good benefits, and keeping workers on a career path of higher wages and higher benefits;
3. Reform proposals should recognize the role played by the U.S. economic security system as an economic stabilizer, providing countercyclical economic stimulus to depressed areas of the country during periods of high unemployment; and
4. Reform should promote fairness and efficiency in the administration of our economic security system, and promote compliance with the law by both employers and workers.

In our testimony below, we use these criteria to evaluate the Administration's budget and legislative proposals.

Principle #1: Prevent Hardship and Promote Economic Security

The first and most obvious purpose of the employment security system is suggested by its name: to promote economic security by preventing economic hardship for workers who lose their jobs. This goal is as important today as it ever has been, but it is not being met by the current system.

None of the remarkable changes in the American workforce in the past few decades have obviated the need to promote economic security for displaced workers. Despite an ostensibly low U.S. unemployment rate of 4.7 percent, there are still seven million Americans officially unemployed. If discouraged workers and involuntary part-time workers were counted, the U.S. unemployment rate would be 8.4 percent.

One noticeable change in the U.S. labor market is the rising level of job turnover, which has increased 4 percent just since 2003 (from 37 percent in 2003 to 41 percent in 2005). This troubling development calls for more, not less, UI assistance for displaced workers. It also suggests additional reforms such as universal health care coverage and increased portability of defined-benefit pension plans.

Despite the need for increased assistance, the UI system is now providing less assistance to fewer workers than it has in the past. Unemployment benefits replace only 34.7 percent of the lost income of jobless workers in the U.S., and much less in some states.

States such as California, Arizona, Missouri, and Indiana have raised regular UI benefit levels since the 1990s, but much more remains to be done. To promote higher levels of wage replacement, future special distributions from the federal UI trust funds should be dedicated, at least in part, to raising regular state UI benefit levels.

The percentage of unemployed workers who receive regular state UI benefits has fallen from 50 percent in 1975 to 36 percent in the last quarter of 2005. One reason for the decline in UI eligibility is that most states have failed to update their eligibility rules to reflect the massive entry of women, contingent workers, and part-time workers into the workforce. Low-wage workers are twice as likely to be unemployed as other workers, yet they are half as likely to receive UI benefits, partly because 32 states do not count workers' most recent earnings for purposes of determining eligibility. Approximately one in five workers is employed part-time, most of them women, but only 18 percent of part-time workers received UI benefits in the 1990s.

Several states have adapted to these changes in the workforce by modernizing their UI programs to serve more workers. Nineteen states now cover more low-wage workers by using an alternative base period (ABP) that counts workers' most recent earnings. Twenty-four states allow UI eligibility for at least some part-time workers. And twenty-seven states provide UI benefits to victims of domestic violence who are forced to leave work.

Federal funding should support such state efforts to expand UI eligibility. In the late 1990s, the "stakeholder" process—involving employers, organized labor, state UI administrators, and the U.S. Department of Labor—produced a consensus package of UI reforms that encouraged eligibility expansion. This "stakeholder package" included federal funding for states to cover more low-wage workers by implementing an ABP, as well as federal funding for states to cover part-time workers.

Another noteworthy development in the U.S. labor market is the rise in long-term unemployment, most likely caused by structural changes in the economy. Repairing the dysfunctional federal extended benefit (EB) program would be an especially appropriate response to the increase in structural unemployment. The EB program was intended to allow long-term unemployed workers in high-unemployment states to receive benefits even when Congress has failed to enact a nationwide program of extended federal benefits. However, the EB activation triggers are obsolete, and the "stakeholder package" of UI reforms includes repair of the EB triggers.

Raising UI benefit levels, expanding UI eligibility, and improving UI outreach obviously require additional budget resources. We propose that these reforms be paid for through a special account funded by the Bush Administration's proposed five-year extension of the Federal Unemployment Tax Act (FUTA) surtax.

Principle #2: Set Workers on a Career Path Towards Higher Wages and Higher Benefits

The second principle of reform is to improve the effectiveness of our economic security system in helping displaced workers find, and qualify for, good jobs with good wages and good benefits.

Recent changes in the U.S. labor market underscore the need for a much more ambitious national reemployment strategy. Because of rising job turnover, there are obviously more workers seeking reemployment than ever before. And because of increased structural unemployment, the challenge of finding good reemployment opportunities lies increasingly beyond the means of individual workers and localities, and demands a national response.

Reform efforts should therefore focus on developing a comprehensive "good jobs strategy" to ensure that good jobs are available in the first place; improving the effectiveness of programs that connect workers with the good jobs that are available; and improving the effectiveness of job training programs that help workers qualify for those good jobs.

A comprehensive strategy to create and maintain good jobs must include (1) balanced monetary and fiscal policies to promote full employment; (2) robust investments in physical infrastructure; (3) a national strategy to revive the manufacturing sector, including investments in technology development and dissemination, currency policy reform, and repeal of tax subsidies that encourage off-shoring of manufacturing jobs; (4) trade and currency policies that discourage downward competition in wages and benefits and the off-shoring of good jobs; (5) other sectoral strategies to rescue and modernize ailing sectors of the economy, building on successful labor-management models in hospitality, telecommunications, and health care; (6) economic development initiatives; and (7) policies that promote worker rights and collective bargaining, higher wages, and improved health care and retirement security.

To do a better job of matching workers with available good jobs, the Employment Service (ES) must be reinvigorated. Today the ES administers the "work test" for millions of UI claimants to ensure that they are registered for, and matched with, suitable job openings, and provides reemployment services that help UI claimants return to work. In 2005, the ES helped over 14 million workers look for jobs.

A number of studies have demonstrated that labor exchange services provided by the ES are extremely cost-effective. According to a 2002 paper by Westat researcher Lou Jacobson, public labor exchange services spend about $330 per job placement. Mr. Jacobson observes, "What is particularly remarkable is that virtually every rigorous analysis of PLXs [public labor exchanges] indicates that they are highly cost-effective."

The ES has a unique state and national focus that cannot be duplicated by private contractors, or by One-Stop offices under the Workforce Investment Act (WIA). Private businesses such as Monster.com cannot match the breadth of services or listings offered by the ES. WIA One-Stops have a local focus that is ill-suited to carry out a national, or even statewide, reemployment strategy. Congress should direct the WIA system to devote fewer resources to wasteful duplication of ES infrastructure, and more of its resources to job training. Core services provided by the WIA One-Stops should be provided by ES merit staff employees.

However, the ES cannot meet its current responsibilities, much less shoulder additional responsibilities, without additional budget resources. The ES budget has been cut for five years in a row. In FY 2006 its budget was cut $45.8 million in nominal dollars over FY 2001, and $34 million in DOL grants for reemployment services for UI claimants were eliminated.

Finally, the quality and effectiveness of job training programs must be improved, starting with restoration of recent budget cuts. The WIA system should ensure that training investments lead to good jobs by developing and implementing performance standards, economic self-sufficiency standards, and other measures to ensure accountability of public subsidies.

In light of rising job turnover and structural unemployment, studies show that the most effective job training programs are those that offer workers a broad skill set that can be transferred to multiple employers. There is also a correlation between the effectiveness of job training and the duration of training, which suggests the need for additional budget resources for training, and accompanying income support, modeled after the Trade Adjustment Assistance (TAA) program.

Principle #3: Provide an Economic Stabilizer

One of the original purposes of the UI program was to stabilize local economies by helping displaced workers maintain purchasing power during spells of unemployment. Reform proposals should not overlook this important purpose of the UI program, but rather should seek to create additional countercyclical stimulus.

In the last recession, regular UI benefits pumped over $50 billion back into the economy, and temporary federal extensions injected another $23 billion. According to a 1999 study, every one of these benefit dollars generated $2.15 in additional economic growth.

Reforms designed to raise UI benefit levels, expand UI eligibility, and repair the EB program would serve the dual purpose of stabilizing the economy during economic downturns.

Principle #4: Ensure Fair and Efficient Administration

The best way to ensure fairness and efficiency in the administration of the UI/ES system is to guarantee "merit staffing" (public administration) and adequate congressional appropriations of administrative funding. Adequate administrative funding is also the best way to prevent overpayments and underpayments to UI claimants, and to achieve better tax compliance by employers.

Under current law and regulations, fairness and efficiency in the UI and ES programs are served by the "merit staffing" requirement—the requirement that the UI

and ES programs be administered by state civil service employees. The principle behind merit staffing is that unbiased, nonpartisan staff should perform the functions of the UI and ES programs, which are inherently governmental and intimately related to the public interest.

The merit staffing requirement must be maintained for both the UI and ES programs to ensure unbiased services, confidentiality, and accountability. Merit staffing is important in the ES system, especially, to avoid discrimination against African American and Hispanic workers, who are often turned away from private placement agencies, and to ensure compliance with federal equal opportunity requirements. Merit staffing is necessary in both the UI and ES programs to protect the confidentiality of information provided by workers and employers, which may be compromised in the hands of private firms. And there is greater public accountability over public employees than over profit-motivated private contractors.

Fair and efficient administration also requires adequate administrative funding, which is the responsibility of the federal government. Unfortunately, appropriations for UI administration have not been adjusted for inflation, including personnel and services costs, since 1995.

To protect states against chronically inadequate appropriations, the "stakeholder" process recommended mandatory funding of UI administration at levels sufficient for states to adequately administer their UI programs. At the very least, Congress should support the NASWA proposal to increase funding to $3.023 billion in FY 2007, $283 million more than DOL's request.

Inadequate administrative funding hampers state "program integrity" efforts to ensure that unemployed workers receive the correct amount in UI benefits and employers pay the correct amount in payroll taxes. Most overpayments of UI benefits result from innocent errors that could be reduced or avoided with more adequate administrative resources.

However, the underfunding of UI administration also results in *underpayments* to workers, which also should be avoided. The National Employment Law Project (NELP) estimates that workers were improperly denied a total of $1.3 billion in benefits in 2002, while DOL statistics show overpayments of $888 million.

The chronic shortfall of UI administrative funding hampers the ability of states to detect and collect unpaid employer taxes. While DOL recommends that states audit 2 percent of employers, states audited only 1.7 percent of employers in 2004, though nearly half of state audits result in the adjustment of reported wages. States blame their failure to conduct more audits on a shortage of administrative funding.

Furthermore, additional administrative resources are necessary to detect employer misclassification of workers as "independent contractors" rather than "employees." According to a recent report by the DOL Inspector General, seven states that use IRS data sets to detect misclassification of employees have recovered close to $1.5 billion in underpaid employer taxes, and two-thirds of their audits have resulted in adjustments of employer taxes. Congress should direct DOL to provide IT resources, training, and grants to help states prioritize use of the IRS data.

Federal administrative funding is also necessary to help states detect SUTA dumping. In 2004 Congress passed legislation to prohibit "SUTA dumping" schemes, in which employers evade payment of UI taxes by improperly transferring their UI experience ratings to third parties. The GAO has identified 14 states that have uncovered SUTA dumping schemes costing over $120 million in lost UI revenue. Funds made available for the implementation of SUTA dumping detection systems have been insufficient for states to purchase the necessary hardware, train staff to implement the programs, or investigate and prosecute SUTA dumping schemes.

Finally, legislative changes are necessary to increase recoveries from SUTA dumping. The 2004 legislation ignored one of the most common forms of tax evasion—the transfer of employees to the payroll of a professional employee organization (PEO). California estimates that PEO schemes account for half of the $100 million in UI taxes underpaid every year. Congress should pass legislation to allow states to recover unpaid taxes from employers who evade taxes through the use of PEO schemes.

The Bush Administration's FY 2007 Budget Proposal for DOL Programs

Unfortunately, the Bush Administration's FY 2007 budget proposal violates all four of the reform principles discussed above. None of the Bush budget proposals would help prevent economic hardship for workers when they lose their jobs, or make it easier for workers to find reemployment at good jobs with good wages and good benefits.

The budget proposal would make it harder for displaced workers to find and qualify for the higher-quality jobs that are available. It calls for a reduction of $63 million in real dollars for all ES programs over FY 2006, and $378 million over FY

2001. It would also eliminate America's Job Bank (AJB), funded through the ES, which is now the largest listing of job openings in the world.

DOL also proposes another round of cuts in the job training budget. The budget proposal would eliminate funding for WIA programs designed to help unemployed workers, disadvantaged adults, and at-risk young people, and cut training and assistance overall by $831 million in real dollars over FY 2006, and by more than $2 billion over FY 2001.

Finally, the FY 2007 budget request for UI administration is only slightly higher than the appropriation for 2003, and far less than what is needed to administer the UI program.

DOL's Legislative Proposal to Divert UI Trust Funds to Pay for Employer Subsidies, PRAs, and Wage Insurance

In a letter to Speaker Hastert dated May 3, 2006, Secretary Chao outlined DOL's legislative proposal to waive fundamental requirements of the UI program, including the requirement that states use their UI trust funds only to pay for UI benefits, and the requirement that states assess UI employer taxes based on employers' experience rating. We strongly oppose this proposal.

The scope of DOL's proposal is astonishing. It would allow states to divert UI trust funds to purposes other than UI benefits—the only limitation being that such diversions must be "consistent with" one of two purposes: (1) accelerating reemployment or (2) improving the effectiveness of state administrative activities. There is no restriction on the size of such diversions, so states could divert the entirety of their trust funds to other purposes.

Obviously, diverting UI trust funds to other purposes threatens the ability of states to provide unemployment compensation to workers who need it. Furthermore, it makes it far less likely that states will be able to make needed reforms such as expanding UI eligibility or increasing UI benefit levels. Diversion of UI trust funds may also compromise the role of the UI system as an economic stabilizer if the trust funds are used in ways that have less stimulative effect on the economy.

On May 4, Deputy Assistant Secretary of Labor Mason Bishop gave two examples of how DOL expects states to divert their UI trust funds under the proposal: personal reemployment accounts (PRAs) and wage insurance. Mr. Bishop testified that DOL expects states to set up personal accounts that workers could use to pay for job training, which is yet another formulation of the controversial PRA proposal, and that DOL expects states to supplement the wages of unemployed workers who find reemployment, a concept known as "wage insurance." As part of wage insurance programs, DOL expects states to use UI trust fund money to provide "unemployment tax incentives" for employers who hire workers receiving a wage supplement.

The drawbacks of PRAs are well known. PRAs would result in less, not more, assistance to displaced workers. Certainly the amount of unemployment compensation for workers would fall if UI trust funds were diverted to other purposes. And while PRAs could be used to pay for job training and reemployment services, it is unlikely that overall funding for such assistance would increase by a corresponding amount, given that funding for job training and reemployment services has been cut five years in a row.

While details are missing from this latest version of the PRA proposal, previous versions would reduce the amount of assistance available to individual workers. PRAs would establish—for the first time—a federal cap on the amount of job training and reemployment services available to workers, at a level lower than the amount available under current law.

Another significant drawback of PRAs is that they would discourage workers from enrolling in job training. If workers are able to retain the unspent balances of their accounts upon finding a job, or if they receive a cash bonus for finding reemployment within a certain period, they are less likely to spend down their accounts on training. This is because unemployed workers cannot know in advance what the payoff to retraining will be, or when that payoff will occur, yet they are often in dire need of immediate cash assistance.

This is not an unintended consequence of PRAs; it is their principal selling point. It is the reason why DOL expects PRAs to qualify for the proposed waiver authority: because PRAs are "consistent" with the purpose of "accelerating the reemployment of individuals who establish initial eligibility for unemployment compensation under a state's law."

However, in many cases it may not be in the best interest of workers to forego training. Many training programs are effective, and a generalized policy of steering workers away from job training can have the effect of diminishing workers' long-term job prospects and living standards.

Wage insurance is a very similar concept, and shares many of the same flaws. Like PRAs, wage insurance would reduce the amount of UI trust funds available to pay for UI benefits. Like PRAs, wage insurance would accelerate reemployment by offering workers a cash incentive. The intended purpose of wage insurance, like PRAs, is to induce workers to accept jobs they might not otherwise accept.[1] And neither proposal takes into account the quality of those jobs, or the sacrifice workers are being induced to make in terms of wages, benefits, and working conditions.

The jobs that workers would be induced to accept are not promising career choices. By definition, they would pay less than the worker's old job. Only if the pay cut were substantial would a wage supplement affect workers' decisions (because the wage supplement is determined as a percentage of the pay cut). The new employer is therefore unlikely to be one that pays high wages. Any on-the-job-training that might be provided by low-wage employers is likely to be poor quality training that does not give workers transferable skills. And once the wage supplement is exhausted, workers may well end up with poorer job prospects than when they started.

Meanwhile, workers would have foregone whatever opportunities they may have had to find a good job with good wages and good benefits. Workers who are able to rely on UI income support while conducting a thorough job search, receiving career counseling, or enrolling in job training are often able to find higher-quality jobs.[2]

The more wage insurance programs succeed in inducing workers to accept "rapid reemployment" at lower-paying jobs, the greater the potential sacrifice of job quality for workers. Unfortunately, under DOL's proposal, there is no limit on the amount of state UI trust funds that could be diverted to wage insurance. While worker participation would presumably be voluntary, states could easily favor wage insurance by making it harder for workers to remain in the UI program. Employers that benefit from the resulting downward pressure on wages,[3] or from DOL's proposed tax subsidy, would have an economic incentive to agitate for such policies. Already, DOL has proposed a new regulation—not yet implemented—that could pressure UI recipients to accept low-wage jobs.[4] DOL's waiver proposal threatens to transform UI into a workfare program, instead of a "good jobs" program.

The problem with "rapid reemployment" schemes is that they fail to distinguish situations in which "rapid reemployment" at low-wage jobs is beneficial to the worker from situations when it is not. Their effectiveness in modifying workers' behavior depends largely on the degree to which workers lack information and are financially vulnerable, not the degree to which "rapid reemployment" would serve workers' long-term interests.

A better approach is to make workers less financially vulnerable and provide them with information necessary to properly assess their best interests. This is precisely what the UI system and the Employment Service (ES) are designed to do. The ES promotes "rapid reemployment" too, by providing workers with the information they need to find good jobs that match their skills. In 2000 the Labor Department noted that every $1 spent on reemployment services produces $2.15 of savings to the UI Trust Funds.[5] But ES promotes "rapid reemployment" when it is in the worker's best interest. When a broader job search or retraining might better serve a worker's needs, the ES also supplies the information workers need to make that determination.

DOL Legislative Proposal to Privatize Administration of the UI System

DOL's legislative proposal would also allow states to privatize administration of the UI system by obtaining waivers of Section 303(a)(1) of the Social Security Act, which requires that states establish and maintain a merit-based personnel system to administer the UI program. This proposal should be rejected for reasons dis-

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[1] Carl Davidson and Stephen Woodbury, "Wage-Rate Subsidies for Dislocated Workers," Upjohn Institute (January 1995) ("The wage-rate subsidy we consider—would induce dislocated workers to search harder for jobs and accept employment that they might otherwise refuse").

[2] *See, e.g.,* Heather Boushy and Jeffrey Wenger, "Finding the Better Fit: Receiving Unemployment Insurance Increases Likelihood of Re-employment With Health Insurance," Economic Policy Institute (April 14, 2005).

[3] Litan et al. apparently believe that wage insurance would subsidize employers by depressing wages. Robert Litan, Lael Brainard, and Nicholas Warren, "A Fairer Deal for America's Workers in a New Era of Offshoring," Brookings Institution (2005) ("The second critical value of wage insurance is that it acts like a training subsidy for the new employer").

[4] 70 Fed. Reg. 42474, at 42477.

[5] Stephen Wander and Jon Messenger, Worker Profiling and Reemployment Services Policy Workgroup: Final Report and Recommendations, U.S. Department of Labor Employment and Training Administration (2000).

cussed above—namely, because the administration of publicly-funded UI benefits is an inherently governmental function, and because privatization would result in diminished guarantee of fairness and equal opportunity, compromised confidentiality, and less accountability.

DOL Legislative Proposals to Recover UI Overpayments and Underpayments ("Program Integrity")

DOL's "Unemployment Compensation Program Integrity Act of 2006" includes five legislative proposals designed to promote the "program integrity" of the UI system. These legislative proposals represent an unfair and unworkable approach whose shortcomings could be avoided if DOL would simply provide states with adequate levels of administrative funding.

Ensuring "program integrity" of the UI system is an administrative function that should be financed through federal administrative grants to the states. Several of DOL's "program integrity" proposals would use money belonging to the state UI trust funds—recoveries of benefit overpayments and tax underpayments—to finance this administrative function. Instead of using state UI trust fund money to pay for UI administration, the federal government should fulfill its responsibility to adequately fund administration of the UI system.

If UI administration were adequately funded, there would be fewer benefit overpayments in the first place, as well as fewer underpayments to workers. The failure to provide adequate administrative funding also unfairly skews enforcement priorities against workers, since improving tax compliance by employers requires additional administrative resources.

Under DOL's proposals, the weight of collection efforts would fall on workers, in many cases unfairly. DOL fails to distinguish UI benefit overpayments that result from fraud from those that result from innocent error. In 2005, only 38 percent of overpayments were the result of fraud; about 30 percent were caused by errors on the part of the UI agency or employers; and the remaining overpayments were due to innocent errors on the part of claimants.

Moreover, DOL's proposal to intercept tax refunds would affect mainly low-income workers, since a greater percentage of low-income individuals receive tax refunds. According to CPS data, 41 percent of UI claimants have incomes low enough to receive the Earned Income Tax Credit (EITC).

The tax intercept proposal may also be unworkable. Because UI benefits are taxable income, if overpayments are deducted from a taxpayer's federal tax refund, the taxpayer may be owed a refund of taxes paid on the UI benefit. The IRS would either have to recalculate the worker's taxes or offset the tax overpayment against the benefit overpayment, at considerable cost and effort.

With regard to fraudulent overpayments, we strongly oppose DOL's proposal to allow private collection agencies to collect up to 25 percent of recoveries. This proposal would establish a dangerous precedent for the privatization of "program integrity" activities, by allowing private parties to recover money that belongs to the UI trust funds. And there is no evidence that private collection agencies would perform any better than public agencies in collecting these debts.

This proposal illustrates many of the problems with privatization of UI administration generally. The profit motive of private collection agencies could lead to abusive and potentially fraudulent collection practices. Private collection agencies are the most complained-about industry in the country in terms of unfair and abusive practices, even though they are subject to the Fair Debt Collection Practices Act. Moreover, it is unclear how the privacy controls that govern state agency employees would apply to private collection agents. Even when such privacy protections exist, private contractors have an abysmal record of protecting the confidentiality of taxpayer information.

Conclusion

The dramatic changes that have occurred in the U.S. economy in recent decades underscore the need for significant improvements in our economic security system. We propose an ambitious new national reemployment strategy to help displaced workers find good jobs with good wages and good benefits. But we strongly oppose shifting the mission of our economic security system to promoting downward economic mobility and subsidizing low-wage employers.

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