INCREASING ECONOMIC SECURITY FOR AMERICAN WORKERS

HEARING

BEFORE THE

SUBCOMMITTEE ON
INCOME SECURITY AND FAMILY SUPPORT

OF THE

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

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INCREASING ECONOMIC SECURITY FOR AMERICAN WORKERS

THURSDAY, MARCH 15, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON INCOME SECURITY AND FAMILY SUPPORT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:00 a.m., in room B–318, Rayburn House Office Building, Hon. Jim McDermott (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON INCOME SECURITY AND FAMILY SUPPORT

FOR IMMEDIATE RELEASE
March 08, 2007
ISFS–3

CONTACT: (202) 225–1025

McDermott Announces Hearing on Increasing Economic Security for American Workers

Congressman Jim McDermott (D–WA), Chairman of the Subcommittee on Income Security and Family Support of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to review proposals designed to improve security for American workers. **The hearing will take place on Thursday, March 15, 2007, at 10:00 a.m. in room B–318 Rayburn House Office Building.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include Robert Reich, former Secretary of Labor under President Clinton, and other experts on programs and policies designed to assist jobless workers and respond to changes in the U.S. labor market. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Unemployment Insurance (UI) system, established in 1935, continues to serve a vital role in providing temporary and partial wage replacement for unemployed workers and in stabilizing the economy during recessions. However, significant changes have occurred in the American workforce and in the U.S. labor market since the program's inception. Most obviously, women now constitute a much larger share of the workforce. But many other important changes have occurred, including a major decline in the portion of the workforce employed in manufacturing jobs, an increase in the share of the labor force working part-time, a rise in the duration of unemployment, and a drop in employment tenure in the same job. In some cases, the UI system has failed to adequately respond to these and other changes in terms of access to unemployment benefits. In other instances, there may be a need for additional support systems for workers moving between jobs.

In announcing the hearing, Chairman McDermott stated, **"Our first, best approach to ensuring economic security for American workers are policies that support good jobs and rising wages. But, we also need a broader vision of supporting employment—one that helps workers through periods of dislocation and transition. I want to consider two possibilities. First, helping States fix some of the more obvious holes in the unemployment insurance system. And second, establishing a new program of wage insurance to support dislocated workers when they move into a new job that pays less than their previous employment. The concept of insurance is to be prepared in case something adverse happens, not because you expect it to happen. That's how I view this issue."**

FOCUS OF THE HEARING:

The hearing will focus on proposals to improve the unemployment insurance system and to replace a portion of any lost wages between past and current employment for workers involuntarily changing jobs.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

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 "*110th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). 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 **March 29, 2007**. **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. For questions, or if you encounter technical problems, please call (202) 225–1721.

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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.

Chairman MCDERMOTT. The Committee will come to order. We are here today to talk about a couple of issues that I put in some draft legislation and circulated around to start our thinking.

When it comes to securing a brighter future for the American worker, our first goal really ought to be to support policies that grow jobs and increase wages. Also, at the same time, we have to realize that some level of dislocation is inevitable, especially in an era of globalization and rapid technological change. A comprehensive vision of promoting employment really calls for supporting workers through these periods of transition.

Unfortunately, our present safety net for dislocated workers has more holes, really, than net. A little more than one-third of the jobless workers actually receive unemployment insurance, and there are particular barriers limiting access to low-wage and part-time workers. Additionally, there is no help for dislocated workers who subsequently become re-employed in lower-paid jobs.

In short, much of our response for helping displaced workers has been on a kind of automatic pilot for a long time, even as the workforce and the labor market has changed dramatically. When I arrived in the State legislature in 1970, Boeing had just gone from 106,000 people down to 36,000 in the course of about 5 months, when the Safe Secure Transit contract went away.

So, I know about what happens with unemployment, and how it's cyclical, and then they went back up to whatever thousands. That cyclical nature of the seventies is not what we're dealing with today.

Now, I have suggested, two responses to the evolving needs of the American worker. These draft proposals are designed to stimulate discussion, and to get us moving in the right direction. They could easily fit into a broader response that includes some other important issues in my mind, such as portable health care coverage.

First, we should fix some of the most obvious holes in the unemployment insurance system. We have money set aside in the Federal unemployment trust funds for the purposes of helping dislocated workers. I think it's time we use some of it to meet that goal. My proposal would distribute up to $7 billion to encourage, assist, and reward States for making specific improvements to their unemployment insurance (UI) programs.

The first reform required of States to receive their share of these new funds is to count an applicant's most recent wages when determining their UI eligibility. Twenty States have already taken that step. Other steps, include ending discrimination against part-time workers, eliminating prohibitions on covering workers who leave work for compelling family needs, and providing extended benefits to workers in State-certified training programs. There is a real disconnect between unemployment and training in this country, and we need to begin to rectify that. In combination, these reforms might increase UI coverage for as many as half-a-million workers a year.

The second step we should take is to create a national program of wage insurance to help dislocated workers who suffer a decline in wages when they are re-employed. Now, we have car insurance and home insurance, and even some pet insurance in this country. It seems to me that it's not unreasonable to consider having some wage insurance.

Among re-employed full-time workers between 2001 and 2003, the average earnings dip by 13 percent. The Congressional Budget Office (CBO) tells us that 1 in 5 workers experienced an earnings decline of at least 25 percent from one year to the next.

Now, to help displaced workers who become re-employed at lower-paying jobs, I have worked with Senator Schumer to craft a wage insurance proposal. The proposal would replace half the difference between a worker's old and new salary, up to $10,000 a year for up to 2 years. The wage insurance program would supplement the current unemployment insurance system, not replace it.

There would also be a need to help people who are seeking new unemployment, as the UI system now does.

Wage insurance is designed to take the next step that should help displaced workers after they have found another job, by replacing a portion of any lost wages.

Take the example of a factory worker who loses a job paying $50,000 a year, but can only find one paying $30,000 to replace it. The wage insurance program would fill half the gap in lost wages, bringing their take-home pay up to $40,000 a year. This reduces the level of hardship imposed on the worker, and it gives him or her time to gain experience, on-the-job training, job seniority, in order to climb the employment ladder back to a prior wage level.

Now, some say that we should never concede that a worker may have to take a lower-paying job. Also, I am not a very good ostrich. I can't bury my head in the sand and ignore reality. When 4,000 jobs at Maytag end in Iowa, the likelihood of those coming back any time in the foreseeable future is zero. For us to say that, well, we will just have those workers wait it out is simply, in my view, not realistic.

So, I look forward to hearing the witnesses' comments on these proposals, and also their own ideas about what we need to be doing to increse economic security for America's workers. I would yield now to our ranking Member, Mr. Weller. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman, and thank you for conducting today's hearing. Thank our panelists for joining us, and participating here.

I do want to comment, Mr. Chairman, that things happen fast. We are just a couple of months into the new Democrat-majority congress, and today we are here to discuss a proposal to create the new first Federal payroll tax increase since 1965. This would be just part of the proposed 5-year new and additional $40 billion tax increase and raise in Federal taxes.

Under this proposal, there would be even more tax hikes to come, since the up front Federal tax hikes will be matched by State payroll tax hikes down the line. These new taxes ignore the fact that there is currently $35 billion sitting unused in the Federal unemployment accounts. That large balance is enough to pay the current Federal responsibilities in the unemployment benefit system for the next seven years, even if we did not collect another dime in Federal taxes during that time.

That argues for ending the Federal unemployment surtax, not extending it, as my friend, the Chairman's, proposal would do.

Stated purpose for all these new tax increases is to assist workers confronting increased economic pressures due to trade, globalization, and a range of other factors, which is a fair goal. Also, the problem is, most workers don't sit around the kitchen table, thinking they would be more financially secure if only the Federal Government raised their taxes some more.

In fact, after paying current Federal and State income taxes, Social Security taxes, Medicare taxes, unemployment taxes, property taxes, sales taxes, and on and on, most families figure another tax is the very last thing their family budget needs. The fact that these new Democrat tax hikes involve payroll taxes on wages, which are really taxes on job creation and wage growth, only makes matters worse.

Today's hearing will also review the Chairman's proposal to fundamentally alter the nature of the Federal State unemployment benefits program. That program has provided laid-off workers benefits since the thirties, with States determining eligibility and collecting State payroll taxes to support those benefits. States today are free to cover various categories of unemployed workers, including some who voluntarily leave their jobs, or who are seeking only part-time work.

The Chairman's proposal seeks to reward—or some would say bribe—all States into permanently expanding eligibility for unemployment benefits with a one-time infusion of Federal funds. Moreover, after those Federal funds are gone, the broader eligibility will remain, forcing States to raise payroll taxes to keep paying promised benefits. Again, it's hard to see how more payroll taxes could promote job creation and higher wages.

The final issue we will review today involves a concept of wage insurance. In terms of encouraging work, this idea has broad bipartisan appeal. In fact, yesterday I introduced H.R. 1513, legislation that would encourage all States to seek waivers to develop wage insurance, personal savings, and other pro-work programs, as part of their current unemployment benefits system.

As the work of this Subcommittee in recent years, and even the Chairman's current proposal suggests, the nation's unemployment benefit system needs repair to better connect dislocated workers and new jobs. However, instead of sensible reform, this new proposal proposes creating an entirely new program with a new Federal payroll tax on top of today's current unemployment benefits program.

It seems more logical to first try and address deficiencies of the current system, especially since the current unemployment benefit system will collect and spend almost $200 billion over the next 5 years on unemployment benefits. That leaves ample margin for States to develop ways to better assist workers in finding new jobs. This waiver approach is a model we successfully followed leading up to welfare reform, and it worked. The States are innovators. That is a path we can, and should, follow again.

In fact, welfare reform worked so well at promoting work, that States were left with substantial savings. In the unemployment benefit system. That would result in state payroll tax cuts, since more work means less unemployment benefits going out the door. Now, that would be a novel idea.

Mr. Chairman, I look forward to our witnesses' testimony.

Chairman MCDERMOTT. Thank you very much, Mr. Weller. I think we will have quite an interesting discussion as we go down the road.

Our first witness is Robert Reich, who is—I read your biography, and I don't think we're going to go through the whole thing here. He was labor secretary under Mr. Clinton, and has been an advisor in other administrations. I think 10 books and a play, and a few other things—we're glad to have you here today.

I understand that you have gone to California, which is Nirvana, and we—leaving Boston—and we are eager to hear your testimony today.

Your full, written testimony will be entered into the record. So, whatever you would like to say beyond that will be helpful to the Committee. Thank you.

STATEMENT OF ROBERT B. REICH, J.D., PROFESSOR OF PUBLIC POLICY, UNIVERSITY OF CALIFORNIA, BERKELEY

Mr. REICH. Thank you, Mr. Chairman. I commend the Committee for looking at the issue of economic insecurity, because, as you know, although the macro-economy, in terms of recessions and inflation, is well under control—far better under control now and over the last 10, 15 years, than the macro-business cycle was under control years before that—the structural changes in the economy are affecting average working people to a far greater extent than ever before.

When I say "structural changes," I am talking about changes in technology, in globalization, in supply and demand. The fact is that consumers and investors now have more choice than they have ever had before, and they can move to better deals, almost at the speed of an electronic impulse. That's great, if you're a consumer or an investor. You can get a better deal.

The opposite side of the same coin is that working people in jobs, in businesses, in industries, are being buffeted as never before by these structural changes. Job security is a thing of the past. Wage security is a thing of the past. Now, that's fine if you're a young person, and you have the right skills, and you have a four-year college degree. Maybe that looks like a very exciting and dynamic set of opportunities for you. I hope it is.

However, if you're 40 or 50 years old, and you're in an old industry, and you don't have perhaps as much education and training as would be ideal, these structural changes are threatening you, and they are threatening your family.

In my formal testimony, Mr. Chairman, that I submitted for the record, I provided the Committee some evidence. I think the Committee probably has already had quite a lot of evidence as to the effect of structural changes on working people.

Now, let me just say something. The dynamism of the American economy is one of its greatest strengths. We ought to celebrate that. The fact that people are moving from job to job, and field to field, and occupation to occupation, sometimes industry to industry, is a great, great boon to the American economy.

Also, we have probably, of all wealth nations, the worst—least adequate—system of moving people from job to job, for providing some employment security for people, so that when they get the next job, the next job does not pay less than the former job, or that they have a reasonable chance of when they do get buffeted by the winds of economic change, having another job that pays almost as well.

Let me put this in a little bit of context, if I may, and then I would be very pleased to answer your questions.

Unemployment insurance should be, in my view, viewed as part of a system of active labor market supports that move people, as quickly and reasonably as possible, from job to job, as long a the next job pays—or has a very good chance of paying—as much as the job that was lost.

You need to, first of all, fix the holes in the unemployment system. That unemployment system was developed at a time in our Nation's history when the biggest threat to people was that they get laid off from their job during a period of recession, and then they would get the job back again when the economy recovered.

Well, most people that lose their jobs today never get the old job back again. We saw this beginning in the 1990/1991 recession, we saw it to even a larger extent in 2001. Since then, we have had huge numbers of lay-offs, even though we have had a recovery. People don't get the old job back again. The unemployment insurance system was premised on the notion that these were temporary lay-offs by workers who had been in full-time jobs, and would most likely get that full-time job back once the recession was over. It's not happening.

We have got a huge number of part-time workers in the workforce now, a lot of contingent workers. Most people's wages—most people's wages, even if they are full-time workers now—are premised on either overtime or billable hours, or some other variable, depending upon how well their employer is doing over the preceding interval.

So, nobody has the kind of job security they used to have, and unemployment insurance needs to respond to the new reality. There are many women in the work force who are also the primary caretakers in their homes. Fortunately or unfortunately, women are the primary caretakers in our society. That means that if children or parents of loved ones need help, they have to leave their job. Or, if there is abuse in the family, sometimes they may have to leave the job, and leave their spouse.

Our unemployment insurance, as it is now constituted, doesn't take account of part-time workers, it doesn't take account of people who may have to leave for a variety of family reasons.

Just one word on wage insurance. I understand, Mr. Chairman and Members of the Committee, that some are nervous and anxious about wage insurance, because it might, in their view, substitute for unemployment insurance. That is, the fear is if you have a wage insurance system, why do you need an unemployment insurance system? Somebody can get a new job. If it pays less, then they simply get a little cushion against the possibility of wage loss.

Most of the studies show—and most of the studies I have seen, and I included in my statement show—that if you have a good, solid system of unemployment insurance that gives people who lose their jobs an adequate opportunity to search for a new job, then it increases their odds that the new job will pay relatively well, or better than it would pay if they didn't have that unemployment insurance.

Wage insurance should be understood as a complement and supplement to unemployment insurance, not as a substitute to unemployment insurance.

Finally, let me say something about job training. I know it's not directly under the jurisdiction of this Subcommittee, but it is, it seems to me, very important. I speak from my experience as Secretary of Labor, not only with regard to unemployment insurance, but also the inextricable relationship between a good unemployment insurance system and a good job training and retraining system.

In my view, the Workforce Investment Act (P.L. 105–220) was a big, big improvement over the Job Training Partnership Act (P.L. 97–300). However, there is not adequate funding for it. I have talked to workers across this country and seen study after study showing that in a dynamic economy likes ours, we need a much more effective and well-endowed training system, if it's going to work.

I also know that the whole issue of international trade is not directly under this Subcommittee's jurisdiction. Trade adjustment assistance is something that hopefully will be addressed. However, it should not matter why somebody loses a job. They need help.

Right now, it takes far too much time and energy and, often, a huge amount of bureaucratic delay to determine why it is somebody lost a job, and whether they are eligible for trade adjustment assistance. In my book, regardless of why somebody lost a job, they need help getting the new job. It's in their interest and in the public's interest to get them into a new job that pays well as quickly as possible. Thank you very much.

[The prepared statement of Mr. Reich follows:]

Statement of The Honorable Robert Reich, J.D., Professor of Public Policy, University of California, Berkeley

Mr. Chairman and Members of the Subcommittee:

Economic insecurity is now endemic. Fear of job loss, and accompanying fear of loss of income as well as loss of employer-provided or sponsored health care, affects almost every member of the American workforce. What can and should be done? The first step is to understand that the problem is very different from what we've faced before.

The New Problem of Insecurity: From Cyclical Change to Structural Change

It used to be that the main cause of economic insecurity was temporary and often short-term job loss during economic downturns. But downturns in the business cycle have become shallower. Indeed, the business cycle itself has become smoother than it was decades ago, and neither recession nor inflation as threatening. This is due, in part, to better management of the economy by the Federal Reserve Board, improvements in the quality and quantity of information available to the private sector in planning investment decisions, just-in-time inventory control systems, and the ease with which spare capacity can be found abroad.

But structural changes in the economy have become more dramatic. Shifts in supply and demand are often sudden and large. That's because globalization and technological change are generating continuous waves of new products and services. The entry of China and India into global trade and investment has in effect expanded the global labor force about 70 percent—mostly at the lower end of the wage scale. But even if America was so unwise as to try to retreat from rest of world behind protectionist walls, job and wage security would still be a thing of the past. Computer software is now capable of doing many of the jobs people used to do: Numerically-controlled machine tools and robots do much of the factory work that used to be done by workers on the line; software also does much of the clerical work that used to be done inside offices by secretaries and lower-level white-collar workers. The answer to "what happened to that job?" is as often "it's being done by software" as "it's being done elsewhere."

Meanwhile, consumers and investors are gaining easier and easier access to information about better deals, and easier means of executing such deals. The result is almost continuous economic upheaval on a scale never before experienced. Consumers and investors switch allegiances at the speed of an electronic impulse. That makes the market extraordinarily efficient at getting them what they want, when they want it. But the corollary is that just about every business in every industry is continuously at the mercy of consumers and investors who may abandon it in pursuit of better deals. Employees, whose pay and benefits typically constitute 70 percent of the cost of doing business, are especially vulnerable. While capital is more mobile than ever, most people who work for a living are relatively immobile. They live and work in specific jobs, with specific skills, in specific places, often with families whose members also have specific connections to those places.

Decades ago, most jobs were fairly permanent and earnings were predictable because the economy was based largely on high-volume, standardized, stable mass production. Stability of work and wages were necessary for economies of scale to be achieved. A handful of firms dominated each industry, because there was only room for a that handful Competition was minimal. Consumers and investors had little choice of products or services. A sufficiently large portion of jobs were unionized (in the mid 1950s, more than a third of America's workers belonged to a union), that unionized contracts established prevailing wges and working conditions throughout the economy. Periodically, this stable system would succumb to recession and large numbers of workers would be temporarily laid off, until aggregate demand picked up, and they were hired back. The very term "layoff" suggested its temporary nature. Employees were "laid off" until they were back "on" the payrolls.

Fast forward to 2007. Today, almost every job is temporary—even if it's called "permanent." And for the vast majority of workers, earnings are unpredictable. Pay now depends on number of hours of overtime, billable hours, commissions, profits, bonuses, or some other variable measure of the unpredictable demand for their employment. Instability has become an inherent part of the structure of the economy. A recent CBO analysis shows that between 2001 and 2002, one in four workers saw their earnings increase by at least 25 percent while one in five saw their earnings drop by at least 25 percent.[1] Workers who lose their jobs permanently typically get new paying 16 percent less than the old. For displaced manufacturing workers, the typical drop in earnings has been 20 percent. In certain industries, wage losses are even greater. Workers who have lost jobs in the tire and blast furnace industries have experienced average wage losses of over 45 percent.[2]

The Panel Study of Income Dynamics at the University of Michigan, which has tracked 65,000 people since 1975, has found that over any given two-year stretch about half of all families experience some decline in earnings. Although many make up for such losses later on, the swings have become progressively larger as the decades have passed. In the 1970s, a typical decline was about 25 percent. By the late 1990s, it was 40 percent. By the mid-2000s, family incomes rose and fell twice as much as they did in the mid-1970s, on average.[3]

Polls show a substantial increase over recent decades in the percent of Americans worried about losing their jobs.[4] Last year, the fifth year of an economic recovery, some 4.5 million Americans, on average, left their jobs or were fired every *month,* and some 4.8 million people started new jobs every month. Presumably some of these people chose to change jobs. They relished the change of pace, the new opportunities, and the excitement of all this tumult. Presumably some would have preferred to stay where they were.

But we also assume that a not insignificant number had difficulty finding a new job. They may have had to change industries, develop entirely new skills, or move to a new location. All this took time. Over the last twenty years we've witnessed a substantial increase in the rate of long-term joblessness. During this interval they may have drained their savings, or put them and their families deep in debt. Chances are, even if they qualified for unemployment insurance, they exhausted it before they found a new job. Typically, they had difficulty finding the training they needed for the new job, or couldn't support themselves and their families while get-

[1] The CBO analyzed data from the 2001 panel of the Bureau of the Census's Survey of Income and program Participation. Workers with less education tend to experience more volatility in their earnings than do workers with more education. See CBO, *Changes in Low-Wage Labor Markets Between 1979 and 2005 (December, 2006).*

[2] See Lori Kletzer, "Trade-Related Job Loss and Wage Insurance: A Synthetic Review," *Review of International Economics 12(5), 2004.*

[3] See Panel Study of Income Dynamics, University of Michigan, various years. See also Mark Rank, *One Nation Underprivileged: Why American Poverty Affects Us All(New York: Oxford University Press, 2004), p. 93; Jacob Hacker, The Great Risk Shift (New York: Oxford University Press, 2006).*

[4] See, for example, Pew Social Trends Poll, August 30, 2006. A representative sampling of Americans was asked: "Compared to 20 or 30 years ago, do you think the average working person in this country . . . has more job security, less job security, or about the same amount?" Results: More job security, 11 percent of respondents; less job security, 62 percent; about the same, 24 percent; don't know or refused to say, 3 percent.

ting the training. And they had to accept a new job that paid significantly less than the job they lost.

Upheaval can be stimulative when the electricity bill can be paid and there's enough food in the refrigerator. It is considerably less welcome when the kids have to go hungry, even temporarily.

The Current Employment Transition System Is Outmoded and Broken

The American labor market has among highest rates of job turnover of any wealthy economy. That's one if its great strengths. But our current system for easing job transitions is the weakest of all wealthy nations. That's one of our economy's most significant weaknesses. Employment transition includes an unemployment insurance system that reaches fewer than 40 percent of people who have lost jobs; a retraining system that's so piecemeal, unresponsive, and underfunded it hardly merits the term "system;" and, as a practical matter no real re-employment insurance at all. Taken as a whole, Americans who lose their jobs get almost no help toward gaining new jobs that pay at least as well as the old.

There are many reasons why comparatively few unemployed workers receive unemployment insurance. One is they don't know they're eligible for it. Unions once played a major role in disseminating information about the availability of unemployment insurance, but now that only 7.4 percent of private-sector workers are unionized, they cannot play this role. Another reason is that far women are in the labor force today than before, and many of them are working part time in order to preserve enough time to take care of children or parents. Women are still the major unpaid caretakers of American society. But certain states deny unemployment insurance to people who have lost part-time jobs. Another reason is that the job-holder is working several part-time jobs simultaneously, and the eligibility rules of that state don't recognize that the loss of one or more may impose a substantial hardship. Or it may be that even though the worker had been employed full time, he or she didn't earn enough to qualify for unemployment insurance under the rules of certain states. Or it may be that someone has to leave a job in order to accompany a working spouse to another city or state, and is deemed ineligible because that job loss is not considered to be involuntary.

The point is that the current unemployment insurance system is full of holes because it was designed for a time when almost all workers had full-time jobs with predictable wages, when relatively few women were in the workforce, when most families did not depend on two incomes, and when unemployment was due to a temporary downturn in the business cycle. None of these conditions holds true any longer. So it's no surprise that the system is failing.

Meanwhile, our system of job training is woefully underfunded, and remains a patchwork of programs put together for the convenience of government agencies and congressional authorizing committees rather than people who need help. The Workforce Investment Act of 1998 is an improvement on the Job Training Partnership Act that preceded it, and the idea of one-stop shopping for workers who have lost their jobs and need an array of re-employment services is a good one. But community colleges are not included—although community colleges often provide among the most important sources of retraining. Nor is the job-training system sufficiently integrated with unemployment insurance so that people who lose their jobs and need retraining to get new jobs that pay at least as well as the one they lost can count on income assistance while they retrain. Nor, most fundamentally of all, has nearly enough money been authorized and appropriated under the Act for all the training—both the quality and the duration—that a workforce in such rapid transition needs.

Trade Adjustment Assistance is theoretically available to supplement unemployment insurance for those who lose their jobs because of trade, but as a practical matter it is often impossible to separate out the reasons for job loss, and difficult and time-consuming to prove that one is entitled to benefits and training under the TAA program. Nor does it make any sense to separate out workers who have lost their jobs because of trade from those who have lost it because of displacement by technology or some sudden shift in demand.

Despite reform in 2002, Trade Adjustment Assistance is helping fewer than 75,000 new workers each year, while denying over 40 percent of employer's petitions. The Department of Labor, which I used to run, has interpreted the TAA statute so restrictively as to exclude the growing number of service workers who have been displaced by trade. The Department is denying TAA benefits to roughly three-quarters of workers who are certified as eligible for them. Moreover, like the Workforce Investment Act, TAA funding has been woefully inadequate. Two-thirds of newly certified workers do not receive any training benefits at all.

The Current Debate—Preserve the Old Job vs. "Let-'er-Rip"

What to do? Most of our debates over what to do about the rising tide of economic insecurity occur between two ideological schools, neither of which provides any practical hope of dealing with the situation most Americans now face. One the one side are those who urge that America preserve and protect existing jobs. They advocate trade protection for jobs threatened by workers overseas, and laws curbing global outsourcing. They often seek government subsidies for industries whose jobs are threatened by competition—domestic as well as international. Occasionally the members of the "preserve and protect" school want regulations that keep new technologies at bay and require that businesses continue to hire workers for jobs that the technologies otherwise would displace. Members of this school are not, in general, enthusiastic about job training, on the theory that there are few if any new jobs to be trained for—a battle-cry they often express as "training for *what*?" And they are wary if not hostile to wage insurance, fearing that it is inevitably a means of reducing the scope and duration of unemployment insurance, and little more than grease on the slide of downward mobility.

Opposed to this preserve and protect school of thinking is what might be termed the "let-'er-rip" school, which sees the workings of the "free market" as so sublime that any government effort to take account of social costs is automatically deemed an "interference" almost guaranteed to "distort" the market. For subscribers to this school, any move to cushion workers against the shocks of economic change will encourage laziness or lassitude on the part of those so helped. Unemployment insurance inevitably slows the rate at which the unemployed find new jobs because, according to this thinking, it reduces the pain that provides a prod to find a new job, or allows a worker to indulge in the fantasy that the old job will return. Help with job training is also assumed ill-advised, on the theory that the only training that matters occurs on the job, when a newly-hired worker is sufficiently fearful of losing the new job that he or she has a strong incentive to learn everything necessary to perform it well. Wage insurance, by this view, is also wasteful and inefficient because it reduces any immediate incentive to work harder and put in longer hours.

Neither of these positions is tenable. America cannot preserve and protect old jobs. Even to try to do so would impose an extraordinary cost on the nation, forcing Americans to sacrifice the significant benefits that come with globalization, technological change, and a wide choice of goods and services. But nor can we allow the market to subject so many Americans to wanton economic insecurity, pain, and fear of job loss and income decline. There is nothing sacrosanct about the "free market." The market is a manmade creation; it exists because of laws that define and redefine private property, fair exchange, reasonable liability, and require minimum standards of fair dealing, disclosure, and protection for consumers, investors, and employees. Whether we call the real pain of economic change as a "social cost," an "economic externality," or a human problem, it is very real, and it is becoming larger. It must be addressed, and be reduced.

In sum, neither position is tenable. Those who wish to preserve and protect ignore the structural changes that are now engulfing the economy. Those who want to let the market "rip," ignore the pain that these changes are inflicting. To the extent our politics endorses one or the other of these positions, we will have difficulty meeting the challenge ahead.

The Need for a New Employment Security System: The Three-Legged Stool

The best and only practical solution is through active labor market policies that ease the transition of our workforce out of old jobs and into new ones that pay at least as well as the old. The goal, in other words, cannot be job security because no job can be secure; and it cannot be the insecurity that comes with the sort of structural changes we are experiencing, because that puts too many people in jeopardy. The goal must be, rather, employment security—the security that comes in knowing with a high degree of confidence that even though the current job and wage cannot be counted on forever, there's a high likelihood of finding new employment at the same or higher wage.

Such an employment security system would require, in my view, at least three things: 1. Income support while unemployed; this requires, at the least, filling the holes in the current unemployment insurance system. 2. Easy access to training and skill development that leads to a new job paying at least as much as the old. 3. Wage insurance during the transition period—providing workers who can only find a new job paying less than the old with a portion of the difference in pay—long enough that workers can begin learning on the job and improving their skills and productivity, well on the way to matching or exceeding the pay on their former job.

Think of it as a three-legged stool. If any one leg is missing, the support is inadequate. If the current holes in the unemployment insurance system remain unfilled, wage insurance alone is likely to mean downward mobility for too many workers who have lost their jobs and must quickly find new ones in order to maintain their incomes. Without adequate unemployment insurance, workers lack the ability to undertake a full and adequate search for a new job. That means, in too many cases, a new job with much lower wages than would be the case if the job search were longer. Indeed, studies show that workers who collect unemployment insurance enjoy an increased likelihood of finding a new job that will have employer-sponsored health insurance.[5] Another study has found that workers who receive unemployment benefits receive higher pay, as well, by a factor of $240 a month compared to those who do not collect unemployment benefits.[6] Hence, wage insurance should not undermine funding and support for necessary reforms of unemployment insurance. It should not be viewed as a "work first" requirement, and it should be be designed in such a way as to be entirely compatible with job training.

On other hand, if workers only have access to unemployment insurance and not to wage insurance, then they may well reach the end of their unemployment benefits and be forced to settle for jobs paying far too little for them to be able to maintain the standard of living they and their families had before the job loss. Wage insurance is critical in helping them stay on the new job long enough to gain sufficient experience and on-the-job skill to justify wage that's near or matching the wage of the job that was lost.

But on-the-job training and experience is seldom adequate, especially if the worker who loses a job has to find a new one in a new industry or occupation. If workers have access to unemployment insurance and wage insurance but not to job training, there is little reason to suppose—given the pace of structural change in the economy—they will find a job paying as well as their old job. Finally and most obviously, if they are eligible only for training, but not for unemployment benefits or for wage insurance, then many will not be able to take advantage of the training because they cannot afford the loss of income such training would entail.

In sum, each leg of the stool is important for allowing workers who have lost their jobs to balance the three things they need most—income support during their search for a new job, income support during training for a new job, and a wage supplement at the start of the new job while they gain on-the-job training and experience.

Mending the Holes in Unemployment Insurance

The proposed legislation makes a good start at mending the current holes in unemployment insurance. It makes sense to create incentives that provide extra funding from the Federal Unemployment Account to states that meet specific criteria such as:

- *Counting applicant's most recent wages (from last completed quarter) when determining eligibility for UI benefits.* Workers who lose their jobs shouldn't have to wait three months before getting unemployment benefits. Computerized information available to most state unemployment offices should be adequate to accomplish this.
- *Insure part-timers.* States should not deny unemployment insurance to an individual solely because that person is seeking part-time work. Some states still require recipients to seek full-time employment even if they can only work part time. This makes no sense, and fails to account for the changes in the structure of the economy to which I alluded, above.
- *When determining UI eligibility, permit good cause allowance for voluntary employment separations that related directly to compelling family reasons such as avoidance of domestic violence, caring for a disabled family member, and following a spouse whose employment has been relocated.* This is also a sensible reform. There are wide disparities among states on good cause allowances for voluntary separations. Given the changes in the economy, and in the structure of families, the current system in many states imposes an unreasonable burden on too many families.

Encouraging Job Training and Education—Off and On the Job

Job training—both on and off the job—should be an important component of any new employment system. Numerous studies have documented the economic value of job training, especially longer-term training in programs designed to prepare workers for jobs that employers are actively seeking to fill, for which they are likely to continue to need employees. On-the-job training is critically important as well; it

[5] Boushey, Wenger, "Finding the Better Fit: Receiving Unemployment Insurance Increasese Likelihood of Re-Employment with Health Insuracne," Economic Policy Institute, April, 2005.

[6] Kiefer, Neumann, "An Empirical Job Search Model with a Test Constant Reservation Wage Hypothesis," *Journal of Political Economy,* Vol. 87, No. 1, 89–107.

has been estimated that for ever dollar invested in on-the-job training yields an additional 13 cents in annual earnings for the working lifetime of the individual; the return is 19 percent for workers without a college degree.[7]

- *Lifetime training.* The Workforce Investment Act is underfunded, relative to the palpable needs of our workforce in an economy subject to significant structural change. I would also urge Congress to consider imposing on employers—especially those employing more than, say, 100 employees—a requirement that they invest at least one and a half percent of their payrolls into the continuing education and training of all their employees. Any portion of this percentage that is not so used should be paid into local Workforce Investment Act funds.[8]
- *Training assistance benefits to claimants who have exhausted their regular unemployment insurance.* States should be urged to provide such funding so long as recipients are making satisfactory progress in a state-approved training program related to a high-demand occupation. The proposed legislation would require that weekly cash benefits be the same as benefits provided under regular unemployment insurance, which seems reasonable to me. I would urge that states have discretion as to duration, but that the duration of such training assistance should be at least 26 weeks.
- *Wage insurance that effectively subsidizes on-the-job training on the new job.* One of the most important rationales for wage insurance is that it recognizes that workers who are new at a job or an occupation gain value as they gain experience, and often learn relevant skills, on the job—eventually justifying a higher wage. In this respect, wage insurance can and should be understood as a temporary subsidy for on-the-job training.

Insuring Wages

- *Replace half a worker's lost wages compared to previous employment for up to two years, and up to total of $10,000 per year.* The proposed legislation calls for this, and it seems reasonable to me, although replacement rates may have to be higher for workers who earn less than half the median income.
- *Make the insurance available to all permanently displaced workers who have at least two years of tenure at the previous job, and whose new job is a full-time job.* This also strikes me as reasonable—the requirement of a new full-time job would avoid any possible incentive to reduce hours of work.
- *Consider making it available on a pro rata basis to part-time workers who move on to new part-time jobs that require the same hours but pay less.* Given the practical realities of work in the current economy—especially as they relate to women—I would urge the Subcommittee to consider making the insurance available on a *pro rata* basis to part-time workers who move on to new part-time jobs that pay less than their former part-time jobs, as long as the number of hours in the new job is the same as that of the old one.

The Longer Term: A More Ambitious Agenda

The three-legged stool of income support, training, and wage insurance is a beginning. If our workforce is to have the flexibility it—and our dynamic economy—needs, other innovations will be necessary.

Universal and affordable health insurance. For most Americans, economic insecurity is intimately connected to the fear of loss of health insurance, because employer-based health insurance continues to be the major vehicle through which health insurance is dispensed in America. But this system makes less and less sense. It amounts to a tax subsidy estimated to be in the range of $160 billion a year. Yet people who need it most—who have lost a job, either because of their own health problem or a health problem in their family made it difficult for them to continue—have no access to it. And poorer workers tend to receive a much smaller portion of this tax subsidy—sometimes no health insurance at all—than top executives, whose employer-provided health insurance for them and their families is often quite generous. It makes eminent sense, therefore, to decouple health care from employment and apply the $160 billion to the cost of providing universal and affordable health care.

American employers are on the way to decoupling health insurance from employment in any event. The proportion of large and medium-sized companies offering full health coverage for their employees dropped from 74 percent in 1980 to 18 per-

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[7] See Rosen, "Taxation and On-the-Job Training Decisions," *The Review of Economics and Statistics vol 64 (3), pp. 442–449.*

[8] The diligent reader with a long memory will notice that this idea first appeared in Bill Clinton and Al Gore, *Putting People First (Times Books, 1992), p. 128.*

cent in 2005. As recently as 1988, two-thirds of medium-sized employers provided health insurance to their retirees; by 2005, the portion had fallen to around a third.[9]

Paid Family and Medical Leave. Another feature of a more ambitious agenda would be paid family and medical leave. All too often, a family's economic security is jeopardized by the need for a family member to provide temporary care for a child or a parent or other relative. The nation's current Family and Medical Leave system, requiring employers to provide twelve weeks of unpaid leave for family and medical emergencies, has proven to be a large success; but many families are unable to take advantage of it because they cannot afford to forfeit income during the time away from work. Before the Act was passed and signed into law, in 1993, employers predicted a wave of fraudulent leave-taking, arguing that even without pay, large numbers of employees would take advantage of the Act and take days or weeks off of work whenever they chose to, on the pretext of a family emergency. That has not been the case. The vast majority of American workers want to work and need to work. They also need to be able to attend to family and medical emergencies when they occur. Congress should follow California's example and establish paid leave, running along side the unemployment insurance system.

Housing Transition Assistance. I would also urge Congress to consider including housing transition assistance for workers in towns and cities from which major employers have left. Given the upheavals in the economy, the housing stock in places that suffer from falling employment over a period of years often loses substantial value. Meanwhile, the value of housing in towns and cities where employment is growing often rises considerably. Research has shown that a doubling of employment in a metropolitan area is associated with a 33 to 55 percent increase in owner-occupied housing prices.[10] Given that one's house is often the family's largest single asset, this mismatch can make it particularly difficult for Americans to leave a town or city where they have lost a job and move to a town or city where new jobs are available.

Housing transition assistance could take many forms, including using a limited portion of unemployment insurance funds to provide below-market loans for workers leaving towns or cities where housing prices have fallen and moving in search of work to towns or cities where housing prices have risen. Some states have created "home protection funds," providing revolving loans that save homes from foreclosure and help maintain their communities.

Conclusion

I commend the Subcommittee for the proposed reforms in unemployment insurance and the creation of wage insurance. These are important starts on one of the most important challenges facing the American economy today—providing our people with enough security to accept the changes that will inevitably affect almost every job in every industry—and, hopefully, prosper in the economy of the twenty-first century.

Chairman MCDERMOTT. Thank you. The hardest thing to—or at least one of the hard things in trying to make a new public policy is to sell the idea. I am sure the idea of unemployment insurance in 1935 was sort of radical. So, whenever you come with anything that seems like a departure from the way things have gone—how do you explain to people that this is not a replacement for unemployment insurance?

You have a program, and maybe you're saying to people, "Look, take a job. You're not eligible. We have a job over here, and you can take that job, and you can take the wage insurance buffer and go to it now. We're not going to pay you for 6 months, or your 26 weeks of regular unemployment insurance." How do you answer that question? How do you structure it so that someone can stay

[9] *National Compensation Survey: Employee Benefits in Prigvate Industry in the United States (U.S. Department of Labor, Bureau of Labor Statistics, March, 2006).*

[10] Hwang, Min and Quigley, Economic Fundamentals in Local Housing Markets" Evidence from U.S. Metropolitan Regions," *Journal of Regional Science,* vol 46 (3), pp 425–453, 2002.

on the 26 weeks, if they want to, and not be forced into a lesser paying job?

Mr. REICH. Well, I think you build and structure the program in such a way that the unemployment insurance is—and remains—available to someone. It becomes very clear, in the framing of the issue, in the public understanding of the issue, that wage insurance is not a substitute for unemployment insurance.

You see, I think this Committee—I think it's very important for public officials to make it clear to the public that the purpose of unemployment insurance is not, and has never been—at its inception it was not—to give people simply an excuse to sit back and not do a job search. Most people, most studies show, most people who have lost their job don't use unemployment insurance to sit back and just wait for the next job to come along. They are actively engaged in a job search, and they are looking for a job that is most suitable, not only to their skills, but also to their family's needs, with regard to earnings and benefits.

The longer that job search is allowed to proceed—and this is what the purpose of unemployment insurance is—the more likely it is that somebody is going to find a job that meets all of those criteria. However, you don't want to get to the end of that 26 weeks and have somebody in a very dynamic economy—and, again, this is a much more dynamic economy than it was in the thirties, forties, fifties, sixties, seventies, or eighties—you don't want somebody to get to the end of that 26 weeks and have to dramatically sacrifice their standard of living because the only job available to them is one that pays substantially less than the job they lost. That is where wage insurance comes in.

You want to give them the opportunity to get a new job that does not entail a huge sacrifice and standard of living, and also gives them a leg up on getting on-the-job training, so that they have a good chance of eventually getting back to where they were before.

Wage insurance, therefore, is a natural complement, a natural supplement, to full unemployment insurance. That's the way it needs to be understood, that's the way it needs to be sold, in my view.

Chairman MCDERMOTT. How do you deal with the employer who says to himself, "I could lower my wages a little bit here, and see if I couldn't get some of those unemployed people to work here, and use the cushion as a way of saying, 'Well, you have the cushion, so you don't need this salary that I used to pay for this?' "

Mr. REICH. Well, there is absolutely no evidence that employers have used the earned income tax credit in that way, or any kind of employment subsidy in that way. Employers are eager to get the best employees they can, and will pay the marginal benefit that those employees provide to that employer. They are in competition for other employers for every employee.

There is no reason to believe that any government subsidy, whether it's called the earned income tax credit, or it's called wage insurance, is going to change that fundamental dynamic.

Chairman MCDERMOTT. Thank you. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman, and Mr. Secretary, it's good to have you with us. I remember reading your book after your service in the Clinton Administration, "Locked in the Cabinet." I enjoyed it, and the sense of humor. How is Waffle, your dog? Is he still with you?

Mr. REICH. Still with us, yes.

Mr. WELLER. Yes. Must be getting older. I had a puppy for a long time, and enjoyed him.

The Chairman's proposal before us creates a new wage insurance proposal. As you stated, and as I have stated, it has bipartisan appeal. Something that—so I am very pleased that it gives us an opportunity for Democrats and Republicans to work together.

One of our witnesses before us today, Mr. Rosen, has authored a report suggesting workers will benefit more from personal savings in the event they become unemployed. There is a scholar with the Brookings Institution, Jeffrey Kling, who has a similar proposal. The President has proposed creating personal accounts to help workers retrain for new jobs. Each proposal suggests creating a new program on top of the current unemployment benefit system, which people on both the right and left agree needs repair.

Mr. Secretary, I feel that a more logical first step would be to allow the states to do what they do best, and that is to innovate, to experiment, and to be creative within the context of the current unemployment benefit system.

I have introduced, as I mentioned earlier, H.R. 1513 this week. It is legislation that I would note allows the states to innovate, obtain waivers, something they were able to do prior to the Welfare Reform Act 1996, which experimented a lot with welfare reforms that were successfully incorporated in Federal legislation.

I would note that they would be able to provide wage insurance in addition to unemployment benefits, under my legislation, once granted these waivers.

So, again, I noted that you agree wage insurance has tremendous potential. You served as the Secretary of Labor in the Clinton Administration. You also sought the office of Governor, so you saw the State of Massachusetts as an opportunity to innovate with some of the ideas you wanted to bring into public policy.

My friend, the Chairman, has a proposal that suggests expanding current unemployment benefits, increasing Federal taxes by $40 billion, and then creating, as part of that, a new wage insurance program. Wouldn't the more logical approach be to allow the states to do what they do best, to innovate and develop wage insurance programs as part of their unemployment insurance programs in their state, as proposed in H.R. 1513?

Mr. REICH. Congressman, I think it is an enormous benefit of a Federal system such as we have, that states can innovate, and they can experiment, and they do get waivers. The history of welfare reform, indeed, the history of most of our labor laws, if you go back to the decades of the 20th century, as you know, centered on states trying various experiments.

What concerns me is that there is enormous pressure on states—and I saw this as Secretary of Labor—fiscally, to minimize any kind of expenditures, particularly those expenditures that happen to require, episodically, expenses, and—such as job losses associated with unemployment insurance.

I will not suggest that there is a race to the bottom, because I don't think that states see it as a race to the bottom. Also, the fact of the matter is that the states are, not only in times of recession, but even right now, they are quite constrained with regard to what they are able to do.

When a state faces declining employment, or in times where major industries in the state begin to suffer stress, states don't have, often, the wherewithal that they need to do all the experimenting that we would like them to do.

Mr. WELLER. Mr. Secretary, that brings up a follow-up question here. Under the proposal that's before this Subcommittee, there is, essentially, a $40 billion tax increase. It provides additional assistance to states, and I have never met a state program director that hasn't welcomed more money. I have enjoyed working with those for my State of Illinois. My Governor has proposed $8 billion in new tax increases so far in the state legislative process, so he can spend more money.

So, the question I have is the Chairman's proposal provides, as I understand it, with this $40 billion tax increase, assistance to the states to expand their programs. However, it's temporary. In that case, once that money is no longer there, the programs have been expanded, the states would have to come up with the money from somewhere else.

So, in that case, is it suitable to expect the states to either have to cut spending somewhere else to continue those higher promised benefits, or would they have to raise payroll taxes to replace that lost revenue a few years down the road?

Mr. REICH. Congressman, I don't know precisely what the structure of this proposed legislation is. Also, let me just say, generally—and we did this with the School to Work Opportunities Act (P.L. 103–239), and many other pieces of legislation in the nineties—giving states additional funding to try things that they otherwise may not be able to try, letting them see, as you yourself suggested a moment ago, see what works with that additional funding, and then, on the basis of that experimental period, have an opportunity to draw conclusions and see what makes most sense for them—and then, for the Federal Government to withdraw that funding, and leave it up to states as to which programs and which aspects they want to continue——

Mr. WELLER. Sir, I want to follow up. I realize my time is running out. If you suggest providing additional funding, we have almost $35 billion in surplus funds in the Federal unemployment trust fund, UI trust fund. That, today, with current allocations of funds, is enough for almost seven years, without collecting one more dime in payroll taxes to fund that. So, we have a large amount of funding.

Would you suggest, or agree, that that funding that is in the surplus that is current there is adequate, without raising taxes, if we want to provide additional assistance to the states?

Mr. REICH. If it is adequate right now, I am not sure—and I am certainly not going to claim—that it will be adequate, come the next recession. Most of these insurance funds are designed in such a way that they are safeguards, they are safety nets. Should the economy go into recession, I don't think we have repealed the business cycle, even though business cycles are more moderate than they were 25 or 30 years ago. So, I—this is something the Committee obviously has to decide.

Also, let me make a more general point, if I may. That is that our systems of active labor market policy is for helping people navigate through a treacherous economy are inadequate. They are inadequate, both in terms of the design of our programs, and they are inadequate in terms of the amount of money available to people to do that navigation, whether it's unemployment insurance or job retraining, or it's the proposed subsidy for job wage insurance.

Mr. WELLER. Thank you, Mr. Chairman. You have been generous.

Chairman MCDERMOTT. Mr. Stark will inquire.

Mr. STARK. Thank you, Mr. Chairman. I guess you will be accused of offering to raise taxes. Also, in the current suggestions of how to raise taxes, you are a real piker. The President has suggested increasing taxes by $300 billion over 10 years, which would be the net effect, according to the Joint Tax Committee, of giving everybody a $7,500 tax deduction for health insurance.

So, one person's tax increase might be another person's political suggestion, but I—there is no way it will pay for some things—we won't be able to fight wars or have police protection or fire protection or education—unless somebody is willing to pay for it. I have yet to find the tax fairy who is going to put that money under our pillow, unless some of us are willing, at some point, to vote for it.

I wanted to talk with you, Mr. Secretary, a minute about your adopted residence. Maybe we can keep you there permanently. However, south of you, in my district, is a factory, a joint venture between Toyota and General Motors. I am allowing a little poetic license here, but I believe there are about 6,000 employees there.

As I can remember from the—my experience in the late forties in the Somerville Ford assembly plant, assembly line work is not something that would have even required my ability to mess with the slide rule in those days. It is hard work, but it doesn't require computer skills, it doesn't require much—I suppose—much more than, really, good eighth grade math and algebra, maybe.

What I am wondering—and those jobs, now in Fremont, are paying $22 an hour to start, plus benefits, which the United Auto Workers has—can justifiably take great pride. Not a whole hell of a lot of jobs in your new adopted territory where somebody, basically with a high school degree, can start at $22 an hour. The rates go up. There were some seniority increases.

Furthermore, as we know, automobile plants have a way of disappearing, almost overnight—move south, move to other countries, move to Canada. What would we do, and I guess, what—the union strategy, as near as I can tell at this point, is to write me a letter and say, "Please buy a Corolla." However, even if I got all my colleagues to buy a Corolla, I am not sure that we have the wherewithal to keep that plant alive, just by saying, "Buy that," and the competitive—what should we encourage the unions to do, support part of Mr. McDermott's plan?

In the event—what would happen to those 6,000 people, all of whom live in the Bay area? They could probably get $10 an hour at Wal-Mart, I'm guessing—maybe not quite that high—and other such jobs. That's just—where do they go? They are not going to start another automobile plant in the Bay area. There are not many jobs in manufacturing that will—we have the dot-com and the computer industry and all of that, which requires much more—a higher level of skills.

These employees, for the most part, are a bit elderly. They have been there through the Chevy plant that preceded it, and so they have been long-time workers. What should the unions do, or ask me to do, in the event that something would happen to that plant?

Mr. REICH. Congressman, the active labor market policies that we are talking about today—that is, unemployment insurance, fixing those holes, job and wage insurance, and good job training—will probably not deal with the fate of the 50 or 55-year-old auto worker paid $22 an hour who has a high school degree, but nothing more than that, and who has to get a new job. The chances are, given our current economy, that that person is not going to get a new job paying that well.

Now, the good news is that there is a mismatch now between the demands of employers around the country for technicians—people who have maybe a year or two of job training in a technical area, where they can do the installation and maintenance and upgrading of computerized machinery that is finding its way into factories, offices, medical facilities—a mismatch between employer demand and the numbers of people available to do that kind of work.

Not every 55-year-old auto worker can be trained to have the technical skills necessary to do the kind of new work that is available, but some of them can. Certainly a 40-year-old auto worker can do that, and could, based upon current supply and demand, get a new job paying comparable wages and benefits to that old job.

However, you are raising, it seems to me, a much larger question.

Mr. STARK. However, they would have to move to do that.

Mr. REICH. They may have to move. They may have to move.

Mr. STARK. Then their house would be sold to a Republican, and what would happen to my district?

[Laughter.]

Mr. REICH. Well, that is a problem for you, Congressman.

However, in my prepared remarks, I talked about universal and affordable health care, and also housing insurance, housing transition assistance. Today's USA Today had a piece about the difficulty many workers have when they are in a city or a region faced with large unemployment, where housing prices decline because there is not much demand for housing, and want to move to a place that has a lot of jobs where housing prices are going up because there is a demand for housing. That is a tremendous barrier right now to the kind of flexibility that employees need, as is the lack of health care.

So, it's hard to know where to begin, except to stipulate that right now we do not have the supports in place.

Mr. STARK. Thank you.

Chairman MCDERMOTT. Thank you. Mr. Herger will inquire.

Mr. HERGER. Thank you very much, Mr. Chairman, and I thank you, Secretary Reich. It is good to have you with us. This is certainly an incredibly important issue that we are dealing with.

The economy that we're in today, a global economy, one that is moving, as you mentioned in your testimony.

The old days, if you will, where someone would be in a job, maybe they would be in two jobs in their lifetime, is gone. We see people that are in five, six, seven jobs, on average, because of things changing. How do we adapt to this is certainly one that all of us need to be looking at. Perhaps how we might go about doing that might be different, but certainly the goal that we are doing is one that is very important.

I have a concern about what it does to our economy, and what it does to workers when their taxes are raised, when they have less disposable money. Of course, we have these wonderful programs that are well meaning programs. However, my concern is what happens when you take money out of their pockets.

Current law would suggest that the Federal unemployment surtax will expire after 2007. Wouldn't continuing it be a tax increase?

Mr. REICH. Congressman, there are various ways in which the unemployment insurance payments could be structured, in terms of employers paying into the trust fund, so that, with regard to the incidents of demand for labor, the cost does not fall on working people.

You are raising, it seems to me, a larger question, that if you will allow me to address, I would love to. Again, we are getting slightly beyond this Subcommittee's jurisdiction, but if I may say, as the Committee knows, I'm sure, there has not been quite this degree of inequality in wages and in overall income in the United States since the twenties. By some measurements, since the 1880s. People who are earning over $300,000 to $400,000 a year have never had it so good.

If this Committee and other Committees are worried about how to provide even the minimum safety net for workers in this tumultuous economy, it would seem to me, in terms of my values, entirely appropriate to raise the marginal tax on the highest income earners because, again, they have never had it so good, and median wages, despite an economy overall that continues to grow quite well, median wages have been stuck in the mud.

If I can say just one more thing on that theme, economy insecurity is so endemic right now in the United States, that we are seeing people all over the political spectrum, whether they call themselves Republicans or Democrats or Independents, beginning to lose support, or lash out, against free trade. If you look at the polls, free trade is very unpopular. That kind of backlash against free trade is to be expected—not justified, but to be expected—in an economy in which so many people feel economically insecure.

If we—and I say "we," as you and all of us who believe, fundamentally, in free markets and free trade—don't provide more economic security, we are going to face a backlash that makes it impossible for the President to get fast track authority this coming June or July, and also to proceed with any free trade agenda that is so important to the world economy.

Mr. HERGER. Mr. Secretary Reich, let me just mention what my very strong concern is. Keeping in mind what we are both—the context of what we're talking about now, and what you're just referring to.

One is that I think it would be very detrimental if we raised taxes. As Mr. Weller mentioned, in this area of extending this, we already have $35 billion in this account. So, I think it could be argued that we really don't need to raise taxes here. My concern is this seemingly class warfare.

I think it's great that we have people in our society who are making more money. Poor people don't hire people. It's people who have an excess of money who hire. You see small businesspeople that are out, that are doing better, that can hire more because they're making more. I do have concerns about—I know you had an article that you wrote in December of 2006 where you were supporting getting back toward 70 or 90 percent marginal rates. Is that correct?

If you take that into estate taxes, effectively, the top marginal rate would be over 100 percent. I just—I think that would——

Chairman MCDERMOTT. I think we are going to——

Mr. HERGER. Okay.

Chairman MCDERMOTT (continuing). Recess for about—long enough for us to walk over to the floor and back, which is about 10 minutes. If you can wait, we would appreciate it.

Mr. REICH. That will be fine. Thank you.

Chairman MCDERMOTT. We will be right back.

[Recess.]

Chairman MCDERMOTT. The Committee will come to order. Mr. Lewis of Georgia will inquire. Mr. Lewis?

Mr. LEWIS OF GEORGIA. Well, thank you very much, Mr. Chairman, thank you. Mr. Secretary, it is good to see you.

Mr. REICH. Good to see you, Congressman.

Mr. LEWIS OF GEORGIA. Thank you for being here. Mr. Chairman, I want to thank you for holding this hearing today.

Mr. Secretary, in the next panel, one of our witnesses, Mr. Douglas Holmes, will argue that there are no really—there are not really any holes in the unemployment insurance system, and that benefits have been paid to those who have an attachment to the workforce and are looking for work. How do you respond?

Do low-wage and part-time workers have equal access to unemployment insurance?

Mr. REICH. No, Congressman. Low wage workers, workers who are working in part-time jobs, workers who have a contingent relationship to work, indeed, much of the new workforce that is now in place, is not eligible for unemployment insurance, because unemployment insurance was designed at a time in our Nation's history when most workers worked full-time, had steady jobs, and could count on steady work. That is simply not the case today.

So, the holes in our system are as a result of changes in the system of employment. I don't think any of us wants to—or thinks we can—go back to the old days of full-time, steady, secure work. We have to accept, fortunately or unfortunately, changes in the structure of the economy. However, part of accepting the changes in the structure means that we have got to fill the holes that have developed.

Mr. LEWIS OF GEORGIA. How do we go about filling the holes, or fixing the holes, or——

Mr. REICH. Well, I think that the proposal put forward by this Subcommittee is an excellent beginning. Using the surtax—and, by the way, Congressman Weller, this would not be a tax increase. I want to make sure that we all understand that, with regard to the unemployment insurance hole-filling aspect of this proposal, my understanding, at least, is that there is no tax increase; it is an extension of the Federal Unemployment Tax Act (FUTA) (P.L. 76–379) surcharge, which has been in place for 30 years, and indeed, which the President's budget expects to—and proposes to—increase.

Congressman, using that, and providing to the states an incentive for filling some of these holes, strikes me as an excellent idea.

Mr. LEWIS OF GEORGIA. What do you really mean when you stated that job security is something of the past? That people who—at one time in our history, people went to work for a company and they worked for 30 years, 35 years, and they stayed there until they retired. I know there were people in my own family who left rural Alabama and they went to Detroit, and they worked in the automobile industry, and they stayed there. That was the only place they worked, until they retired.

Are you saying that people cannot look forward, in years to come, to staying at a company, or staying with the same employer for years?

Mr. REICH. No. The structure of the economy has changed. Thirty years ago, the biggest threat to job security was recession. When people got laid off from their jobs, because aggregate demand was inadequate, they would have to wait, usually a few months—on average, 26 weeks—until they got the job back again. Unemployment insurance for 26 weeks fit that model perfectly.

However, most people who lose their jobs these days don't get the old job back again. Job loss can happen at any time during the business cycle. It is not cyclical. Again, it has to do with structural changes. Entire industries are affected.

The automobile industry that you were referring to has seen major structural changes. Detroit has endured, over the last 30 years, fundamental changes. Only a fraction of the number of auto workers in places like Flint are still there. Indeed, most people who are now 18 years old, or 22 years old, and embarking upon their careers, cannot plan on being with the same employer for 20 or 30 or 40 years.

Just one more point, Congressman. I think that the efforts of this Subcommittee to repair unemployment insurance and provide wage insurance as a supplement—not a substitute, but a supplement—for unemployment insurance that is so mended, is a good place to start. However, it is vitally important that we also mend our health insurance system.

Right now, as you know, health insurance comes, for most people, through employment. Well, if you are in the kind of economy we are in, given the structural changes and the likelihood that you are going to lose your job, that kind of health care system is inadequate. Universal and affordable health care has got to be put into place, and we have got to decouple health care from employment.

Mr. LEWIS OF GEORGIA. Thank you, Mr. Secretary. My time has expired. Thank you, Mr. Chairman.

Chairman MCDERMOTT. Thank you. Mr. English will inquire.

Mr. ENGLISH. Thank you, Mr. Chairman. Secretary Reich, it's a real privilege to have you here. I just have, because my time is limited, some quick, rapid-fire questions.

In your testimony, you focus on one of the current dysfunctional features of the unemployment compensation (UC) system, and that is extended benefits. As you know, the Employee Benefit (EB) program is very important for workers in states that have gone into an extended recession. However, right now, the triggers don't work.

Is the extended benefits system something that needs to continue to be part of the UC system? How would you recommend we change the current trigger mechanism, so that we are not making arbitrary decisions in congress as to when to turn it on, turn it off, and for what states?

Mr. REICH. Yes. We went through this in the past two recessions, Congressman, and I think, again, we haven't repealed the business cycle, although the business cycle is more modulated than it has been, or was 20 or 30 years ago. However, extended unemployment insurance is going to be necessary. It is a necessary part of the system.

I am not prepared right now to offer you a perfect formula, but I think you are on the right track. I think Congress needs to look and see how that formula can be changed, so that Congress is not forced to continuously revisit the issue every time there is a recession.

Mr. ENGLISH. Let me just make the standing offer, if you do have any suggestions, I, for one, would very much welcome them, because this is an area of great interest, particularly representing, as I do, a state like Pennsylvania.

You have advocated here for extending unemployment insurance to part-time workers. I have seen, over the years, many proposals to do that. How do you avoid the problem of moral hazard implicit in any insurance program, that by designing a program for part-time workers, you create an opportunity for employers to design employment opportunities that, in effect, allow the rest of the employment base to subsidize their part-time employment?

You took a question from Mr. McDermott which was similar. However, I wonder, do you see any problems around the edges with designing this extension of the program?

Mr. REICH. As long as the recipient of the benefit goes into a new part-time job that has as many hours as the old part-time job—that is, what you don't want to do—and here, I think, is your moral hazard issue—you don't want to create, through wage insurance, for example, an incentive for people to move from full-time job, and reduce the hours of work, and thereby use the wage insurance as a vehicle for subsidizing their move to fewer hours.

With regard to unemployment insurance, I don't see the problem on the employer's side, if that's what you're getting at, because employers have every incentive to pay individuals the marginal value of their employment, as long as that employer is in a competitive labor market, and has to pay people what they are "worth," in economic terms.

Mr. ENGLISH. However, the flip side of it is that we do have employers who provide high value-added full-time jobs, who also strongly support the UC system by providing the employer-end of those UC taxes. This is still a system based mostly on employer taxes.

On that point, are there not situations where employers in certain industries which tend to produce part-time jobs, in effect, could, under what you have proposed, be subsidized by employers that produce good, full-time jobs?

Mr. REICH. Well, first of all, Congressman, there is always, in every system, at the margin—as you've said, you used the term "at the margin"—a moral hazard problem. However, let me just say that if an employer is providing a part-time job, and that employer is in competition with other employers offering either part-time or full-time jobs for employees, there is no reason to suppose that that employer is going to be able to get employees at less than the going rate, given that employee's marginal value.

Mr. ENGLISH. Understood. Last question, quickly. Unemployment benefits used to be tax-free, prior to the 1986 tax. I am a strong advocate of rolling back the tax on unemployment benefits. Some have criticized the idea as, believe it or not, tax cuts for the rich. I think it's tax cuts for workers who are represented by unions, and who are commanding higher wages, as a result.

Any thoughts on whether unemployment benefits should be tax free?

Mr. REICH. I am in favor of making every benefit tax free, but then there is this question, Congressman, of how you pay for the benefit.

Mr. ENGLISH. Thank you very much. I sense I am chopped off here.

Chairman MCDERMOTT. The reality hits the road. Mr. Porter.

Mr. PORTER. Thank you, Mr. Chairman, and I appreciate the secretary being here today. I periodically hear folks say things were better in the good old days, and I hear that frequently. Probably, in some respects, they are.

Also, you mentioned about the polls today. Of course we can look at polls in many different ways, and especially in Washington we use them to our own gain. However, you mentioned that in 1997—well, today, let's move to today, and I will go back to 1997—that 60-some percent today are not happy, and feel less job security than did a generation ago. However, if we go back to the polls that were done in 1997, actually, it was higher. It was almost 70 percent of those that felt that they had insecurity regarding their job. How do you explain that, in today's terms?

Even in 1997, back when the Clinton Administration was in place, security was less.

Mr. REICH. Well, some of this, obviously, Congressman, is affected by the business cycle. However, I included data in my testimony from the Michigan panel on income dynamics, in which they have studied 65,000 people over decades, to try to get a sense of what the actual cycles are in their own income, and in their own wage and job experiences.

What that panel study shows is that average working Americans are seeing greater instability of income and job today than they saw 10 years ago or 20 years ago.

Mr. PORTER. To Pew, that's not the case.

Mr. REICH. I'm sorry?

Mr. PORTER. According to the Pew Research Center, that's not the case.

Mr. REICH. Well, I am happy to exchange with your staff all of the information I have, and I have published some of it, many colleagues working in—with the data have shown that economic insecurity is greater today, controlling for the business cycle.

Maybe it could be that the difference in data that we're seeing has to do with where we are in the business cycle.

Mr. PORTER. Actually, I am using from your testimony. You cited the Pew social trends poll, August——

Mr. REICH. Yes, but Congressman, let me just emphasize that not only do the academic researchers find greater insecurity in this decade than in previous decades, but also the opinion polls, Gallop and most of the Roper polls—and, again, I am happy to supply your staff with them—are showing greater degrees of job insecurity and wage insecurity.

Mr. PORTER. I had a poll about a month ago that I gave to Ways and Means from the USA Today stating just the opposite, again. So, I guess enough said on the polls.

However, you also mentioned that a supplement—you would want this proposal to be a supplement, and not a substitute. So, how is that not a tax increase?

Mr. REICH. Well, are you talking about the wage insurance, or are you talking about filling in the holes? You're talking about wage insurance?

Mr. PORTER. Yes.

Mr. REICH. Well, here again, I did not say that it would not be a tax increase, in terms of wage insurance. I said that with regard to filling the holes in the unemployment insurance, my understanding of the proposal is that it would require continuing the FUTA surtax, which even—again, my understanding is that the President has included a continuation of that surtax, which has been continued for 30 years, in his proposed budget.

Undoubtedly, if you're going to go beyond that and provide wage insurance, there would have to be some funding of that wage insurance, and that would include a tax—a slight increase, a small increase—on employers, with regard to unemployment insurance.

Moreover, the issue here, Congressman, is whether it's worth it. I—and I am sure you are not, either—am not doctrinaire, as to whether taxes are good or bad. It always depends on whether the public benefits exceed the cost of the taxes.

Given what I have—and, again, my testimony, I hope, reflects this—what I have seen, and what I have understood about the labor force is that there is a need for some cushions. Otherwise, we are facing not only a great deal of economic pain and stress, but also a backlash against the whole concept of free markets and free trade.

Mr. PORTER. Since the 1930s, it has really been driven by the states, don't you think?

Mr. REICH. I'm sorry?

Mr. PORTER. Since the thirties, it has really been driven by the states. This is a substantial change. However, why not go with something like Mr. Weller is suggesting, giving the states more flexibility?

Mr. REICH. I am personally in favor of a great deal of flexibility. However, as I stressed, wage insurance should not be a substitute for unemployment insurance. I fear that if the states were given enough flexibility to do the wage insurance through the unemployment insurance system, as it is now, that there might be too much pressure on states, given pressure on state budgets, to reduce other aspects of unemployment insurance.

Therefore, the wage insurance becomes—starts to become—a substitute for unemployment insurance. I don't think that is fair to American workers, and I think it would also generate a huge amount of opposite.

Mr. PORTER. My final comment, I appreciate your passion on this, and your attempts to make the system better. Thank you very much.

Mr. REICH. Thank you.

Chairman MCDERMOTT. We thank you very much for coming to Washington, D.C. to see old friends, and we hope you will come again before the Committee.

Mr. REICH. Well, thank you very much, Mr. Chairman, and thank you, Members of the Committee.

Chairman MCDERMOTT. The next panel—if you will assemble at the table—I will begin to introduce you, as you're sitting down.

Ms. Lee is from the AFL–CIO, the assistant director of public policy. Mr. Rosen is a visiting fellow with the Peterson Institute for International Economics. Maurice Emsellem is the policy director for the National Employment Law Project, and Mr. Holmes is president of UWC, which is a strategic services on unemployment and worker's comp. Acronyms in Washington, D.C. have to be explained.

We welcome all of you. Your whole testimony will be entered into the record. We would like you to take 5 minutes to give us an overview of what you want us to know. Ms. Lee, will you begin?

STATEMENT OF THEA LEE, ASSISTANT DIRECTOR OF PUBLIC POLICY, AFL–CIO

Ms. LEE. Thank you very much, Mr. Chairman, Members of the Subcommittee, for the opportunity to talk about these two important topics that are before you.

The two issues include, first, proposals that have been put forward to strengthen and modernize the unemployment insurance system, and second, to provide wage insurance, wage subsidies for workers who take new jobs that pay less than their old jobs.

On the first topic of unemployment insurance modernization, we have been asked to comment on the proposed legislation that would distribute as much as $7 billion from the Federal UI trust funds over 5 years, to encourage states to modernize their UI programs. The AFL–CIO has strongly supported, many of these proposals over the years, and we welcome the proposal by Chairman McDermott.

This proposal correctly rewards states that have been leaders in building a stronger UI system, and incorporates some of the best UI reforms that have been pioneered in the states. So, we applaud the Chairman for taking this initiative, and we look forward to working with him to enact this bill.

We did want to add one point. While this proposal is an important step forward, it doesn't address all the shortcomings of the UI program. For example, much work needs still to be done to restore UI eligibility to a higher percentage of the workforce, to restore higher benefit levels, to repair the dysfunctional extended benefits program, as was recently discussed, and to address the severe underfunding of UI and the employment service administration.

However, we are really pleased to see this legislation on the table, and we look forward to working closely with you as it is implemented.

The second proposal that we came to talk about is the wage insurance proposal. It would cost approximately $3.5 billion per year, and would create a universal wage insurance program for displaced workers. This builds on the experience we had with the pilot program in the trade adjustment assistance program that is now available only to certain workers over 50 years of age who lose their jobs because of trade.

We do have some serious concerns with this proposal, and I would like to summarize them briefly. You all have my written testimony. There are some contradictions in what the proponents of the wage insurance program have put forward, what their arguments are of what the benefits would be, and what we know about the research.

There are three sets of problems that we wanted to talk about today, and the first is whether wage insurance is a well-defined program that would fit into what we would call a good jobs strategy, a national good jobs strategy. I'm pretty sure everybody in this room would agree that wage insurance isn't the only jobs program we need, and would also agree that we have a lot of challenges, in terms of getting the right macro-economic policies, labor market regulations, trade policies, tax policies, infrastructure, and investment in education and training. Those are the broader foundation of national good job strategy. I go into more detail in my written testimony.

The key part to that is increasing the bargaining power of workers, giving them the skills that they need to compete in a global economy. However, also, providing the regulatory framework that would support the creation of good jobs, and the investment that this country needs to make in good jobs.

In our view, wage insurance does not help workers get good jobs. On the contrary, the most frequently invoked rationale for wage insurance is that it promotes rapid re-employment by encouraging workers to look for, consider, and accept lower-paying jobs they would not otherwise take.

Getting workers to take bad jobs quickly is not part of what we would consider a good jobs strategy. It only really makes sense if workers are getting useful skills and moving up the job ladder in the 2 years in which they're in the lower-paying jobs, receiving the wage subsidies.

Our reading of the research on this is that this is based, essentially, on wishful thinking on the part of the proponents. I think people are well meaning, who have put this proposal forward. They do want to help workers, they want to improve the function of the labor market.

One of the key arguments that has been made is that workers who receive wage insurance would receive on-the-job training of a higher quality than that provided by training programs. In fact, what the research shows is that lower-wage employers are the least likely to offer on-the-job training that provides transferable skills, that most of the on-the-job training that happens in the U.S. labor market is in the high-skilled, high-paid jobs.

There is nothing about the wage insurance program that requires employers to offer on-the-job training, or that monitors whether they have provided on-the-job training, or provided any kind of skill ladder or wage ladder.

Our fear is that workers would be induced to take a job, if, in fact, the wage insurance works as its proponents argue it should, to get workers more quickly into the labor market, sit in that job for two years, and at the end, emerge still in a low-paid job, and without the skills they might have gotten, or without the job that might have provided health care and a decent wage.

The second issue is whether the wage insurance program would, in fact, divert needed resources from other training programs, and other programs that serve displaced workers. The concern that we have was reinforced by Mr. Weller's proposal that, in fact, this program be funded through taking funds out of the unemployment insurance system.

It is a fact that resources are tight, and that we need to make sure that every dollar that we spend, every new tax dollar, is spent in the most appropriate way possible. Our concern is that the wage insurance program does not meet that test, that it would have unintended consequences of promoting downward mobility, possibly crowding out lower-skilled workers from other jobs, and in that sense, would have some possible pernicious, unintended side effects, and divert resources from other needed programs.

So, we look forward to your questions, and we thank you very much for the opportunity to be here today.

[The prepared statement of Ms. Lee follows:]

Statement of Thea Lee,
Assistant Director of Public Policy, AFL–CIO

Thank you, Chairman McDermott, and members of the Subcommittee, for this opportunity to testify on two forthcoming legislative proposals: one to strengthen and modernize the unemployment insurance (UI) system; the other to provide wage subsidies for workers who take new jobs that pay less than their old jobs (called "wage insurance").

UI MODERNIZATION

Chairman McDermott has asked us to comment on proposed legislation that would distribute as much as $7 billion from the federal UI trust funds over five years to encourage states to modernize their UI programs. For many years the AFL–CIO has strongly supported several of the specific items in this legislation, which we believe would make significant progress towards strengthening the UI system.

Under Chairman McDermott's proposal, one-third of the maximum grant amount available to each state would be distributed if the state counts workers' most recent wages for purposes of determining UI eligibility. Using such an "alternative base period" would address one of the most significant gaps in UI coverage by expanding eligibility for predominantly low-income workers who have paid into the UI system and earned qualifying wages. The AFL–CIO participated in the Advisory Council on

Unemployment Compensation (ACUC), which recommended this particular reform in 1996, and since then we have consistently supported legislation to establish incentives for states to use an alternative base period.

The remainder of the maximum grant amount available to each state would be distributed if a state meets two of three additional conditions: (1) it provides extended unemployment benefits for workers enrolled in state-approved job training; (2) it provides for the UI eligibility of workers seeking part-time work; or (3) it provides for the UI eligibility of workers who quit their jobs due to compelling personal circumstances (domestic violence, caring for a disabled family member, or following a spouse who has been relocated).

First, we believe that providing incentives for states to support workers enrolled in training programs for high-demand occupations is an especially good idea that fits within a broader strategy of helping workers get good jobs. Similar programs in seven states have produced impressive outcomes with regard to employment and wage replacement.

Second, the ACUC also recommended promoting UI eligibility for workers seeking part-time work, and since 1996 the AFL–CIO has consistently supported legislation to establish financial rewards for states that adopt this reform.

Third, providing incentives for states to accommodate workers' compelling personal circumstances recognizes and rewards groundbreaking reforms that are especially important to women with families.

Finally, Chairman McDermott's bill would distribute to the states a total of $100 million per year over five years for the purpose of administering these reforms and making other improvements in the administration of the UI and Employment Service (ES) system. Since 2001, federal funding for administration of the UI system has been cut by $305 million in real terms despite increasing demands on the system.

Chairman McDermott's proposal correctly rewards states that have been leaders in building a stronger UI system, and incorporates some of the best UI reforms that have been pioneered in the states. We applaud the Chairman for taking this initiative and we look forward to working with him to enact this bill.

While Chairman McDermott's proposal is an important step forward, we realize that it does not address all the shortcomings of the UI program. For example, much more needs to be done to restore UI eligibility to a higher percentage of the workforce, to restore higher benefit levels, to repair the dysfunctional extended benefits (EB) program, and to address the severe under-funding of UI and ES administration. The National Association of State Workforce Agencies (NASWA) has recommended a special distribution of $2.4 billion over three years for administration of the ES/UI system, and this figure does not take into account the additional administrative needs arising from this legislation.

WAGE INSURANCE

Chairman McDermott has also asked us to comment on proposed legislation costing approximately $3.5 billion per year that would create a universal wage insurance program for displaced workers—far larger than the small pilot program within the Trade Adjustment Assistance (TAA) program that is available only to certain workers over 50 years of age who lose their jobs because of trade. There are three main points I would like to make about this proposal.

1. Wage insurance does not fit within a "good jobs" strategy.

America is hemorrhaging good jobs, wages are stagnating, and the system of employer-provided health and pension benefits is being eroded. America is in dire need of a good jobs strategy. Such a strategy should strive to create good new jobs; to transform bad jobs into good jobs; to improve the effectiveness of programs that connect workers with the good jobs that are available; and to improve the effectiveness of job training and education programs that help workers qualify for those good jobs.

A strategy to ensure that good jobs are available in the first place must include (1) balanced monetary and fiscal policies to promote full employment; (2) robust investments in communications and transportation 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 policies that discourage downward competition in wages and benefits and the off-shoring of good jobs; (5) sectoral strategies in emerging sectors of the economy, such as renewable energy technologies, building on successful labor-management models in manufacturing, 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.

Wage insurance does not help workers get good jobs. On the contrary, the most frequently invoked rationale for wage insurance is that it promotes "rapid reemployment" by encouraging workers to look for, consider, and accept lower-paying jobs they would not otherwise take.[1] Getting workers to take bad jobs does not fit within any good jobs strategy we would propose.

In fact, getting workers to take bad jobs is not a worthy objective at all. Our national focus cannot be rapid reemployment to the exclusion of job quality, because this would argue for the elimination of all assistance for displaced workers. It is undoubtedly true that eliminating all assistance for displaced workers would result in more higher-skilled workers finding reemployment more quickly at Wal-Mart and McDonald's, but this would hardly be a desirable outcome for higher-skilled workers, for the lower-skilled workers they displace, or for the economy as a whole.

Helping workers find rapid reemployment in good jobs is a worthy objective, but our priority should be job quality. It is possible to reconcile job quality with rapid reemployment: for example, the Clinton administration created a grant program to provide reemployment services for UI claimants, but the Bush administration defunded the program in its FY 2006 budget. In addition, the Employment Service (ES) provides workers with information they need to find good jobs that match their skills, and in 2000 the Labor Department noted that every $1 spent on reemployment services produces $2.15 in savings to the UI trust funds.[2] But the Bush administration cut ES funding by $256 million in real terms between 2001 and 2007.

To the extent that a wage insurance program diverts resources away from ongoing efforts to help workers get good jobs, or to improve that assistance, it amounts to giving up on workers. Even if wage insurance is funded with new revenues, this is money that could be used to create good jobs and help displaced workers get those jobs.

Proponents of wage insurance sometimes argue that the existing job training programs do not work. It is true that some job training programs—particularly the less costly shorter-term training promoted under the Workforce Investment Act (WIA)—are less effective than others, but there are also many examples of effective training programs. The answer is to improve the effectiveness of job training programs, not to encourage workers to forego job training.

Proponents of wage insurance routinely argue that wage-subsidized workers would receive on-the-job training of a higher quality than that provided by training programs.[3] We know of no basis for this argument. In fact, lower-wage employers are the least likely to offer on-the-job training that provides transferable skills.

Research has established that the probability of workers receiving workplace education is directly proportional to their wage and education levels. Workers with the highest wages and the most formal education receive the most extensive workplace education, while workers with the lowest wages and least education receive the least extensive workplace education.[4]

Workers who accept lower-wage employment because of wage insurance are likely to be no better off at the end of their eligibility period. They will have foregone any opportunities to engage in a more fruitful search for a good job or to improve their skills or education level to qualify for a good job. As a result, we are concerned that the earnings potential of many participants could be negatively affected. Oddly enough, it is often the proponents of wage insurance who emphasize that education

[1] *See, e.g.,* Howard Rosen, Testimony Before the Ways and Means Subcommittee on Human Resources (May 4, 2006) ("Wage insurance is specifically designed to encourage people to return to work sooner than they might have otherwise"); Robert Litan, Lael Brainard, and Nicholas Warren, "A Fairer Deal for America's Workers in a New Era of Offshoring," Brookings Institution (May 2005) ("A main purpose of wage insurance is to accelerate the pace at which permanently displaced workers are reemployed").

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

[3] *See, e.g.,* Lael Brainerd, Testimony Before the Joint Economic Committee (February 28, 2007) ("The retraining that a displaced worker receives on a new job provides new skills that contribute directly to his or her performance in the new job and is thus directly useful not only to the worker but also to the new employer"); Howard Rosen, Testimony Before the Ways and Means Subcommittee on Human Resources (May 4, 2006) ("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"); Robert Litan, Lael Brainard, and Nicholas Warren, "A Fairer Deal for America's Workers in a New Era of Offshoring," Brookings Institution (May 2005) ("The retraining that displaced workers receive on a new job is the best kind—in sharp contrast to generalized training programs such as those available under TAA").

[4] See Ahlstrand, Bassi, and McMurrer, Workplace Education for Low-Wage Workers, W.E. Upjohn Institute for Employment Research (2003).

and training are the key to ensuring that the gains from economic growth are shared more broadly.[5]

2. Advocates of wage insurance have proposed diverting resources from already under-funded programs serving displaced workers.

We understand that Chairman McDermott has no intention of substituting wage insurance for existing programs that assist displaced workers. However, this is precisely what other advocates of wage insurance have proposed.

Wage insurance has repeatedly been proposed as a substitute for the UI program.[6] At a May 4, 2006 hearing of this subcommittee, the Bush administration proposed legislation that would permit the diversion, without limitation, of state UI trust funds to pay for wage insurance.[7] Then last September a paper commissioned by the Hamilton Project proposed diverting two-thirds of aggregate UI funding to pay for wage insurance.[8] And just last month the Bush administration again included the same legislative proposal in its FY 2008 budget.[9]

Wage insurance has also been proposed as a substitute for the TAA program. The conservative Heritage Foundation has proposed replacing the TAA program in its entirety with wage insurance.[10] Sen. Baucus (D–MT) alluded to such proposals in May 2002: "There are those who would like to abandon traditional TAA entirely in favor of wage insurance. If this experiment [the TAA pilot program] succeeds, that may be just the course we decide to take in a few years."[11]

We are concerned that resources may be diverted away from TAA and the UI–WIA system if workers' choices are structured so that they "choose" wage insurance over alternative forms of assistance. This choice will not be a meaningful reflection of worker preferences, however, if the alternatives to wage insurance are rendered unattractive or inaccessible. Already, workers who want to enroll in TAA job training are being denied access due to funding shortfalls, and the Bush administration's proposed TAA regulations would restrict access even further. Funding shortfalls and the Bush administration's emphasis on rapid reemployment are already limiting access for non-trade-affected workers who want to enroll in quality WIA job training,

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[5] *See, e.g.,* Prof. Lawrence Summers, Testimony Before the Senate Finance Committee (March 8, 2007) ("It is particularly important that investments [in education be made to ensure all of our citizens have a chance to fully participate and share in our prosperity—I believe it is also appropriate that consideration be given to thinking about methods of wage insurance"); Deputy Assistant Secretary of Labor Mason Bishop, Testimony Before the Ways and Means Subcommittee on Human Resources (May 4, 2006) ("the data—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, et cetera, apprenticeship programs—That is how people's wages are going to rise—We have many, many individuals who, with better access to post secondary education and training, could get higher wages").

[6] *See, e.g.,* Robert Reich, "Despite the U.S. Boom, Free Trade Is Off Track," *Los Angeles Times (online)* (June 18, 1999) ("Turn unemployment insurance into wage insurance. Unemployment insurance was originally intended as temporary income support during economic downturns, until the old jobs returned. But it is less relevant today, when most workers who lose their jobs never get them back. Their major worry is that the new job will pay less"); Timothy Kane, Heritage Foundation, Transcript of Hearing of the Ways and Means Subcommittee on Human Resources (May 4, 2006) ("I would want to encourage the states to experiment with radical freedom on how they do UI and wage insurance").

[7] Unemployment Compensation Program Integrity Act of 2006 (May 3, 2006) ("The Secretary of Labor may waive the requirements of—the Social Security Act to permit an exception to the requirement that money withdrawn from the unemployment fund of the state be used solely for the payment of unemployment compensation" if the waiver will assist in "accelerating the reemployment of individuals who establish initial eligibility for unemployment compensation"); "Administration Wants UI Income Maintenance Strategy Waivers," *Employment and Training Reporter* (May 15, 2006) ("The Bush administration is asking Congress for authority to grant waivers of federal unemployment insurance policies that would allow states to implement novel strategies aimed at accelerating claimant reemployment—Deputy Assistant Secretary for Employment and Training Mason Bishop told the subcommittee—Perhaps states would subsidize new-hire wages through wage insurance,' he said")

[8] Jeffrey Kling, "Fundamental Restructuring of Unemployment Insurance," The Hamilton Project (September 2006).

[9] U.S. Department of Labor, "FY 2008 Budget Justification of Appropriation Estimates for Committee on Appropriations," (February 2007), at SUIESO 25–26.

[10] Denise Froning, "Trade Adjustment Assistance: A Flawed Program," The Heritage Foundation (July 31, 2001) ("The current TAA program has failed to provide effective assistance, one of the crucial factors for a successful adjustment program. If the aim of such programs is to help workers find new jobs, then the TAA should be eliminated over time and replaced by a program that provides incentives, not disincentives, for workers to do just that. Wage insurance is one such proposal that has won widespread support").

[11] Sen. Baucus, *Congressional Record* (May 2, 2002), at S3795.

and the administration's proposed WIA regulations would restrict access even further.

The supposed cost advantages of wage insurance would create an incentive to structure workers' choices in this way. Some advocates of wage insurance argue that it would be less costly per worker than TAA.[12] Others conclude that wage insurance would be less costly per worker than UI.[13]

We are especially concerned that workers' choices would be structured in this way because of the known philosophical preference, on the part of some, for promoting rapid reemployment without any consideration of job quality. Critics of the UI–WIA system and TAA have traditionally argued that the availability of income support and job training creates a "moral hazard" that encourages workers to stay unemployed longer. By contrast, the leading argument for wage insurance is that it would counter this "moral hazard" by encouraging workers to take lower-paying jobs that they would not otherwise search for, consider, or accept, and thereby reduce the duration of their unemployment spell.[14]

The issue of rapid reemployment is certain to arise when Congress next considers extending federal unemployment benefits during a recession. We know exactly what these debates look like. In 2001, 2002, and 2003, opponents of an extension argued that unemployment benefits prolong unemployment, and used inflated numbers to claim that laid-off workers already receive generous amounts of assistance. If this pattern repeats itself, the existence of a wage insurance program designed to promote rapid reemployment will be used as an argument against extending jobless benefits. And if this argument is successful, wage insurance will substitute for, rather than complement, unemployment benefits.

We fully appreciate that Chairman McDermott has no intention of financing his wage insurance proposal through the unemployment payroll (FUTA) tax system. Instead, his proposal would be financed through a new dedicated payroll tax of 0.1 percent of wages up to the taxable wage base of the Social Security program, which is currently $94,000 per year. But if there is bipartisan agreement on the design of a wage insurance program, we question whether it is realistic to expect defenders of the UI system to prevent the diversion of UI resources by insisting on an increase in payroll taxes.

It would be especially unfortunate if wage insurance were financed by revenues from extension of the 0.2 percent FUTA surtax. The FUTA surtax is scheduled to expire in December 2007, but for the last two years the Bush administration has proposed a five-year extension. The surtax generates $7.4 billion over five years. We believe that any additional revenues from unemployment payroll taxes should be used solely to fund modernization of the UI system, and not for wage insurance.

3. Further study would be necessary to resolve the many unanswered questions about a universal wage insurance program—including potential harm to workers.

There has been remarkably little research into the possible consequences of a universal wage insurance program, and the empirical data on wage insurance is scarce.

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[12] Lael Brainerd, Testimony Before the Joint Economic Committee (February 28, 2007) ("On a per worker basis, this cost falls midway between the current unemployment and retraining benefits available under UI and Worker Investment Act (WIA) programs and the comprehensive costs of TAA benefits"); *see also* Sen. Baucus, *Congressional Record* (January 4, 2007) ("Wage insurance—can even save money over traditional Trade Adjustment Assistance.")

[13] Howard Rosen, Testimony Before the Ways and Means Subcommittee on Human Resources (May 4, 2006) ("Wage insurance is also a less expensive form of assistance than unemployment insurance").

[14] See, e.g., Lori Kletzer, "Hamilton Project Media Call on Income Stability Among American Families" (September 12, 2006) ("Part of its genesis came around in thinking about unemployment insurance itself. That is, unemployment insurance has a recognized distortion in the sense that you only collect UI if you remain unemployed. So there's a whole labor supply disincentive. Well, if one becomes eligible for wage loss insurance, only when you become reemployed, then there's a counter to that distraction—So it can counter the disincentive—More jobs look interesting or possible in the presence of wage insurance because if somebody who is making under $50,000 a year has to think about going from a job with tenure to a reentry job, with wage insurance, those jobs start to look a little more attractive. Jobs that were spurned won't be so spurned—it's a program that actually addresses in very important ways some issues that are out there regarding unemployment durations and job search"); Howard Rosen and Lori Kletzer, "Reforming Unemployment Insurance for the 21st Century Workforce," The Hamilton Project (September 2006) ("Wage-loss insurance has some clear roots in the literature of optimal UI policy design, most clearly as a response to moral hazard concerns arising from a UI-recipient worker's reduced incentive to leave unemployment due to a reduction in the net return to securing a job"); Jeffrey Kling, "Meeting the Challenges of the Global Economy," Brookings Institution Transcript (July 25, 2006) ("Receipt of UI benefits encourages longer unemployment spells—The new system [of wage insurance would also introduce incentives to reduce unemployment—by creating stronger rewards for finding another job quickly").

Our only real experience with wage insurance is with two pilot programs—one a short-lived pilot in Canada and the other an ongoing pilot with the TAA program. Further study would be necessary to resolve the following issues:

To what extent would a universal wage insurance program shorten unemployment spells? Although rapid reemployment is the leading rationale for wage insurance, there has been relatively little study of this question. The Canadian pilot program showed only a small impact on unemployment spells.[15]

To what extent would a universal wage insurance program induce workers to accept lower-wage employment they might otherwise refuse? In 1995 the Upjohn Institute performed the only economic modeling to date on wage insurance and concluded that it "would induce dislocated workers to search harder for jobs and accept employment that they might otherwise refuse."[16]

Would these lower-paying jobs lack benefits such as health insurance? We know that workers who collect unemployment benefits, by contrast, are more likely to find a new job with employer-provided health insurance.[17]

What portion of wage subsidy recipients would have taken lower-paying jobs even without the subsidy? Some proponents of wage insurance argue that its purpose is to provide income support for workers who would take lower-wage jobs even without the subsidy, while acknowledging that it will induce some workers to take lower-paying jobs.[18] However, it is unknown what portion of subsidy recipients would take lower-paying jobs even without the subsidy. The smaller the portion of recipients induced to take bad jobs, the less the potential harm to workers.

To what extent would the employment of wage-subsidized workers displace other workers? The Upjohn Institute's economic modeling found that the employment gains from wage insurance came almost completely at the expense of employment for other workers.[19] If wage insurance turns out to be simply a game of musical chairs, encouraging workers laid off from highly-paid jobs to take lower-paying jobs that would otherwise go to workers with less skill and experience, then it raises serious equity concerns.

To what extent would employers provide subsidized workers with on-the-job training? Proponents of wage insurance regularly argue that wage insurance acts as a subsidy for employers to provide on-the-job training.[20] But Chairman McDermott's proposal contains no requirement that employers provide any on-the-job training at all. Wage insurance is a particularly poor policy choice for subsidizing on-the-job training. The Job Training Partnership Act (JTPA) required that on-the-job training lead to a progression of job skills and higher wages, with protection against displacement of other workers, and that labor organizations be consulted so that subsidized training met quality standards and linked workers to good jobs.

To what extent would any on-the-job training given by employers provide transferable skills? Again, we know of no basis for the claim that employers of wage-subsidized workers would provide better on-the-job training with transferable skills. Chairman McDermott's proposal contains no requirement that on-the-job training lead to a progression of skills or higher wages.

To what extent would a large-scale universal wage insurance program subsidize low-wage employers such as Wal-Mart? If wage insurance advocates are correct that

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[15] Bloom, et al. "Testing a Reemployment Incentive for Displaced Workers: the Earnings Supplement Project," Social Research and Demonstration Corporation (May 1999), at 39.

[16] Carl Davidson and Stephen Woodbury, "Wage-Rate Subsidies for Dislocated Workers," Upjohn Institute (January 1995).

[17] Heather Boushey and Jeffrey Wenger, "Finding the Better Fit," Economic Policy Institute (April 2005).

[18] Jeffrey Kling, "Meeting the Challenges of the Global Economy," Brookings Institution Transcript (July 25, 2006) ("The new system [of wage insurance would also introduce incentives to reduce unemployment—by creating stronger rewards for finding another job quickly").

[19] Carl Davidson and Stephen Woodbury, "Wage-Rate Subsidies for Dislocated Workers," Upjohn Institute (January 1995) ("But the simulations also raise the possibility that the gains for dislocated workers could come at the expense of other groups of workers; that is, other groups of workers could experience small increases in employment duration, and decreases in employment levels, that almost fully offset the gains for dislocated workers").

[20] Joint Economic Committee, "Meeting the Challenge of Household Earnings Instability" (March 2007) ("Perhaps most importantly, wage insurance would subsidize the hiring and training of workers who transition into new jobs or sectors"); Lael Brainerd, Testimony Before the Joint Economic Committee (February 28, 2007) ("Wage insurance can act as a subsidy of on-the-job training for the worker's new employer"); Robert Litan, Lael Brainard, and Nicholas Warren, "A Fairer Deal for America's Workers in a New Era of Offshoring," Brookings Institution (May 2005) ("The second critical value of wage insurance is that it acts like a training subsidy for the new employer"); Sen. Baucus, *Congressional Record* (January 4, 2007) ("Wage insurance provides an incentive for employers to hire lower-skilled and older workers and train them on the job").

wage insurance acts as a subsidy to employers, recipients of the subsidy would be, by definition, lower-wage employers. And the amount of the subsidy would be greater for employers such as Wal-Mart that pay lower wages than their competitors, such as Costco.

To what extent would employers be able to capture the subsidy by paying subsidized workers less than they would otherwise? Wage insurance can act as a subsidy for employers only if employers are able to pay program participants, or other employees, less than they would otherwise pay. It is sometimes assumed that employers will not know the identity of workers who are eligible for wage insurance, but this assumption is questionable. Any employer would be able to identify former Boeing workers after a Boeing layoff in Seattle, or former Delphi workers in Flint, Michigan, or former employees of any large employer whose layoffs are publicized.

To what extent would wage subsidies lower wages for non-recipients? Subsidized employers might further benefit from a reduction of wages resulting from an increase in the total labor supply [21] or from an increase in the number of workers willing to work for lower wages.

To what extent would the availability of a program designed to promote "rapid reemployment"—such as wage insurance—be used as an argument against strengthening programs serving displaced workers that have historically been attacked for prolonging unemployment? To what extent would it enable critics of programs serving displaced workers to make them less accessible or less attractive?

CONCLUSION

We strongly support Chairman McDermott's proposal to strengthen and modernize the UI system, and we look forward to working with him to enact this legislation. We believe available budgetary resources should be dedicated on a priority basis to a good jobs strategy, which includes strengthening the UI program and other severely under-funded programs that provide assistance for displaced workers. But we believe it makes little sense to divert scarce budgetary resources away from a good jobs strategy towards proposals that are specifically designed to induce workers to take lower-paying jobs. And further study would be necessary to determine whether a universal wage insurance program adversely affects workers by promoting downward economic mobility, diverting resources away from severely under-funded programs that serve displaced workers, subsidizing lower-wage employers such as Wal-Mart, and causing job loss for lower-skilled workers.

Chairman MCDERMOTT. Thank you.

Mr. Rosen.

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

Mr. ROSEN. Thank you very much, Mr. Chairman. To the Committee, I appreciate the opportunity to be here to discuss an issue that I think has been ignored for too long, and is one of the most important issues in this country to millions of people.

Mr. Congressman, your proposals, I think, go very far in improving the relevance of the unemployment insurance program to current labor market conditions. They are probably the most ambitious proposals in the last decade. I applaud you for them.

You will hear in the discussion some disagreements on specific aspects of your proposals. However, I think it's very important to understand that I think all of us agree that unemployment insurance is a bedrock in this country, and we need to strengthen it, so that all people have access to it.

Unemployment insurance cannot be a substitute for sound, economic policies that create high-wage, high-skilled jobs. Similarly, wage insurance cannot be a substitute for unemployment insur-

[21] Jeffrey Kling, "Responses to Questions About Fundamental Restructuring of Unemployment Insurance"' (September 2006) ("increases in total labor supply from wage-loss insurance may reduce wage levels, in the same manner as any other policy that encourages work").

ance. Let me just take a second to talk about some of the major changes in the labor market that have taken place over the last couple of decades. Please, keep in mind the fact that our unemployment insurance system has not kept pace with these changes.

The first is that the unemployment rate has been falling. The economy is doing better. However,, on the other hand, the duration of unemployment has been rising. If you look carefully at this graph, the gray areas are recessions. You see something very interesting. The duration of unemployment continues to rise after the end of a recession. Recessions are getting shorter, but the labor market conditions continue to worsen after recessions.

As Secretary Reich mentioned, this is radically different from the labor market of the past, which was basically short-term unemployment during cyclical downturns. In many cases, people went back to their previous jobs. This is no longer the case. If you are one of the unlucky people in this country to lose your job, and the percentage of people losing their jobs is smaller today, the costs on you are much higher than they were in the past.

If I could ask you to remember one chart, it is this chart. This is what happens to people who are seriously dislocated. I am not talking here about the transitional unemployment. These are people who lose their jobs and their occupations. About a third of these people, between one and 3 years after layoff, do not find re-employment. Forty percent of them— and this is only in manufacturing— take a new job and experience an earnings loss, a long-term, lifetime earnings loss. Only one-quarter of people end up better off, in terms of wages, after their unemployment.

Let me just jump ahead and say a wage-loss insurance system, however it is structured, would immediately help those 40 percent, which is the largest share of people.

Here are the same data for workers from the service industries. It's pretty much the same. The point being is that the labor market these days is not just a manufacturing issue any more. It's a total employment issue. It is manufacturing and services.

The unemployment insurance system has remained the same, despite major changes in the labor market. I can go into that in a little more detail in our discussion. As a result, only about one-third of unemployed people in this country get unemployment insurance. If you are lucky enough to get it, the average across the nation is $260 a week.

Now, what we have always been saying is that $260 is below the poverty rate for a family of 4. The $260 is now below the minimum wage which Congress is currently considering. What is the point? On what basis are we setting that number? As mentioned by Congressman English, the extended benefit triggers are broken. They are not automatic. The extended program has not worked in the last two recessions.

In addition, let me add something. Extended unemployment insurance program is also relevant in cases of Katrina, or natural disasters. We had problems in those cases, providing long-term unemployment insurance to those people, because the triggers were broken.

One of the reasons why we have additional money left in the UI trust fund is because we haven't been using it for extended benefits. Congress has taken that money out of general revenue.

There has been a lot of concern this morning about fiscal policy. Would it not be better to have a healthy extended benefit program that uses money from the trust fund, and not money out of general revenue?

Here, I think, is the most egregious problem. Congressman Weller, you made a statement, I think, that reflects a lot of people's thinking, which is that payroll taxes are egregious, and they hurt the creation of employment. Many studies do not confirm this. However, if you believe that, the current structure of our FUTA does it in the worst way. The maximum income upon which FUTA is charged right now is $7,000. So, what that means is if you believe that the payroll tax is hurting the creation of jobs, it is hurting the creation of jobs of precisely those people who need new jobs. The Social Security system has a maximum income of $96,000. Why UI was left at $7,000, I don't understand. It has been there for 20 years. I think it's just been forgotten, and it's time to correct it.

Again, I hope we will engage on this issue of tax policy. We have an automatic increase in the maximum wage in Social Security. It's now at $96,000. It used to be at $60,000, $70,000, $80,000. Do we call that a tax increase? I don't know. That's a semantic issue. So, what I would be calling for is a correction of the maximum income that is used to calculate the FUTA tax. You can see the redline what it would be if it were corrected for, inflation.

I am running out of time. Let me just say that I think that the Congressman's proposals address most of these problems. He would expand eligibility. We need to raise the amount that is provided, fix the triggers, and the weak link to re-employment, which we would address through the wage insurance program.

Let me just say that the wage insurance program, as currently structured, would have no impact on wages in the economy, because it's being paid to the employee. The employer doesn't even know about it. Now, I am speaking from facts, because we have a program already in place. The employer doesn't know about it, so it should have no impact on wages. It is applied for and paid directly to the employee. I would be happy to discuss this further. If we need to know more about wage insurance, then we should have a Government Accountability Office (GAO) study on that, and try to get that information.

A health care tax credit, I will again talk about that later. I think that that's something that we should be also borrowing from Trade Adjustment Assistance. I think it is really an urgency to correct the mistakes in the FUTA tax wage level. Thank you very much.

[The prepared statement of Mr. Rosen follows:]

Statement of Howard Rosen, Visiting Fellow,[1] Peterson Institute for International Economics

Introduction

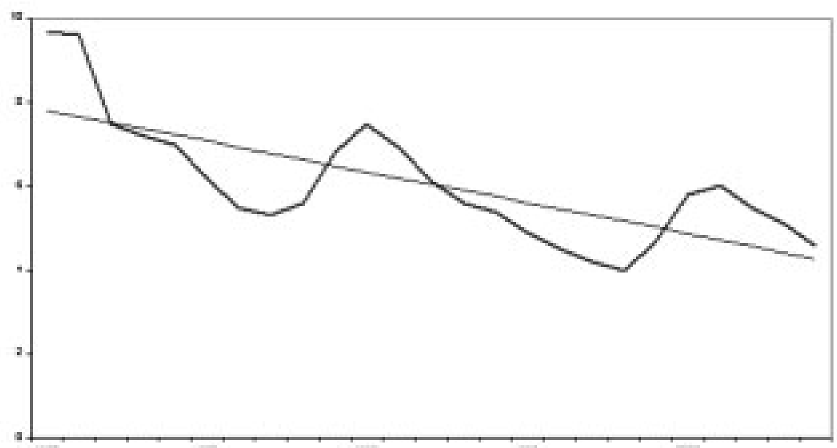
- *The unemployment insurance (UI) system is the foundation of the U.S. Government's response to the hardships associated with economic downturns and related job loss.*
- *There have been no major changes in the basic structure of the UI system since it was established more than 70 years ago, despite significant changes in U.S. labor market conditions.*
- *Currently, only about one-third of unemployed workers actually receive assistance under the program, and that assistance is modest, at best.*
- *Although the basic structure is sound, important aspects of the UI system are in desperate need of reform.*

Changes in the U.S. labor market

Over the last few years there have been changes in the nature of unemployment in the United States. After rising between the 1960s and the 1980s, the average unemployment rate began falling in the 1990s, reaching a low of 4 percent in 2000 and remaining moderate over the past six years. (See Figure 1.)

Despite overall declines in the unemployment rate, the average and median duration of unemployment has increased. (See Figure 2.) These two conflicting trends suggest a change in the source of joblessness—from temporary layoff to permanent displacement.

Figure 1. Unemployment Rate



Source: Bureau of Labor Statistics

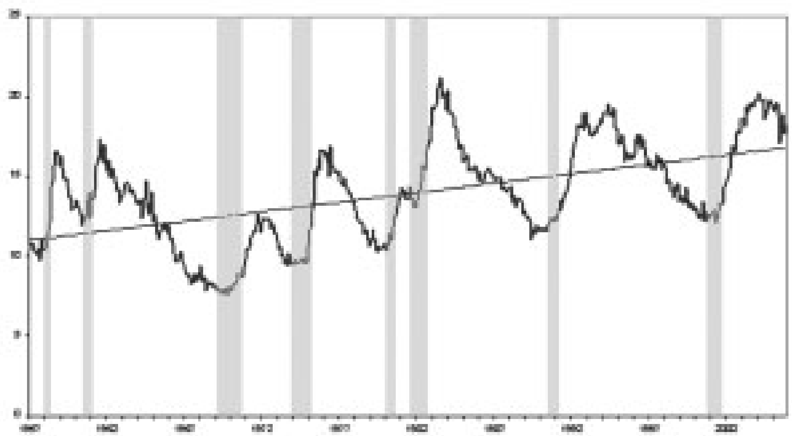
For most of the past century, employment and unemployment were highly correlated with the business cycle. This relationship appears to have changed in recent years. First, with the exception of the early 1980s, there has been a decline in the official length of recessions. Second, there has also been a decline in the magnitude of job losses occurring during economic slowdowns. Third, employment declines have continued for at least one year after the end of the last two recessions and employment recovery has taken longer. Taken together, these three developments suggest that *something has changed in the underlying structure of the U.S. labor market in recent years.*

Data presented in Figure 3 suggest that *there has been a significant decline in variation across state unemployment rates over the past 30 years.* During the late

[1] Howard Rosen is Visiting Fellow at the Peterson Institute for International Economics and the Executive Director of the Trade Adjustment Assistance Coalition. This statement is based on Kletzer, Lori and Howard Rosen (2006), "Reforming Unemployment Insurance for the Twenty-first Century Workforce," The Hamilton Project, Washington, DC: The Brookings Institution.

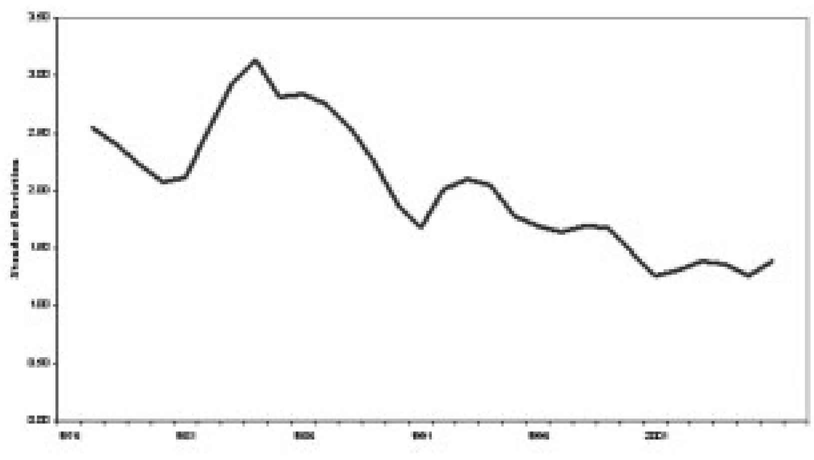
1970s, states in the Northeast and Midwest—regions with high concentrations of traditional industries such as automobile manufacturing, textiles and apparel, and steel—experienced significantly higher unemployment rates than states in other regions. Beginning in the 1980s, state unemployment rates began converging toward the national average, reflecting a slow decline in overall unemployment and more similarity in state unemployment rates. This convergence suggests that, during the past 20 years, unemployment has been explained more by national factors than by state or regional factors.

Figure 2. Duration of Unemployment



Source: Bureau of Labor Statistics

Figure 3. Variation in State Unemployment Rates



Source: Authors' calculations from Bureau of Labor Statistics data.

To summarize, the U.S. labor market has experienced 3 major developments in recent years:

- *Despite a moderate aggregate unemployment rate, the duration of unemployment has increased, with a greater incidence of permanent job loss than of temporary layoffs.*

- *State unemployment rates are converging, reflecting a reduction in their variation.*
- *Changes in employment and unemployment seem to be due more to structural rather than to cyclical factors.*

The original UI program was designed to offset income losses during cyclical periods of temporary involuntary unemployment. By contrast, current workers face long-term structural unemployment. *The existing UI system is inadequate in responding to these current labor market conditions.*

The current UI system does not assist workers who seek part-time employment, workers who voluntarily leave one job in order to take another, or workers who experience long-term unemployment. New entrants and reentrants into the labor market are not currently eligible for UI, since these two groups of unemployed do not fit well with one of the program's original objectives, i.e., insuring against the risk of involuntary job loss. Covering these workers would raise issues concerning the amount and duration of assistance, since they may not have relevant work experience.

Underlining these macroeconomic changes to the U.S. labor market is a shift from traditional employer-based full-time employment to an increased reliance on contingent and part-time employment. The shift to these nontraditional forms of employment reflects additional shortfalls in the current UI program. *A system designed to provide income support during temporary layoffs for workers who were permanently attached to a single employer is not well designed for a labor market with considerable self-employment and contingent, part-time, and low-wage employment.*

The Current UI Program

Federal law established the UI program in 1935 in order to provide temporary and partial wage replacement to workers involuntary separated from their jobs. It was believed that UI would serve as a countercyclical mechanism to help stabilize the economy during economic slowdowns. In the more contemporary language of the economic analysis of insurance, the primary goal (or benefit) of UI is the ability of the government to smooth income and consumption during unemployment spells.

The UI program was established as a federal-state system. The federal government sets rules and standards, primarily on minimum coverage and eligibility criteria, and imposes a minor tax to finance the overall administration of the program. Individual states set their own benefit amounts, duration of assistance, and means of financing that assistance.

Coverage and Eligibility

The existing eligibility criteria for receiving assistance, listed below, are based on monetary and non-monetary determinations; the application of these criteria varies by state:

- record of recent earnings, over a base year
- length of job tenure (calendar quarters employed)
- cause of job loss
- ability and willingness to seek and accept suitable employment

Monetary eligibility is essentially a sufficient work history prior to job loss. Each state determines its own sufficient work history, relying on earnings during a base period.[2] Most state programs assist only those workers who lose their jobs through no fault of their own, as determined by state law. In more detail, reasons for ineligibility of UI include the following:

- voluntary separation from work without good cause
- inability or unwillingness to accept full-time work
- discharge for misconduct connected with work
- refusal of suitable work without good cause
- unemployment resulting from a labor dispute

There is enormous variation across states in the definition of good cause *for voluntary separation,* i.e., leaving to accept other work, compulsory retirement, sexual or other harassment, domestic violence, and relocation to be with a spouse. Program discretion in setting these standards results in numerous inconsistencies. For example, workers who quit to move with a spouse and meet the monetary eligibility criteria are eligible to receive UI benefits in some programs—including California, Kansas, and New York—but not in others—including Connecticut, Delaware, the District of Columbia, and Massachusetts.

[2] See Kletzer and Rosen (2006) for a complete discussion of the base period used to determine UI eligibility.

Workers who quit because they have been victims of sexual or other harassment are potentially eligible for UI benefits in all programs except six: Alabama, Georgia, Hawaii, Missouri, New Hampshire, and Vermont. Workers who voluntarily leave their jobs in anticipation of a plant closing in order to accept another job are potentially eligible for UI in many states, including California, Minnesota, New York, and Pennsylvania, but are ineligible in North Carolina, South Carolina, Tennessee, and West Virginia. In a highly mobile society, with integrated labor markets, it is difficult to imagine a plausible argument in support of these differences in state programs.

The base period monetary criteria are used as an imperfect proxy for labor market attachment. One unfortunate consequence is that some workers have insufficient work experience to meet the base period requirement, i.e., reentrants into the labor market who are actively seeking employment are not eligible for UI. As a result, women who decide to postpone returning to work after childbirth and workers who return to school or who take up training following a job loss can be ruled ineligible for UI. This is true despite the fact that their current or former employers paid UI taxes, and despite the likely satisfaction of monetary eligibility requirements for the immediate base period prior to the job loss.

The percent of total unemployed workers receiving assistance, the *recipiency rate,* has declined over the past two decades. The recipiency rate peaked in 1980 when half of all unemployed workers received UI. The rate fell to as low as 30 percent in 1984, before rebounding to 39 percent in 1991. Receipt of benefits increased to above 40 percent in 2001, 2002, and 2003, before falling back in 2004. (See Figure 4.) The average recipiency rate over the past 27 years is approximately 37 percent. In other words, in recent years only a little more than one-third of unemployed workers actually have received assistance under the UI program.

Benefit Levels

One of UI's initial goals was to replace half of lost wages. Because of the federal-state nature of the program, each state sets its own minimum and maximum weekly benefit amounts. Although several states have set their maximum weekly benefit at approximately two-thirds the state weekly wage, currently only one state—Hawaii—has achieved the initial goal of actually replacing, on average, half of lost wages.

Almost all states set their maximum weekly benefits somewhere between $200 and $500, with the largest concentration of states between $300 and $400. Puerto Rico has the lowest maximum weekly benefit ($133). States with the highest maximum weekly benefits include Massachusetts ($551 to $826), Minnesota ($350 to $515), New Jersey ($521), and Rhode Island ($492 to $615). 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 $262.24.* This average is almost 10 percent less than the weekly equivalent of the poverty level for a family of three that was set by the U.S. Census Bureau.[3]

The *replacement rate,* defined as average weekly benefits as a share of average weekly earnings, is a useful measure of benefit sufficiency.[4] The District of Columbia has the lowest replacement rate, less than one-fourth of average earnings. As mentioned above, Hawaii's UI program comes closest to replacing half of unemployed workers' average weekly earnings. Thirty-eight states have an average replacement rate of more than one-third but less that one-half of their workers' average weekly wages. The states with the lowest replacement rates include Alabama, Alaska, Arizona, California, Connecticut, Delaware, Louisiana, Maryland, Mississippi, Missouri, New York, Tennessee, and Virginia. *The average replacement rate for the United States between 1975 and 2004 was 0.36,* reaching as high as 0.38 in 1982 and as low as 0.33 in 1998 and 2000.

Duration of Benefits

In the early years of the program, the duration of UI benefits was 12 to 20 weeks. Starting in the 1950s, a period of relatively low unemployment, a sizable number of states increased their UI duration to 26 weeks. By 1980, 42 states had a maximum duration of 26 weeks, and the duration for the 11 remaining programs was between 27 and 39 weeks. By the 1990s, 50 states had a uniform maximum duration of 26 weeks, with two jurisdictions at 27 to 39 weeks. Currently, all jurisdictions except three have a maximum duration of 26 weeks.[5]

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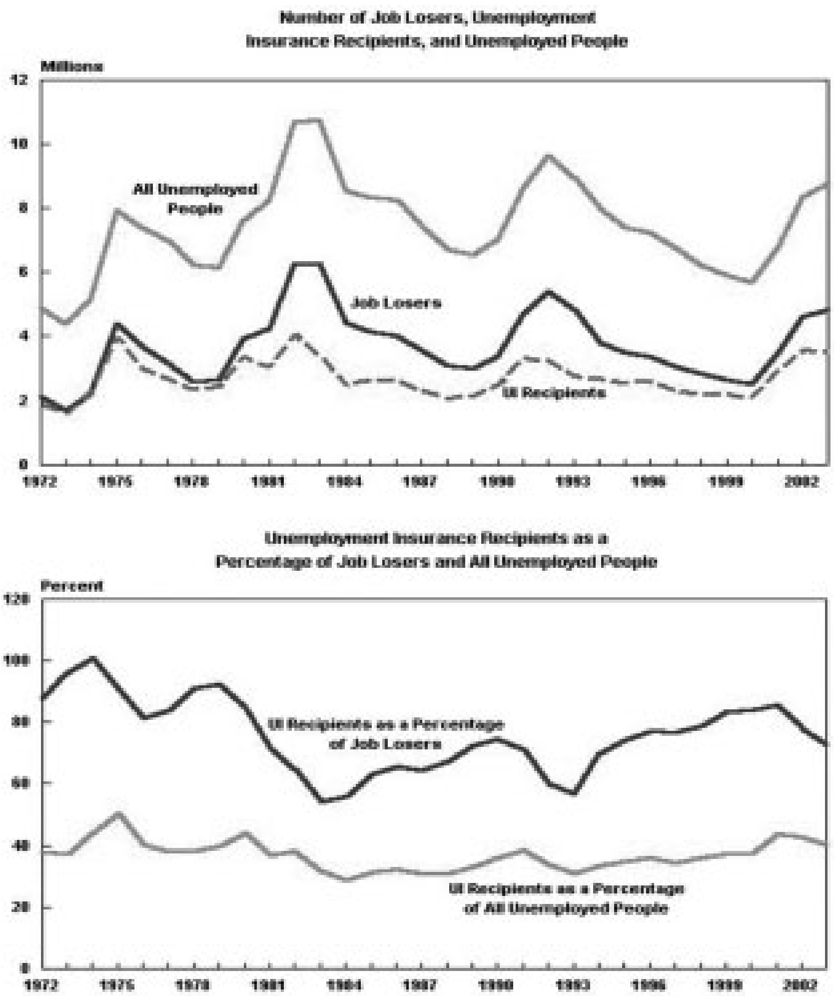
[3] Annual incomes at and below $14,974, for a family of three, with one child under the age of 18, were defined as poverty level for 2004 (U.S. Census Bureau 2005).

[4] Only average weekly earnings for UI recipients are used in calculating the replacement rate.

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

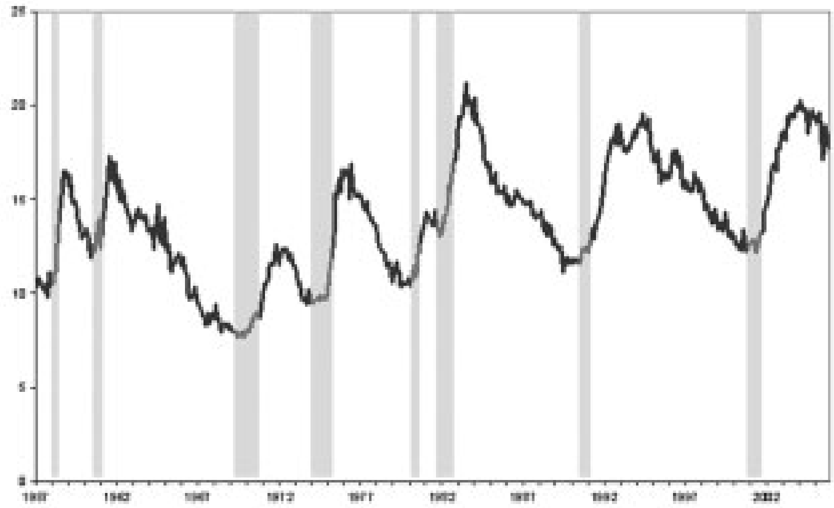
Over the past 30 years, the average duration for receiving UI has ranged from a low of 13 weeks in 1989 to a high of 17.5 weeks in 1983, hovering around 15 weeks for most of the period. (See Figure 5.) *A sizeable fraction of UI beneficiaries exhaust their benefits, i.e., remain unemployed beyond the period for which they can receive UI, ranging from a low of 25.8 percent in 1979 to a high of 43.9 percent in 2003.* On average, approximately one-third of UI recipients exhaust their benefits before finding new jobs.

Figure 4. Unemployed Workers, Job Losers, and UI Recipients, 1972–2003



Source: Congressional Budget Office 2004, Figure 3.

Figure 5. Average Duration of Unemployment Insurance Receipt, with Periods of Recession Highlighted, 1957–2005



Source: Bureau of Labor Statistics, U.S. Department of Labor and National Bureau of Economic Research.

With the trend increase in the average duration of unemployment, the maximum period that workers can receive UI has fallen from two times to a little more than 1.5 times the average duration of unemployment. *As with benefit levels, there does not appear to be any significant relationship between benefit duration and local labor market conditions.*

Extended Benefit Programs

The UI system proved unable to respond to surges in unemployment during most of the cyclical downturns over the past half century. Increases in the duration of unemployment during and immediately following those recessions were the primary impetus for extending statutory UI beyond its base period. Congress enacted the first temporary extension of UI during the 1958 recession. In 1970, Congress enacted the 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 resulted in the need for subsequent congressional action to deal with heightened levels and prolonged duration of unemployment during recessions.

Under the current program, UI benefits can be extended for an additional 13 weeks when the unemployment rate of those workers covered by the program, i.e., the Insured Unemployment Rate (IUR), for the previous 13 weeks is at least 5 percent and 20 percent higher than that rate for the same 13-week periods in the previous two years. Since states are required to finance half of the extended benefit programs, they are free to adjust this trigger.

Changes in the labor market combined with the static nature of the triggers, have produced an extended benefit system that is not automatic. As a result, Congress has occasionally found it necessary to extend UI through the Temporary Extended Unemployment Compensation program. Since the 1980s, the standard extended benefit program has provided a smaller share of assistance to unemployed workers than the emergency extensions of UI enacted by Congress.

Although helpful to millions of workers, these temporary stopgap measures have politicized unemployment, thereby undermining one of the initial goals of the UI program. *These temporary programs have proven to be clumsy, typically being enacted after hundreds of thousands of workers have already exhausted their UI.* In addition, the sunset provisions are arbitrarily set and usually fall before employment has recovered. *Overall, the nation's UI program has become less automatic and more dependent on congressional action in response to prolonged periods of economic slowdown.*

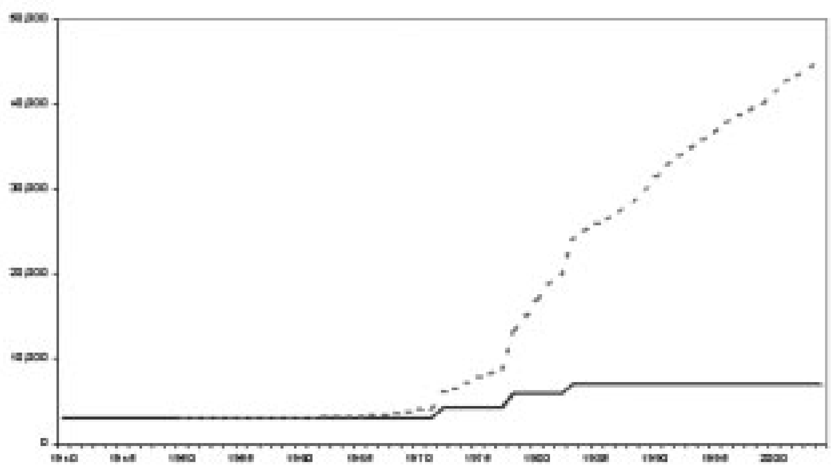
Financing UI

UI is financed by a combination of federal and state payroll taxes. Revenue from the federal payroll tax is used to finance the costs incurred by federal and state governments in administering the UI program and to cover loans to states that exhaust their regular UI funds. States are required to raise the necessary revenue to finance regular UI benefits paid to their unemployed workers. Federal and state governments share the costs of financing benefits under the automatic extended benefit program. Currently, federal taxes finance 17 percent of the UI program. The remaining 83 percent is financed by state taxes. Temporary extended UI programs enacted by Congress have typically been financed by federal budgetary expenditures without any specific revenue offset.

The federal tax established by the Federal Unemployment Tax Act (FUTA) is currently 6.2 percent on the first $7,000 of annual salary by covered employers on behalf of covered employees.[6] Employers must pay the tax on behalf of employees who earn at least $1,500 during a calendar quarter. Employers in states with federally approved UI programs receive a 5.4 percent credit against the tax, making the effective FUTA tax rate 0.8 percent. *The bottom line is that the federal tax is trivial: A maximum of $56 is collected annually for each worker who is covered under the program.*

There have been few adjustments in the FUTA taxable wage base since it was first established in 1939. The wage base, originally set at $3,000, remained fixed for 32 years, until 1972, when it was raised to $4,200. That increase kept the taxable wage base in line with its real value in 1960. Congress raised the federal taxable wage base to $6,000 in 1978 and to $7,000 in 1983, where it has remained for the past 22 years. *Had the taxable wage base been adjusted for inflation over the past 65 years, it would currently be approximately $45,000.* (See Figure 6.)

Figure 6. Federal Taxable Wage Base, 1940–2004



Source: U.S. Department of Labor, and authors' estimates.

If the taxable wage base were adjusted to $45,000, the net federal tax rate, i.e., the tax rate minus the credit, could be reduced by half, to 0.4 percent, and generate the same amount of revenue that is currently being collected. Although it is unrealistic to expect an adjustment of this magnitude anytime soon, any increase in the wage base to make up for the erosion in its real value over the past two decades could provide additional funding for providing assistance to workers in need, or could enable the federal government to reduce the FUTA tax rate, or both. Most importantly, *adjusting the wage base upward would reduce the regressive nature of the tax.* Under the current structure, the FUTA tax accounts for a larger share of lower income workers' wages. Adjusting for inflation alone, as many states have been

[6] The 6.2 percent includes a 0.2 percent surtax initially passed by Congress in 1976, designed to replenish the UI trust fund. The surtax is scheduled to expire on December 31, 2007.

doing for their own UI taxes, would increase the federal taxable wage base fivefold, make the system more progressive, and provide additional revenues to the system.

Federal guidelines dictate that states have in place UI payroll tax systems that are experience rated. With experience rating, firms that lay off fewer workers face a lower tax rate on their payroll. States have the discretion to structure their own experience rating system, and those systems, as with the tax rates, vary considerably among the states.

Some aspects of the current UI system work well and deserve to be highlighted. *UI constitutes an important source of income for unemployed workers and their families, particularly for the long-term unemployed.* The Congressional Budget Office (2004) reports that UI benefits played a significant role in maintaining the family income of recipients who experienced long-term spells of unemployment in 2001 and early 2002, particularly for those families that had only one wage earner. Before becoming unemployed, recipients' average family income was about $4,800 per month. When recipients lost their job, that income—excluding UI benefits—dropped by almost 60 percent. Including UI benefits reduced the income loss to about 40 percent.[7]

Reforming UI

In recent years, the U.S. labor market has come under increased pressures from intensified domestic and international competition. These pressures have changed the nature of job turnover in the United States. Unlike the cyclical job losses that characterized the labor market and economy from 1945 to the 1980s, job losses are now related more to structural factors, with workers simultaneously changing jobs, industries, and occupations. *The existing UI program, though, is fighting the last battle, one of widespread temporary layoff, where workers were attached to a single employer.*

As discussed above, current labor market conditions differ a great deal from those that existed in 1935, suggesting that it is time to revisit some of the fundamental elements of the original UI program. The reforms outlined below maintain the basic structure of UI, while enhancing its efficiency, reach, and impact to reflect the changes in the labor market since the program was designed. Although each proposal can be evaluated and implemented separately, it would be preferable to enact them all.

Strengthen the Federal Leadership Role in UI

As documented above, *the nature of unemployment in the United States has shifted from cyclical to structural. Although there clearly remain some differences in local labor market conditions, the current pressures on the U.S. labor market are becoming more national.* State differences in the incidence and experience of unemployment have narrowed considerably. Local labor market conditions primarily affect the prospects for reemployment. Given the increasingly national nature of the labor market, UI would better meet its original objectives if the federal government played a more prominent role in this partnership.

In addition to inequities created by disparate rules across states, *a significant downside of the current federal-state partnership is the states' real or perceived fears that program generosity will result in adverse changes to their business environment.* Increased Federal leadership would avoid interstate competition and a "race to the bottom" in program benefits.

An increased leadership role for the federal government would be characterized by expanding standards for eligibility, duration, and level of benefits; and for financing the program.

Eligibility

- *Standardize the base period for determining eligibility to the past four complete calendar quarters prior to job loss.* This change, already implemented by a number of states, updates the operational definition of labor market attachment, and reflects the reduced time needed to report earnings.
- *Use hours rather than earnings in determining eligibility.* Shifting the determination of eligibility to hours rather than earnings would bring more low- and moderate-wage workers—who often most need help during periods of unemployment—into the system.
- *Harmonize non-monetary eligibility standards.* The patchwork of non-monetary eligibility criteria, where some states consider voluntary separations for good cause, while others do not, creates unnecessary complexity and inequities in the system.

[7] Long-term recipients are defined in this report as unemployed workers who received UI benefits for a spell of at least four consecutive months, in 2001 or early 2002.

- *Enable reentrants to the labor force, if determined eligible at the time of job loss or separation, to be eligible to receive the benefits they would have received at the time of job loss.* In a fluid labor market, many workers may leave the labor force for some time (e.g., to care for a child or parent) and then return. If the workers had been eligible for UI when they separated from their previous job but did not claim them at that time, they should be eligible for benefits when they return to the labor force.
- *Amend the work test to allow job search for part-time employment.* Part-time work is a common feature of the current labor market, accounting for 16 percent of employment in July 2006, and unemployed workers should not be disqualified from receiving benefits because they are searching for part-time work.

The share of unemployed workers who actually received assistance under the UI program averaged 37 percent between 1980 and 2005. The proposals outlined above are designed to increase the number and share of unemployed workers eligible to receive assistance. Given the difficulties associated with precise estimation of how much each of the individual proposals would contribute to increasing the number of potentially eligible workers, the costs associated with raising the recipiency rate in increments to 50 percent is estimated (Table 1), which is a reasonable objective for the changes delineated above.

Table 1. Estimated Costs Associated with Increasing the Recipiency Rate

Recipiency rate	Increase in number of workers eligible* (thousands)	Increase in total benefits paid* (billions)
0.40	220	$1.6
0.45	0.45	$4.5
0.50	1,000	$7.4

* Increase in workers and costs (benefits paid) relative to 25-year average.
Source: Kletzer and Rosen (2006).

Benefit Levels and Duration of Benefit Receipt

- *Standardize benefit levels to at least half of lost earnings with a maximum weekly benefit equal to two-thirds of state average weekly earnings.* Table 2 provides budgetary estimates for raising the replacement rate in this manner.
- *Develop standard rules to cover benefits for partial unemployment (reduced hours).* Standardizing these rules would help to update the program to reflect new labor market realities.
- *Establish uniform duration of a minimum of 26 weeks in all state programs.*
- *Fix the extended benefit triggers so that they are more automatic and workers can receive assistance during economic downturns without disruption.*
- *Make benefits more responsive to work experience and local labor market conditions.* Currently, UI benefits are set arbitrarily, primarily based on a state's ability and willingness to pay. In general, benefits do not currently reflect an employee's work experience, nor (and more importantly) do they reflect the costs associated with that worker's job loss, including the potential difficulty in finding a new job. One way to correct this shortcoming would be to set benefit levels according to a formula based on a number of factors, including wage history, local labor market conditions, and reason for separation. Workers living in regions with poor labor market conditions might receive a higher level of assistance, or receive assistance for longer periods, or both.
- *Standardize allowances for dependents across all states.*

Table 2.
Estimates of Costs Associated with Increasing the Replacement Ratio

Replacement ratio	Average weekly benefit at new replacement rate	Increase in average weekly benefit	Increase in total benefits at new replacement ratio (billions)
40 percent	$295.67	$ 34.00	$0.3
45 percent	$332.63	$ 70.96	$0.7
50 percent	$369.59	$107.92	$1.1

Source: Kletzer and Rosen (2006).
Note: Estimates based on the following assumptions: The average replacement ratio between 1980 and 2003 was 35.4 percent; the average weekly benefit in 2003 was $261.67; the average weekly wage in 2003 was $739.18; the total number of weeks of compensation in December 2005 was slightly fewer than 10 million.

Financing

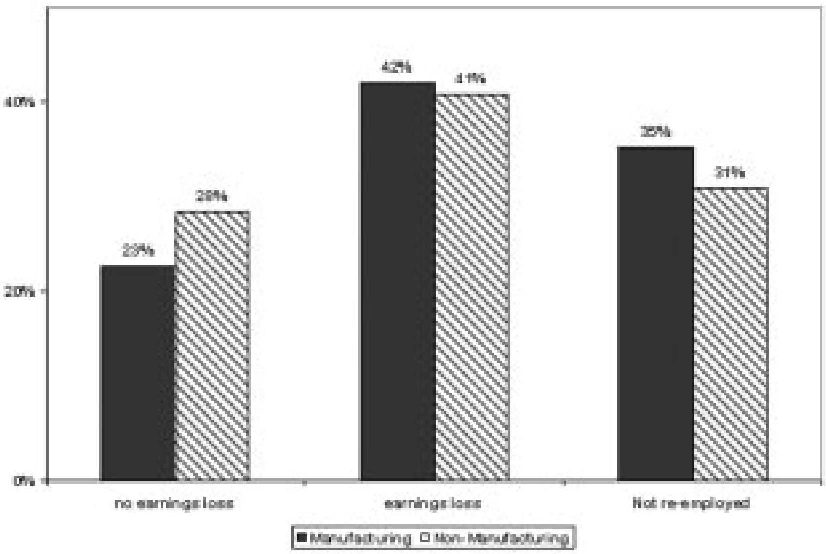
- *Increase the FUTA taxable wage base, in steps, to $45,000.* The last time the UI taxable wage base was adjusted was more than 20 years ago. As a result, the payroll tax is extremely regressive. Raising the taxable wage base to $45,000 would have the benefit of making the tax more progressive while generating new revenue to finance needed reforms in the program. Increasing the taxable wage base to $45,000 while maintaining the same tax rate would generate approximately an additional $9 billion in revenue. This would be enough to finance the costs associated with providing more assistance (i.e., raising the replacement rate) to more workers (i.e., increasing the recipiency rate).

Local or regional wage differences, or both, would be respected under this plan, because the harmonization of benefits would be in percentages of earnings, not dollar levels. Treating workers more equally, in terms of program standards, would remove differences that have little or no justification, other than tradition. Given their long experience in providing these services, local and state providers would remain primarily responsible for reemployment assistance, job training, intake, and administration of benefits.

Augment UI with a Program of Wage-Loss Insurance.

On average, dislocated workers pay a heavy price as a result of unemployment. According to the Dislocated Worker Survey only two-thirds of unemployed workers find a new job within 1 to 3 years after layoff. (See Figure 6.) More than 40 percent of workers experience earnings losses and only approximately one-fourth of workers experience no earnings loss or an improvement in earnings after re-employment.

Figure 7. Re-employment and Earnings Experience of Dislocated Workers



Source: Displaced Worker Survey, Bureau of Labor Statistics, author's calculations.

Wage-loss insurance offers assistance that is tailored to actual earnings losses. In order to be effective, wage-loss insurance must be a complement to traditional UI, since it only assists those workers who find new jobs. Under the program eligible workers would receive some fraction, perhaps half, of their weekly earnings loss over a specific period.

For example, the average weekly wage before layoff for workers displaced from manufacturing industries was $396.88 between 1979 and 2001 and the average weekly age for those laid off from non-manufacturing jobs was $368.65. For those workers who found new jobs, the average percent loss in earnings was 29.2 percent for manufacturing workers and 18.6 percent of non-manufacturing workers. Had a wage-loss insurance program been in place, manufacturing workers would have received approximately $6,000 over a 2-year period, or 15 percent of their pre-lay-off wage. Non-manufacturing workers would have received approximately $3,600 over a 2-year period, or 9 percent of their pre-lay-off wage.

The Trade Act of 2002 expanded Trade Adjustment Assistance (TAA) to include a limited wage-loss insurance program. Under the TAA program, workers who are more than 50 years old and earning less than $50,000 a year may be eligible to receive half the difference between their previous and new earnings, subject to a cap of $10,000, for up to two years. Workers must find a new full-time job and enroll in the Alternative Trade Adjustment Assistance (ATAA) program within 26 weeks of job loss and cannot receive other income support or training under TAA.

Despite its benefits, wage-loss insurance is not a perfect solution to addressing the costs associated with unemployment. Structuring a program with a relatively short eligibility period, starting with the date of job loss, may create a reemployment incentive, addressing one of the most commonly expressed UI concerns, but it also limits the compensatory nature of the program. Displaced worker earnings losses are long term (i.e., earnings losses exist five to six years after job loss), well beyond the two years covered by ATAA.

In order to avoid any adverse effect on wages, wage-loss insurance must be provided to workers, not employers. In fact, there is no reason for employers to even know that workers are receiving assistance under this program.

The cost of a wage-loss insurance program depends on the number of eligible workers, the earnings losses of those reemployed at lower pay, and the duration of unemployment prior to reemployment. Other critical program characteristics include the duration of wage-loss insurance payments, the annual cap on program payments, and the replacement rate. It has been estimated that the cost for a program with a two-year duration, a 50 percent replacement rate and a $10,000 annual cap for all dislocated workers would be around $4 billion.

An expanded wage-loss insurance program could be financed through general government revenues or by raising the FUTA taxable wage base or tax rate. Augmenting UI, with assistance tailored to the size of reemployment earnings losses, is possible with relatively small changes in UI program parameters.

In general, *the current UI system has a limited relationship with efforts to transition workers back to employment.* The Worker Profiling system targets resources on workers at risk of exhausting benefits. Workers receiving UI are required to prove that they are actively seeking employment, primarily by documenting job inquiries and interviews. Most unemployment spells (and benefit receipt) are too short for serious training, but job search assistance can be short term with high return, given its relatively low cost. With the rise in structural unemployment, training needs are likely to expand. As a result of the bureaucratic wall of separation between UI and federally supported training programs in the United States, the amount of funds appropriated are inadequate to provide any kind of serious training to all long-term unemployed workers.

Conclusion

The current federal-state structure of UI is a relic of its 1935 establishment. *The program has not undergone any major reforms, despite significant changes in the U.S. labor market over the last few decades.* The current UI program was created to assist workers experiencing transitional unemployment due to cyclical factors. Today's workers are experiencing longer spells of unemployment and large earnings losses due to structural factors like technological change and intensified competition resulting from globalization.

Changes necessary to move UI into the twenty-first century require strong federal leadership. The very basic structure of UI must be reformed, broadening from the single-employer, full-time worker, temporary layoff model to an approach that accommodates permanent job loss, part-time or contingent work, self-employment, and the incidence of job loss and national, rather than local or regional, unemployment. *Reforming the nation's UI program is necessary in order to make it relevant to the labor market of the twenty-first century.*

Congressman McDermott's draft legislation being considered by the Subcommittee incorporates most of the recommendations outline above. *The Congressman's proposals would go very far in improving the relevance of the UI program to current labor market conditions.* I strongly encourage members of Congress to seriously consider these proposals and to enact them as soon as possible. Delaying their adoption will result in raising the costs that unemployed U.S. workers already face.

Chairman MCDERMOTT. Mr. Emsellem.

STATEMENT OF MAURICE EMSELLEM, POLICY DIRECTOR, NATIONAL EMPLOYMENT LAW PROJECT

Mr. EMSELLEM. I thank you for this opportunity to testify on the critical subject of reform of the nation's unemployment insurance program, and the proposal to create a wage insurance program.

Mr. Chairman, I want to begin by expressing our appreciate for your leadership and the hard work of the staff to move this important and timely discussion of unemployment insurance reform. We strongly support the draft UI bill, which provides $7 billion in incentive funding to help the states modernize their programs.

The bill responds to a documented and desperate need to fill the major gaps in the unemployment insurance system. We estimate that it will help more than half-a-million workers a year to collect unemployment benefits.

The bill also takes the best of the bold, new policies that have been adopted by over half the states during the last decade, and creates a structure to promote, not mandate, broader UI reform. While we support the incentive structure of the bill and the specific reforms that qualify for funding, we also believe that more should be done to target the needs of the long-term unemployed, and increase the incentive for the states to participate in the program, which I will talk a little bit more about later.

With respect to wage insurance, we certainly appreciate the needs of workers and their families who find themselves having to take a major cut in pay to find work in today's economy. For the past 20 years, it has been my job at NELP to help these and other workers get back on their feet and find quality jobs.

We strongly believe that wage insurance is the wrong solution. Rather than encourage workers to forgo their long-term interest for a wage insurance job, Congress should devote its limited resources to policy solutions that create more family sustaining jobs, not more downward mobility. In our testimony, we discuss the need to better protect trade-impacted workers, and consider some of the successful state initiatives, like health insurance coverage for the unemployed, home protection funds to prevent foreclosures that create better options to improve the long-term economic security of workers and their communities.

Now, on unemployment insurance reform. What we appreciate most about the UI modernization bill is how it targets those workers who have been hardest hit by the gaps of the program, including low-wage and women workers. The first priority of the bill is to help low-wage workers who will benefit from the $2.3 billion in funding available to the states to adopt what is called the alternative base period.

Low-wage workers are twice as likely to be unemployed as higher-wage workers, but they are half as likely to collect unemployment benefits, even when they work full time. NELP has conducted a major survey of states that have—operate the alternative base period. Our study documents the significant impact it will have on low-wage workers and the administrative efficiencies that have substantially reduced the limited cost of implementation in recent years.

I could go into more detail about how this alternative base period works, but I figure if you have questions I will get to that. Otherwise, I am going to discuss some of our other concerns with the bill.

The UI modernization bill also targets the growing ranks of the long-term jobless, which includes large numbers of laid-off manufacturing workers. During the last recession and the jobless recovery that followed, a record 44 percent of workers ran out of their state unemployment benefits. It remained—the rate remained—above 40 percent, for a record 28 months. Before that time, it had only been above 40 percent for 4 months in the history of the program.

So, we are concerned about the long-term unemployed. The bill takes on this challenge by providing up to 6 months of additional unemployment benefits for workers to participate in state-approved training, to allow them to better compete in the labor market.

An evaluation of Washington State's program providing UI for workers in training found that 72 percent of the participants, mostly laid-off aerospace workers with only a high school education, were employed after receiving community college training. When they were employed, they earned an average of 93 percent of their pre-dislocation wages, 93 percent. So, training works, if it's done right, as it's done in Washington.

Our major concern with the draft UI bill is it fails to do more to help the long-term jobless, including the 700,000 workers a year who now run out of their UI benefits after just 23 weeks. Contrary to the common perception, most workers do not qualify for a maximum 26 weeks of benefits under state UI laws. In fact, in 14 states, the average worker exhausts his UI benefits after just 20 weeks. That means they also qualify for far less in Federal extended benefits, which are limited to half the workers' state benefits.

So, take the fact that you're getting 20 weeks of benefits. Half of that is 10. During a recession, you're only getting 30 weeks of benefits, not the 39 weeks that folks qualified for if you got 26 weeks of benefits. So, we think that the legislation should incorporate those state laws that provide a maximum of 26 weeks to all workers.

We also believe that the financial incentive for the states to participate in the program should be significantly increased, to be sure that more states, in fact, modernize the program. To maximum the incentive, the bill should take the money left at the end of the 5-year period—which could end up being a very large sum if a lot of the states don't participate in the program—and redistribute it to the states that have enacted the reforms, while capping that amount at a reasonable figure. So, you're creating a whole lot more incentive at the end of the program for folks to participate at the front end.

Chairman MCDERMOTT. Sounds like use it or lose it.

Mr. EMSELLEM. Exactly. Thank you again for your interest and commitment to these issues.

[The prepared statement of Mr. Emsellem follows:]

Statement of Maurice Emsellem,
Policy Director, National Employment Law Project

Chairman McDermott and members of the Committee, thank you for this opportunity to testify on the critical subject of economic insecurity in the United States and respond to legislative proposals to modernize the nation's unemployment insurance program and create a new national wage insurance program.

My name is Maurice Emsellem, and I am the Policy Director for the National Employment Law Project (NELP), a non-profit research and advocacy organization that specializes in economic security programs, including unemployment insurance (UI), Trade Adjustment Assistance (TAA) and the workforce development system. We have a long history serving families hard hit by economic downturns by helping them access their benefits and promoting innovative state and federal policies that deliver on the nation's promise of economic opportunity.

We testify today in strong support of the draft bill providing $7 billion in incentive funding to help states modernize their unemployment insurance (UI) programs. The bill responds to a documented and desperate need to fill the gaps in the UI program that deny or restrict benefits for millions of deserving workers and their families. It also takes the best of the bold new policies adopted by the states over the past decade and creates a structure to promote, not mandate, broader reform. While we strongly support the incentive structure of the draft bill and the specific state reforms that qualify for funding, we also urge that the bill incorporate several critical improvements that better target jobless families and the long-term unemployed.

With regard to the draft wage insurance proposal, we appreciate the concern about the needs of those workers and their families whose lives have been thrown into disarray when they lose a good job and find themselves with no other options but to take a job that requires a major cut in pay. For nearly 20 years, it has been my job at NELP to help these and other workers get back on their feet and generate resources to rebuild their communities. But wage insurance is the wrong solution. Rather than encourage workers to forgo their long-term interests for a wage insurance job, Congress should focus on more meaningful solutions described below that create genuine economic security and more family-friendly sustaining jobs in our economy.

I. Unemployment Insurance Modernization Incentive Proposal

Today's draft UI legislation represents a potential watershed moment in the evolution of the nation's UI program. Despite decades of mounting evidence documenting the need for reform, this is the first Congressional forum where serious federal proposals are being debated to expand and modernize the UI program. Our estimates indicate that the proposal providing Reed Act incentive grants to the states could help more than half a million workers each year, which is well worth the investment of $7 billion from the UI trust funds. Chairman McDermott, we greatly appreciate your leadership and the hard work of the subcommittee staff to move this critical and timely discussion.

A. The Critical Functions of the UI Program

Before we address the need for reform of the UI program, it is important to reflect on the critical role that it plays in the lives of the seven to eight million workers each year who collect benefits and their communities. Despite its limitations, the UI program still serves its core function as the "first line of defense" to help prevent financial hardship to unemployed families while also stabilizing the economy during recessions and thus preventing more unemployment.

Consider the experience of the last recession, which was relatively less severe compared to prior economic downturns. From 2000–2003, the UI program paid over $50 billion in additional state benefits and more than $20 billion in federal extended benefits received by 7.25 million workers. If doubled to account for the documented multiplier effect when UI benefits circulate in the economy, state and federal UI benefits generated about $140 billion in economic stimulus.[1] Of course, the stronger the state's UI benefits, the greater the stabilizing impact on local businesses.

In addition, UI benefits played a significant role alleviating the financial hardship caused by the recession. In 2003, the average worker who collected both 26 weeks of state benefits and the 13-week federal extension received over $10,000 in UI benefits. According to a national poll of unemployed workers conducted in 2003, 78% of those surveyed said that their unemployment benefits were "very important" to help them meet their family's "basic needs."[2] Thus, the Congressional Budget Office concluded that during the last recession UI benefits "played a substantial role in maintaining the family income of recipients who experienced a long-term spell of unemployment."[3]

Although too often overlooked, unemployment benefits also maintain U.S. labor standards and promote economic opportunity. Indeed, one the few federal eligibility mandates requires that a worker not be denied state UI for refusing a job offer that does not satisfy the "prevailing conditions" of work in the community.[4] Like the federal minimum wage laws, this UI federal mandate sets the labor standards floor governing the prevailing "wages, hours and other conditions of work" (including fringe benefits and health insurance) of relevant jobs in the community. Thus, the UI program helps sustain meaningful wages and benefits, especially in those communities experiencing large numbers of layoffs.

The federal law also exempts workers from having to be available for work while they participate in state-approved training, thereby encouraging workers to upgrade their skills. As a result, workers who collect unemployment benefits are also more likely to find a better-paying job (by a factor of $240 a month according to one study)[5] and employment with health care coverage.[6]

[1] Chimerine, et al. *Unemployment Insurance as an Economic Stabilizer: Evidence of Effectiveness Over Three Decades,* U.S. Department of Labor, Unemployment Insurance Occasional Paper 99–8 (1999).

[2] Peter D. Hart Research Associates, "Unemployed in America: The Job Market, the Realities of Unemployment, and the Impact of Unemployment Benefits," conducted April 17–28, 2003 (commissioned by the National Employment Law Project).

[3] Congressional Budget Office, *Family Incomes of Unemployment Insurance Recipients* (March 2004).

[4] 26 U.S.C. Section 3304(a)(5)(B).

[5] Kiefer, Neumann, "An Empirical Job Search Model with a Test Constant Reservation Wage Hypothesis," *Journal of Political Economy,* Vol. 87, No. 1, 89–107.

[6] Boushey, Wenger, "Finding the Better Fit: Receiving Unemployment Increases Likelihood of Re-Employment with Health Insurance" (Economic Policy Institute, April 14, 2005).

B. The Decline of the UI Program

That's the good news. But what about the gaps in the UI program which the draft federal legislation seeks to correct? As documented by several leading authorities, including a bi-partisan panel of experts created by Congress in 1991 (the Advisory Council on Unemployment Compensation),[7] the UI program has failed to evolve to meet the demands of a changing economy and a changing workforce.

The workforce is now dominated more by low-wage and women workers and a changing economy which has produced more long-term unemployment experienced by workers of nearly all income and education levels.[8] Thus, there are two major groups of workers who are falling through the cracks of the current UI program—those who fail to qualify because of outdated eligibility rules and those who qualify for UI benefits but end up receiving far too limited assistance as they struggle to find work over longer periods of time.

The statistics paint a vivid picture of these dual challenges. According to the GAO study, low-wage workers were twice as likely to be unemployed as higher wage workers, but they were half as likely to collect unemployment benefits (even when they previously worked full-time).[9] As a result of the last two "jobless recoveries," many more unemployed workers run out of their limited jobless benefits, now exceeding 35% of those who collect state benefits. During the last recession, the UI "exhaustion rate" peaked at a record 44% and remained above 40% for a record 28 months.

Given these disturbing trends, the UI system has reached a crisis point requiring serious federal action. Indeed, the percent of the unemployed collecting jobless benefits has fallen to dramatically low levels, with just 35% of the unemployed receiving jobless benefits in 2006. That's down from nearly 50% in the 1950's, and over 40% in the 1960s and 1970s. In nine states, less than 25% of unemployed workers collect jobless benefits today.

But the tragic story of the decline of the UI program is not merely a function of the changing economy or the changing workforce. It is also the direct result of state and federal policies that have deprived the program of funding and produced devastating cuts in benefits.

Of special significance, employers have successfully lobbied the states to dramatically cut UI payroll taxes, thus undermining the fundamental principle of "forward financing" of the UI program (where sufficient reserves are built up during good economic times to pay benefits during recessions). During the decade of the 1990s, the average UI tax on employers decreased by 33%, falling to a record low in 2001 of just half of one percent (0.51%) of total wages. Given the more limited revenue, nine states had to take out federal UI loans to pay their UI benefits thus creating significant pressure to restrict UI benefits when workers need the help most.

In addition, the states have been deprived of the federal resources necessary to cover the basic costs of administering their UI programs. As a result, they have cut back on critical services like in-person claims assistance and job counseling, now relying almost exclusively on menu-prompted phone systems and the Internet to process their claims. The states have also been forced to raise their own revenues (to the tune of about $150 million a year) to fill the federal void.[10]

Since 2001, federal UI administrative funding has been cut back by $305 million in inflation adjusted dollars, despite the intervening recession and other increased demands on the state UI programs.[11] The U.S. Employment Service, which provides the critical labor exchange functions matching workers with available jobs, has also been cut by over $300 million since 2001. According to the National Association of State Workforce Agencies, there is now a $500 million annual gap between the workload needs of the state agencies that administer the UI program and the amount appropriated by Congress.[12]

Finally, as a result of devastating cuts by Congress in the 1980s, both the federal program of Extended Benefits (EB) and federal Disaster Unemployment Assistance (DUA) are failing to provide critical benefits to the nation's families hardest hit by

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[7] Advisory Council on Unemployment Compensation, *Collected Findings and Recommendations: 1994–1996* (1996).

[8] Allegretto, Stettner, "Educated, Experienced and Out of Work: Long-Term Joblessness Continues to Plague the Unemployed" (National Employment Law Project & Economic Policy Institute, March 2004).

[9] U.S. General Accounting Office, U*nemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), at pages 13–16.

[10] Power Point Presentation, National Association of Workforce Agencies, "Unemployment Insurance State Administration" (2007).

[11] AFL–CIO, "President Bush's FY 2008 Budget Proposal."

[12] Resolution, National Association of State Workforce Agencies, Reed Act Distribution Resolution, adopted September 7, 2006.

recessions, disaster and terrorist events. For example, the permanent federal program of "Extended Benefits" (EB)—created in 1970 to provide an extra 13 to 20 weeks of benefits—is so outdated in how it measures unemployment that it only provided benefits to workers in five states during the 2001 recession.[13] As a result, Congress created another temporary extension of UI benefits that did not become law until March 2002, when the number of long-term unemployed had already doubled in just one year. In addition, Congress shut down the program just as a record three million workers were scheduled to run out of their state benefits.[14]

The DUA program is also failing as evidenced by the limited relief it provided in response to the unprecedented terrorist attacks and disasters of the last five years. In 1988, the DUA was restricted to those workers who do not qualify for regular state UI, mostly including the self-employed. By shifting the responsibility from federal FEMA to the individual state UI programs, jobless families are often left with extremely limited assistance, especially in Southern states like Louisiana.[15] Moreover, employers and disaster states are left paying the extra costs of the benefits when they can least afford to do so.

C. The States Pave the Way for the Federal UI Modernization Legislation

Despite the magnitude of the challenge, the states have been at the forefront of major reforms during the past decade building on the recommendations of the federal Advisory Council on Unemployment Compensation (ACUC) and other authorities to modernize their UI programs. Since 1996, nearly half the states have adopted bold new policies to fill the gaps in the UI system.[16]

The UI modernization legislation before the subcommittee today takes the best of what has already made its way into these state UI laws and provides the necessary incentive funds to help more states fundamentally improve their programs. In addition, the proposal correctly rewards those states that have been leaders in building strong UI programs. With a reasonable investment of $7 billion, the federal legislation could help at least 500,000 workers a year.

1. *The 33% Incentive Payment for the "Alternative Base Period"*

In 1995, after detailed study, the bi-partisan ACUC recommended that "All States should use a moveable base period in cases in which its use would qualify an Unemployment Insurance claimant to meet the state's monetary eligibility requirements."[17] Since that time, another 12 states have adopted this policy, now covering 20 states and nearly half of the nation's unemployment claims (Table 1). This critical reform fills the most significant gap in the UI program denying benefits to low-wage workers. The draft bill correctly conditions Reed Act incentive funding on a state first adopting this policy.

Why is this policy so critical to qualify for special treatment under the draft UI bill? Most low-wage workers, especially those who have recently returned to work, need to use all their earnings to meet the state work history requirements necessary to qualify for unemployment benefits. But that is not the policy of many states that still fail to count a worker's latest 3 to 6 months of wages. These states instead rely on eligibility rules that date back to when an individual's wages were collected in paper form from the employer and hand processed by the state agency.

For example, if a worker applied for benefits today (March 15th), the only earnings considered by the state would date from October 2005 to September 2006 under the traditional base period, thus not counting 5.5 months of recent wages. As shown below, if that worker was employed at the minimum wage for 20 to 30 hours a week for the past 8.5 months (since July 2006), she would not qualify for benefits even if the state required just $1,500 in base period earnings.

[13] National Employment Law Project, "Nation's Highest Unemployment States Face Major Cuts in Unemployment Benefits Due to Flawed Extension Program" (November 4, 2003).

[14] Center on Budget and Policy Priorities, "Number of Unemployed Who Have Gone Without Federal Benefits Hits Record 3 Million (October 13, 2004).

[15] National Employment Law Project, "Rising Hurricane-Related Jobless Claims Trigger State Cuts in Limited Jobless and Training Benefits" (Revised October 17, 2005).

[16] National Employment Law Project, *Changing Workforce, Changing Economy: State Unemployment Insurance Reforms for the 21st Century* (October 2004), at page 4.

[17] Advisory Council on Unemployment Compensation, *Collected Findings and Recommendations,* at page 19.

Example: Traditional Base Period In a State Requires $1,500 In Earnings, But a Worker Filing March 15th Earning $4,635 Over 8.5 Months Does *Not* Qualify for UI

First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Completed "Lag" Quarter	Time of Lay-off—"Filing" Quarter
(Oct. 2005–Dec. 2005)	(Jan. 2006 to March 2006)	(April 2006–June 2006)	(July 2006–Sept. 2006)	(Oct. 2006–Dec. 2007)	(Jan. 2007–March 15th)
No Earnings	No Earnings	No Earnings	$1,236 (working 20 hours a week at $5.15 an hour).	$1,854 (working 30 hours a week at $5.15 an hour).	$1,545 (working 30 hours a week at $5.15 an hour).

These are workers who have paid into the UI system like everyone else and earned the same qualifying wages, but three to six months of earnings have been disregarded under the state's outdated UI law. Now, with the help of computers, the states are able to readily capture these more recent wages. Thus, when a worker's prior earnings are not sufficient to qualify for UI using the old wage records, the states with the "alternative" (or "movable") base period (ABP) will also consider the most recent completed calendar quarter of wages. In the example above, the individual would therefore be eligible for UI using her latest completed "lag quarter" of earnings.

About 40% of those who do not qualify for UI based on the traditional base period end up collecting in the those states that have adopted the ABP. They are mostly low-wage workers earning on average of $9.58 an hour.[18] For example, in Michigan, 17% of all low-wage workers who qualified for unemployment benefits did so solely because of the alternative base period. As a result, rather than being denied benefits, 26,000 workers a year are receiving an average UI payment of $232 a week.[19]

According to NELP's estimates, nearly 300,000 new workers will qualify for unemployment benefits if the remaining states adopt the alternative base period with the help of federal incentive grants. The annual estimated cost of $550 million for the new ABP states compares favorably with the $2.3 billion proposed by the UI modernization bill over five years. Given the significant impact of the ABP on low-wage workers and the increased administrative efficiencies generated by the new states that have implemented the ABP, the draft bill correctly isolates the policy for special treatment.

2. *The 66% Incentive Payment for Family-Friendly and UI–Training Reforms*

Once a state has adopted the ABP as proposed by the draft bill, it qualifies to receive the remaining two-thirds share of the Reed Act distribution if it has adopted two out of three additional reforms that address major gaps in today's UI programs. Although we urge the committee to include additional provisions that better target jobless families and the long-term unemployed, we strongly endorse the general approach of this section of the bill.

a. *Parity for Part-Time Workers, Mostly Women with Families*

The draft UI modernization bill rewards those states that allow families to work part-time and collect UI benefits, thus removing the state eligibility provisions requiring workers to seek full-time work to qualify for UI benefits.

Part-time work has now become a necessity for many more workers to accommodate their family responsibilities or to find the time necessary to go back to school and improve their job skills. Today, one in six workers is employed part-time, and most of them are women workers. While working an average of 23 hours a week, only 23% of low-wage part-time workers collect jobless benefits.[20] Responding to this conspicuous inequity, Maine recently provided UI to workers seeking part-time

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[18] National Employment Law Project, Center for Economic and Policy Research, *Clearing the Path to Unemployment Insurance for Low-Wage Workers: An Analysis of Alternative Base Period Implementation* (August 2005).

[19] NELP PowerPoint Presentation, "A Decade of Progress Expanding the Unemployment Insurance Safety Net" (December 10, 2006).

[20] U.S. General Accounting Office, *Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), at page 16.

work, and now more than 70% of those who qualify with the help of the new part-time worker protection are women workers (collecting an average of over $2,000).[21]

Like the ABP provision, this reform was endorsed by the bi-partisan Advisory Council on Unemployment Compensation, which recommended that "Workers who meet a state's monetary eligibility requirements should not be precluded from receiving Unemployment Insurance benefits merely because they are seeking part-time, rather than full-time, employment."[22] Twenty states (Table 1) now cover these workers, including seven new states that have reformed their laws in the past 10 years. If the remaining states allow jobless workers to seek part-time work and collect UI benefits, we estimate that about 200,000 more workers will collect $280 million in UI benefits.

b. *Recognizing Compelling Family Circumstances for Leaving Work*

The states have also made significant progress in recent years accommodating those who have to leave work for compelling family reasons. A state study of UI eligibility rules found that 71% of those who leave work for domestic reasons are women.[23]

More than 30 years ago, the Ford Administration issued a directive urging the states to "change by legislation the legal inequities between the sexes" in the operation of the UI laws.[24] Given the gender inequities that continue to plague the UI program, we strongly support the following "family friendly" provisions adopted by the UI modernization bill.

- *Domestic Violence:* The draft proposal rewards the states that have made UI benefits available to those women who are forced to leave work for reasons related to domestic violence and provides federal incentive funding for the remaining states to follow their lead. In 1997, Maine was the first state to specifically provide "good cause" for leaving work as a result of domestic violence, and since then 28 more states have done so (Table 1). These states recognize that domestic violence is more than a safety and security issue for these families. It is also a societal and workplace concern that requires meaningful public policy solutions, including UI benefits for domestic violence survivors.
- *"Trailing Spouse:"* In addition, the bill addresses a fundamental inequity in state UI laws that deny UI benefits to those who leave their jobs when their spouse is forced to relocate by the employer to another area. This issue has played out most recently as more military families are transferred across the country, forcing spouses to leave their civilian jobs without qualifying for unemployment benefits. An analysis of Virginia's law documented that nine out of 10 workers disqualified by these provisions are women.[25] Despite the 1975 guidance from the U.S. Department of Labor calling attention to the discriminatory impact of this policy, only 17 states provide UI benefits in this situation (Table 1).
- *Family Illness & Disability:* Half of all private sector workers in the United States do not have paid sick days on the job to help accommodate the illness of a child, a parent or other immediate family members.[26] These and other working families are routinely forced to leave their jobs to attend to emergency medical situations, regularly scheduled doctor visits, or to remain home to care for sick family members when child care or elder care falls through. Many of them remain available for work, but require accommodations for work, like shift changes, which their employers often fail to provide. The UI modernization bill would offer incentive funding to accommodate these compelling medical needs of working families, which have now made their way into the laws of nearly half the states (Table 1).

Combined, these reforms would benefit about 60,000 workers if adopted by the remaining states, generating an estimated $200 million in UI benefits for these families.

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[21] NELP PowerPoint Presentation, "A Decade of Progress Expanding the Unemployment Insurance Safety Net" (December 10, 2006).

[22] Advisory Council on Unemployment Compensation, *Collected Findings and Recommendations,* 1995–20.

[23] Washington State Employment Security Department, *Study of Voluntary Quits* (2006).

[24] U.S. Department of Labor, Unemployment Insurance Program Letter No. 33–75 (December 8, 1975).

[25] *Austin v. Berryman,* 955 F. 2d 223, 226 (4th Cir. 1992).

[26] Testimony of Heidi Hartmann, Institute for Women's Policy Research, before the U.S. Senate, Committee on Health, Education, Labor & Pensions (2006).

c. *Extended UI Benefits While in Training*

In response to the special employment challenges of dislocated workers, the draft legislation creates the option for states to provide extended UI benefits to workers participating in meaningful training in demand occupations. Without the extra income provided by unemployment benefits to participate in training, workers are left with no real options other than lower-pay jobs. Thus, we strongly support this proposed policy, which is modeled on the seven states that currently operate similar programs.

These programs have produced strong results and a significant return on the investment. When evaluated in 2002, Washington State's program provided an average of 27 weeks of UI benefits for dislocated workers to participate in state-approved training. Those who participate are mostly workers with just a high school degree who were laid off from manufacturing jobs in aerospace and other state industries.[27] 85% of them participated in community or technical colleges, with the largest numbers participating in information technology programs. By the third quarter after leaving the program, 72% of the more than 8,000 participants were employed, making an average of 92.6% of their pre-dislocation wages.[28]

The studies also show that more extended training in community college programs geared toward skills development can have a meaningful impact on the wages of dislocated workers. For example, an evaluation of dislocated workers participating in Pennsylvania's community college programs found that men earned $1,047 more per quarter by attending community college and women earned $812 more.[29] Another evaluation of community college programs serving dislocated workers found that those workers who were able to participate longer periods of time and complete more technical courses experienced a 10% increase in their post-dislocation earnings.

While some evaluations of federal training have produced limited results, many states have developed successful new models of training and education, often based on sector initiatives that build partnerships between employers, unions and training providers. It is not training just for the sake of training. Instead the training is driven by quality state and local planning that helps build a growing economy. For example, California's Employment and Training Fund, which targets key state industries, provides a return on investment of $5 for every $1 spent on the program (measured by benefits to employers, workers and the California economy).[30]

d. *Dedicating the UI Surtax to the UI Modernization Program*

The draft UI bill properly devotes most of the projected $7.4 billion generated over five years from the FUTA surtax to the UI modernization program. The proposed Reed Act distribution is one-time funding that will not compromise the solvency of the federal UI trust funds (which are projected by the Administration to have nearly $40 billion in reserves in 2008). The Bush Administration has proposed that Congress extend the surtax for the fifth time since it was established in 1977. Before 1977, employers were paying $25.20 per worker in FUTA taxes. In current dollars, however, employers would be paying $84.17, which is far more than the $56 per worker they now pay despite the FUTA surtax. As described earlier, the employer community has benefited from record tax breaks since the 1990s, thus it is not burden to continue the UI surtax.

e. *Key Limitations of the Draft UI Modernization Bill*

While we strongly support the incentive funding structure of the bill and the specific state reforms that qualify for incentive grants, we urge that the bill incorporate the following critical improvements before it is finalized and introduced in the House of Representatives.

1. *Guarantee 26 Weeks of Assistance for the Long-Term Jobless:* Despite the common perception to the contrary, most unemployed workers in U.S. do not qualify for a maximum 26 weeks of state unemployment benefits. Indeed, only 12 states provide a maximum of 26 weeks to all workers (Table 1), leaving an estimated 700,000 workers each year who run out of their UI benefits before six months of job searching. Given the new realities of long-term unemployment, we believe the first priority

[27] Washington State Workforce Training and Education Coordinating Board, *Training Benefits Program Review* (December 2002).

[28] Id., at page 8.

[29] Trutko, et al., *Final Report: Earnings Replacement Outcomes for Dislocated Workers: Extent of Variation and Factors Accounting for Variation in Earnings Replacement Outcomes Across State and Local Workforce Investment Boards* (Capital Research Corporation, March 2005), at page A–8.

[30] Press Release, California Employment and Training Panel, "State Investment in Training Workers is Paying Big Dividends for California Employers, Study Says" (June 28, 2000).

before finalizing the bill should be to provide incentive funding to those states that offer a "uniform duration" of 26 weeks of UI benefits.

As discussed earlier, today's workers have been exhausting their regular benefits at record rates, currently exceeding 35%. Although many workers apply for benefits assuming they qualify for 26 weeks, this is not the case because of the variety of state formulas that limit benefits based on an individual's work history. Indeed, the average U.S. worker runs out of UI benefits after 23 weeks of looking for work (Table 2). In 14 states, the average is 20 weeks or less. Therefore, the raising rate of workers who exhaust their state benefits is not just a function of the economy. It is also a direct result of the state UI laws that limit the maximum weeks of benefits.

Worse yet, these same workers are also denied several weeks of federal extended benefits. That is because federal recession benefits typically cannot exceed half the individual's state UI. Thus, if a worker received just 20 weeks of regular state UI, she can only qualify for a maximum of 10 weeks of a 13-week federal extension. That compares with the 39 weeks of benefits available to those workers in the 12 "uniform duration" states (i.e., 26 weeks state UI, plus 13 weeks federal extension).

This situation creates a serious hardship for working families, especially during recessions. Their limited state benefits, which now average $270 a week, are already insufficient to cover the unprecedented gas prices, a mortgage and health care for the family. In addition, the limited weeks of state UI forces more workers into low-pay jobs before they have a sufficient opportunity to pursue better paying jobs or take part in meaningful training to compete in today's job market.

2. *Support "Dependant Allowances":* Unemployment benefits should be sufficient to cover the basic necessities for workers who lose their jobs and have to support a family. In most states, UI benefits replace only one-third of the state's average weekly wage, which is far less than what's needed to care for most U.S. families. Moreover, low-income families spend far more on basic necessities, thus their unemployment benefits should represent a more reasonable share of the prior earnings. To help address this serious concern, 13 states now provide a "dependant allowance," which augments an individual's weekly unemployment benefits by up to $25 for each dependent in the family. We urge that the draft UI bill incorporate these dependent allowances into the proposed state incentive grants.

3. *Substantially Increase the State Incentive by Distributing the Carryover Funding:* As currently drafted, a significant proportion of the $7 billion incentive funds will remain unspent unless literally all the states meet all the bill's requirements to collect their full Reed Act distribution. To maximize the incentive for the states to modernize their UI programs, we urge that the bill provide for an additional Reed Act distribution in the final year of the program to those states that have enacted the required reforms. By distributing the remaining Reed Act funds, the legislation will significantly increase the incentive for many more states to reform their UI programs. The final payments could be capped, if necessary, at a reasonable percentage of the state's original Reed Act distribution.

4. *Increase the State Funding to Pay for Claimant Services:* Federal funding cuts to state UI administration have deprived the states of the critical resources they need to properly serve the unemployed, especially the large numbers of dislocated workers who often require additional assistance. In addition, the specific provisions of the draft UI bill require more intensive services than the states routinely provide (e.g., the processing of ABP claims, the outreach necessary for women workers to qualify for UI domestic violence benefits, and counseling to explore career options for those who qualify for UI while in training). Thus, we also urge that the bill significantly increase the amount of funding (now capped at $100 million a year) provided to the states for these critical claimant services.

II. Wage Insurance Draft Proposal

With regard to the draft wage insurance proposal, we appreciate the concern being articulated by many about the needs of workers and their families whose lives are thrown into disarray when they lose a good job and find themselves with no other options but to take a major cut in pay on a new job. For nearly 20 years, it has been my job at NELP to help these and other workers to get back on their feet and generate resources to rebuild their communities.

But wage insurance is the wrong solution. Rather than encouraging workers to forgo their long-term interests for a wage insurance job, Congress should focus on more meaningful solutions that create genuine economic security and more family-friendly sustaining jobs in our economy. We have seen it work in the states, which have created subsidized health insurance for the unemployed that runs alongside the UI program and self-sustaining "home protection funds" that provide no interest loans to laid-off families in high unemployment areas.[31] The states have also been at the forefront of new models of training that help make their local economies more competitive and save good-paying jobs.

Like the AFL–CIO and several major unions that have expressed concerns with wage insurance, we also believe that there are far too many unanswered questions that convince us it is not the right time to move ahead with a national wage insurance program.[32]

First, it is important to ask whether wage insurance will promote more downward mobility for the nation's most vulnerable workers, since by definition wage insurance jobs pay far less? Thus, wage insurance jobs are also less likely to provide health insurance and other critical benefits. We believe that the limited federal resources devoted to the economic security of America's workers should promote good employment outcomes and quality jobs, but that is not the case with wage insurance.

We are also not aware of any empirical evidence that wage insurance jobs will provide transferable skills or other meaningful training. Because workers are required to be employed full-time to qualify for wage insurance under the draft bill, the program may actually preclude most workers from pursuing the education and training they need to compete for better jobs in today's economy.

Second, does the experience with actual wage insurance programs make a convincing case that now is the time to create a new national program? What we know from the only major evaluation of a wage insurance program, the Canadian pilot program, is that it failed in most areas to achieve its intended results. Thus, the Canadians never adopted wage insurance.[33] And we are still waiting for the results from the U.S. pilot program serving trade impacted workers over age 50, although we know that participation in the trade program has been limited.

Another question that has not received enough attention is what impact will the program have on other workers who are competing for similar jobs with those collecting wage insurance? A leading researcher with the Upjohn Institute found that "virtually all the employment gains experienced by dislocated workers as a result of the wage subsidy come at the expense of other workers."[34] Will this "crowding out" effect be even more severe in those communities in the Midwest and elsewhere where there are already large concentrations of dislocated workers?

In addition to the research questions, there is also the concern that wage insurance could undermine those federal programs that now provide some measure of economic security to U.S. workers. For example, will major funding and support for wage insurance take precedence over long-delayed reforms of the UI program, not limited to the state reforms provided for in the draft UI bill?

The draft bill creates a new $44 payroll tax on employers to be deposited in a special wage insurance trust fund. While technically separate funding from UI, we are not convinced that employers will see it that way when they lobby against more resources for necessary federal UI reforms, like a functional permanent Extended Benefits program. We are also not convinced that the significant new funding required by the state UI agencies to administer wage insurance will not compete with the additional funding desperately needed to pay for existing UI services.

We are also concerned with the precedent wage insurance will set when hostile groups like the Heritage Foundation are on record strongly supporting wage insurance as a "rapid reemployment" substitute to dismantle the TAA program.[35] Will wage insurance set the stage for more attacks on TAA, which is up for reauthorization this year?

And when the next recession hits, will the Heritage Foundation and others argue for a more limited federal extension of jobless benefits when workers can qualify instead for wage insurance by taking jobs that require a significant pay cut? Already, the Bush Administration has called for waivers of federal UI law to authorize states to experiment with wage insurance with their UI funds.

These are some of the difficult questions that leave many of us who work with these programs convinced that wage insurance could do far more harm than good.

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[31] For a more detailed discussion of these and other state programs, see Emsellem, "Innovative State Reforms Shape New National Economic Security Plan for the 21st Century" (National Employment Law Project, December 2006), at pages 10–11.

[32] For a more detailed treatment of NELP's concerns with wage insurance, Testimony of Maurice Emsellem Before the U.S. Congress, Joint Economic Committee on February 28, 2007.

[33] Bloom, et al., *Testing a Re-Employment Incentive for Displaced Workers: The Earnings Supplement Project* (Social Research & Demonstration Corporation: May 1999).

[34] Davidson, Woodbury, "Wage-Rate Subsidies for Dislocated Workers" (Upjohn Institute Staff Working Paper 95–31, January 1995), at page 22.

[35] Denise Fronig, "Trade Adjustment Assistance: A Flawed Program" (The Heritage Foundation: July 31, 2001).

So what are some of the other priorities for federal reform to create a reemployment system that promotes quality jobs? The first priority of the 110th Congress should be to fulfill the promise of economic security to the nation's workers and their communities that have suffered major job losses due to federal trade policies. Given the record trade deficits and the devastating loss of good-paying manufacturing jobs resulting from federal trade policies, Congress should move boldly to create a more robust TAA program.

Congress should start by establishing an entitlement to TAA training, thus removing the $220 million cap on funding that now deprives training to thousands of deserving workers who have been certified as TAA eligible. The entire TAA program is funded at $1 billion a year, which compares with the $3.5 billion in funding being proposed to create a new wage insurance initiative. A serious new investment of funding in the TAA program could also pay for coverage of service workers, a new system of TAA certification that applies to whole industries and regions suffering dislocations due to trade, and other necessary reforms.

As described above, there are a number of priorities for reform to the UI program, not limited to the state improvements proposed in the draft bill. For example, to prepare for the next recession and the next federal disaster or terrorist event, Congress should make it priority to fix the Extended Benefits and Disaster Unemployment Assistance programs. Congress should also explore dedicated health care subsidies for the unemployed, which is a concept that President Bush supported during the last recession but it never made its way into federal law.[36] Massachusetts has such a program that provides major subsidies for health care for those who qualify for jobless benefits. These and other programs can go a long way to provide more long-term economic security.

These are tough times for many more working families, full of concern that they will not share in the promise of the American dream, or worse, that they will end up destitute despite a lifetime of hard work. Mr. Chairman, we greatly appreciate your commitment to a discussion of these critical issues and we look forward to the opportunity to continue working together as the draft bills develop.

[36] President's Radio Address, "Senate Must Act on Economy" (January 5, 2002) ("I'm calling on Congress to act immediately to help the unemployed workers. I've proposed extending unemployment benefits by 13 weeks and I've supported tax credits to protect health insurance of workers who have been laid off.")

Table 1: Selected Unemployment Insurance State Provisions*

States	Alternative Base Period	Uniform 26 Weeks of UI Benefits (or the maximum UI may exceed more than half of base period earnings)	Extended UI While in Training	Part-Time Worker Coverage**	Weekly Dependent Allowance of $15 (“O“ indicates states with less than $15)	Compelling Family Reasons for Leaving Work***		
						Domestic Violence	Spouse Relocates	Illness and Disability
Alabama								
Alaska					X		X	
Arizona						X	X	X
Arkansas								X
California		X (1/2)	X	X		X	X	X
Colorado				X		X		X
Connecticut	X(sunsets 12/08)	X			X	X		X
Delaware		X (1/2)		X		X		
District of Columbia	X			X		X		
Florida								X
Georgia	X							
Hawaii	X	X		X			X	
Idaho								
Illinois	X (effective 2008)	X			O	X		X
Indiana						X	X	X

Table 1: Selected Unemployment Insurance State Provisions*—Continued

States	Alternative Base Period	Uniform 26 Weeks of UI Benefits (or the maximum UI may exceed more than half of base period earnings)	Extended UI While in Training	Part-Time Worker Coverage**	Weekly Dependent Allowance of $15 (“O“ indicates states with less than $15)	Compelling Family Reasons for Leaving Work***		
						Domestic Violence	Spouse Relocates	Illness and Disability
Iowa				X	O			
Kansas				X		X	X	X
Kentucky							X	
Louisiana				X				
Maine	X	X	X	X	O	X	X	X
Maryland					O			X
Massachusetts	X		X		X	X		
Michigan	X				O			
Minnesota				X		X		X
Mississippi								
Missouri								
Montana						X		X
Nebraska				X		X	X	X
Nevada							X	
New Hampshire	X	X				X		X
New Jersey	X		X	X	O	X		

Table 1: Selected Unemployment Insurance State Provisions*—Continued

States	Alternative Base Period	Uniform 26 Weeks of UI Benefits (or the maximum UI may exceed more than half of base period earnings)	Extended UI While in Training	Part-Time Worker Coverage**	Weekly Dependent Allowance of $15 (“O“ indicates states with less than $15)	Compelling Family Reasons for Leaving Work***		
						Domestic Violence	Spouse Relocates	Illness and Disability
New Mexico	X	X (3/5)		X	X	X		
New York	X	X	X	X		X	X	
North Carolina	X			X		X	X	X
North Dakota								X
Ohio	X				O			
Oklahoma	X (capped funding)					X	X	X
Oregon			X			X	X	X
Pennsylvania				X	O		X	
Rhode Island	X				O	X	X	
South Carolina						X		
South Dakota				X		X		
Tennessee								
Texas						X	X	X
Utah								
Vermont	X	X		X		X		
Virginia	X							

Table 1: Selected Unemployment Insurance State Provisions*—Continued

States	Alternative Base Period	Uniform 26 Weeks of UI Benefits (or the maximum UI may exceed more than half of base period earnings)	Extended UI While in Training	Part-Time Worker Coverage**	Weekly Dependent Allowance of $15 ("O" indicates states with less than $15)	Compelling Family Reasons for Leaving Work***		
						Domestic Violence	Spouse Relocates	Illness and Disability
Washington	X		X			X		X
West Virginia		X						
Wisconsin	X					X		X
Wyoming				X		X		
Totals	20	11	7	20	13	29	17	23

*Prepared by the National Employment Law Project, this table is based on an analysis of state laws, regulations and decisions.

**State law provisions that require the entire work history to include part-time work are not counted for the purposes of this survey.

***State law provisions that include specific "good cause" exemptions for the categories listed and those exempt "personal" reasons for leaving work are counted for the purposes of the survey.

Table 2: Average Weeks of UI Collected When Workers Exhaust State Benefits (2005)

State	Average Weeks of State UI Collected When Workers Exhaust Benefits
Alaska	20.5
Alabama	23.3
Arkansas	21.9
Arizona	21.8
California	23.2
Colorado	17.3
Connecticut	26
District of Columbia	18.8
Delaware	25.9
Florida	20.4
Georgia	19.2
Hawaii	26
Iowa	21.2
Idaho	18.4
Illinois	25.2
Indiana	18.6
Kansas	22.1
Kentucky	26
Louisiana	22
Massachusetts	26.2
Maryland	26
Maine	17.5
Michigan	23.9
Minnesota	21.5
Missouri	22.1
Mississippi	22.1
Montana	18.8
North Carolina	21
North Dakota	15.8
Nebraska	17.8
New Hampshire	25.7
New Jersey	24
New Mexico	24.9
Nevada	22.9
New York	26

Table 2: Average Weeks of UI Collected When Workers Exhaust State Benefits (2005)—Continued

State	Average Weeks of State UI Collected When Workers Exhaust Benefits
Ohio	25.4
Oklahoma	22.5
Oregon	24.1
Pennsylvania	25.8
Rhodes Island	21.1
South Carolina	20.8
South Dakota	23.8
Tennessee	21.1
Texas	20.3
Utah	19.2
Virginia	19.9
Vermont	25.8
Washington	25.3
Wisconsin	21.5
West Virginia	25.5
Wyoming	19.4
U.S. Average	22.9

Chairman MCDERMOTT. Thank you.
Mr. Holmes.

STATEMENT OF DOUGLAS J. HOLMES, PRESIDENT, UWC—STRATEGIC SERVICES ON UNEMPLOYMENT AND WORKER'S COMPENSATION

Mr. HOLMES. Thank you, Mr. Chairman, Ranking Member Weller, Members of the Subcommittee on income security and family support. Thank you for the opportunity to submit comments today and testify.

UWC fully supports efforts to maintain a sound unemployment insurance system, and targeted measures to reduce the duration of unemployment of individuals who have become unemployed through no fault of their own.

A review of historical trends, really going back to 1942, demonstrates the unmistakable trend in increasing duration in the average number of weeks of unemployment compensation pay. In fact, Mr. Rosen had a good graph to demonstrate this.

Targeted funding to reduce the duration of unemployment compensation is needed. The trend in increasing duration has been caused by a number of factors, including relaxation of state-determined work search requirements and lack of sufficient funding of state employment security agencies focused on integrity of benefit payments, and re-employment services.

Also, insufficient use of information databases, such as the national new hire database and wage information, to identify issues.

There is ample evidence that efforts targeted at unemployed workers who are job-ready will reduce duration. Despite this, funding for these services has been cut, in real dollars, nearly every budget cycle since the mid-eighties. Before large-scale, new programs are enacted, we should properly fund the features of the system we have in place now, in order to evaluate the most effective methods and best practices in returning unemployed workers to work.

Taxes should be cut, not increased. FUTA tax rates should be cut, not increased, as some have suggested. The fact of the matter is that employers have been over-taxed by the FUTA system for decades, while state employment security agencies have been underfunded for critical employment services.

The case for a tax cut is, indeed, compelling. Current tax rates, even without an extension of the two-tenths FUTA surtax, as has been suggested, generate approximately $5.5 billion in dedicated annual revenue, which increases with an expanding economy each year.

Yet, state and Federal employment security agencies have been funded at amounts under $4 billion per year. This annual over-tax—which is actually greater when the two-tenths is on—led to the accumulated balances in the Federal unemployment trust fund accounts that greatly exceed that which may be needed in the event of triggering Federal extended benefits under the current law, or, for title 12 loans, as projected for the foreseeable future.

Sound fiscal policy dictates that Federal unemployment taxes should be set at levels adequate to fund state and Federal Administration of employment security and Federally extended benefits.

Since the early eighties, when Federal advances of states began to earn interest, there has been no program justification for the Federal unemployment account. This account, which is part of the unemployment trust fund, currently maintains a balance of approximately $14 billion, and is growing. It is no longer needed, because loans to states under the title 12 provision now carry interest. The risk of non-reimbursed Federal outlays for this purpose is minimal, and certainly not justification for the maintenance of this level of service.

There is no need for Federal unemployment benefit dictates to states, as have been suggested by some of the other testimony. Contrary to the suggestion that the employer-funded UI system has holes that are in need of fixing, the system works as it was designed. Let me say a little bit more about that.

The coverage—let's be clear about this—the coverage of the system is, indeed, broad. Ninety-7 percent of the salaried and hourly workforce in this country, according to BLS, is covered for potential eligibility for unemployment insurance. What we are talking about is eligibility. When you set eligibility, the determination is based, in part, on the workforce attachment. I can tell you, from my years working in the State of Ohio, that we struggled with this all the time.

What is sufficient workforce attachment before an individual should become eligible for unemployment compensation? Is it $100 a week? Is it nothing? Should we be paying people unemployment for individuals who have never been employed? Is it $200 a week? That's the question that states, right now, deal with in the context of the solvency of their unemployment trust funds. When we talk about whether there is a Federal hole, what I am saying is the coverage of the individuals is there. The question of eligibility is the item that is, for the states, under the current system to determine.

The system was never designed—nor should it be reformed—to assure cash payments to every individual who is currently not working. It is fundamental that coverage and benefit eligibility must be determined in a system that enables states to set state unemployment insurance tax rates based on experience. Failure of the system to be able to ascribe responsibility for unemployment benefit payments to employers based on experience, will lead to an imbalance in taxes to be paid by individual employers across industrial sectors within the business community. Also, a lack of accountability for unemployment benefit causation and ineffective cost controls.

Benefit eligibility determinations are best left to the states where responsibility and accountability rest. UWC opposes Federal requirements as to state benefit eligibility determination.

It should be noted that without Federal mandates, states have acted to address these issues. According to the U.S. Department of Labor, in their 2006 compendium, 33 states have enacted provisions including alternate base periods, 17 states have provisions enabling unemployed workers to limit work search to part-time work, and 42 states considered domestic violence as good cause for individuals to quit employment.

There are, however, no cookie cutter provisions. Any Federal state law that would mandate would be inconsistent with a number of them.

Let me just say on the issue of the wage insurance, a new Federally-imposed wage insurance program would be duplicative of the existing UI wage replacement system. It would create significant tax and administrative cost burdens for business, and for states, and could lead to unintended consequences.

I recognize that there is value in specific situations where a wage insurance might be part of an overall program that would make sense at the local level, but that's something to take a look at down the road.

The cost of a Federally-imposed, across-the-board wage insurance program simply is not justified by its benefit. At $40 per employee, a new wage insurance tax would cost employers approximately $5 billion annually, with virtually no evidence of benefit, in terms of net reduced cost to employers or duration. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Holmes follows:]

Statement of Douglas J. Holmes, President, UWC—Strategic Services on Unemployment and Worker's Compensation

Chairman McDermott, Ranking Member Weller, and members of the Subcommittee on Income Security and Family Support, thank you for the opportunity to submit comments with respect to proposals to improve security for American workers.

I am Douglas J. Holmes, President of UWC—Strategic Services on Unemployment & Workers' Compensation (UWC). UWC counts as members a broad range of large and small businesses, trade associations, service companies from the Unemployment Insurance (UI) industry, third party administrators, unemployment tax professionals, and state workforce agencies.

UWC fully supports efforts to maintain a sound unemployment insurance system and targeted measures to reduce the duration of unemployment of individuals who have become unemployed through no fault of their own. A review of historical trends since 1942 demonstrates the unmistakable trend in increasing duration in the average number of weeks of unemployment compensation paid.

Targeted Funding to reduce the duration of unemployment compensation is needed.

The trend in increasing duration has been caused by a number of factors, including:

- the relaxation of state determined work search requirements
- the lack of sufficient funding of state employment security agencies focused on the integrity of benefit payments and reemployment services
- insufficient use of information databases such as the national new hire database, wage information, labor market information and unemployment tax information

There is ample evidence that efforts targeted at unemployed workers who are job ready will reduce duration. Despite this, funding for these services has been cut in real dollars nearly every budget cycle since the mid-1980s.

Before large-scale new programs are enacted we should properly fund the features of the system we have in place now in order to evaluate the most effective methods and best state practices in returning unemployed workers to work.

Taxes should be cut, not increased.

FUTA tax rates should be cut, not increased as some have suggested. The fact of the matter is that employers have been overtaxed by the FUTA system for decades while state employment security agencies have been underfunded for critical employment services.

The case for a tax cut is compelling. Current tax rates, even without an extension of the 0.2% FUTA surtax, as has been suggested, generate approximately $5.5 billion in dedicated annual revenue which increases with an expanding economy each year. Yet, state and federal employment security agencies have been funded at amounts under $4 billion per year. This annual overtaxing has led to accumulated balances in the Federal Unemployment Trust Fund accounts that greatly exceed that which may be needed in the event of the triggering of federal extended benefits under current law or for Title XII loans as projected for the foreseeable future.

Sound fiscal policy dictates that federal unemployment taxes should be set at levels adequate to fund state and federal administration of employment security and federal extended benefits. Since the early 1980s, when federal advances to states began to earn interest, there has been no program justification for the Federal Unemployment Account. This account, which currently maintains a balance of approximately $14 billion and growing is no longer needed as amounts "loaned" to states must be repaid with interest. The risk of non-reimbursed federal outlays for this purpose is minimal and certainly not justification for the maintenance of this level of reserve.

There is no need for Federal unemployment benefit dictates to states.

Contrary to the suggestion that the employer funded UI system has "holes" that are in need of fixing, this system works as it was designed, to pay unemployment compensation benefits to those who demonstrate a workforce attachment, become unemployed through no fault of their own, who are able, available and actively seeking suitable work.

The system was never designed, nor should it be "reformed", to assure cash payments to every individual who is currently not working.

It is fundamental that coverage and benefit eligibility must be determined in a system that enables states to set state unemployment insurance tax rates based on experience. Failure of the system to be able to ascribe responsibility for unemployment benefit payments to employers based on experience will lead to an imbalance in taxes to be paid by individual employers across industrial sectors within the business community, a lack of accountability for unemployment benefit causation, and ineffective cost controls.

Benefit eligibility determinations are best left to the states, where responsibility and accountability rest, to set the appropriate state unemployment tax rates, based on experience, to raise the funds needed to pay current and projected benefits.

UWC opposes federal requirements as to state benefit eligibility determinations. This opposition extends to federal mandates with respect to provisions which would permit unemployed individuals to limit their work search to part time employment and treating quits from employment for compelling family reasons as non-disqualifying.

It should be noted that without federal mandates states have acted to address these issues. According to the U.S. Department of Labor, 33 states have enacted provisions including alternate base periods, 17 states have provisions enabling unemployed workers to limit work search to part time work, and 42 states consider domestic violence as good cause for individuals to quit employment.

There are, however, no "cookie cutter" provisions, and any new federal mandate would be inconsistent with a number of these state provisions.

A new federally imposed wage insurance program would be duplicative of the existing UI wage replacement system, create significant tax and administrative cost burdens for business and for states, and lead to unintended consequences.

The current unemployment insurance system provides weekly wage replacement payments to unemployed workers who are covered by the program, and meet weekly eligibility requirements. The UI benefit system typically delivers checks to unemployed workers within three weeks of applying for and claiming unemployment compensation benefits.

Approximately 97 percent of the wage and salaried workforce in the United States is already covered for unemployment insurance. Wage replacement rates for unemployed workers are typically set at 50 percent of the worker's average weekly wage up to state legislated maximum weekly benefit amounts.

In some sectors, particularly in manufacturing, there are Supplemental Unemployment Benefit (SUB) plans that are the products of collective bargaining negotiations and typically provide additional wage replacement payments of 90 to 100 percent of the individual's wages while working. As a condition of receiving these SUB payments, individuals are normally required first to apply for unemployment compensation under the state UI system. SUB pay amounts are then determined to make up the difference as long as the individual remains available to be called back to employment with the employer and otherwise meets the requirements of state unemployment compensation law with respect to continuing eligibility.

Employers with SUB plans would be required to pay the new wage insurance tax while receiving virtually no benefit in reduced regular unemployment compensation duration.

A broad based overlay of yet another wage insurance supplement payment is not necessary and creates administrative complexity for states and employers. For example, under state unemployment insurance law individuals are required to accept suitable work taking into consideration their employment experience and skills, as long as wages paid for the position are consistent with those for such positions in the local labor market.

How will wage supplementation be considered in such situations? May an unemployed worker refuse an offer of work based only on wage compensation that is significantly above that which would otherwise be available in the local labor market? What impact would this have on the willingness of individuals to seek improved education and training? The number of individuals in America's workforce who are working multiple jobs on a full-time and/or part-time basis has grown in recent years, adding considerable complexity and administrative burden in making these determinations.

It should also be noted that even where there may be federal policy justification for wage supplements for targeted populations on a temporary basis, such as the current TAA program, funding for such programs is not appropriately attributable to the employer paid FUTA system. The integrity of the FUTA funded system must be maintained, and benefit determinations controlled by the states, to assure long term solvency of the unemployment system.

It is well accepted that individuals, if not provided with incentives or sanctions, will delay aggressive work search activities until the end of their period of compensable unemployment. An additional wage insurance program to encourage acceptance of the first job, although reducing the duration of regular UI benefits, may result in an extended duration of supplemental wage insurance payments.

The cost of a federally imposed across the board wage insurance program simply is not justified by its benefit. At $40.00 per employee, a new wage insurance tax would cost employers approximately $5 billion annually with virtually no evidence of benefit in terms of net reduced costs to employers.

A review of the current, more modest and targeted TAA program has not been completed and at this point is inconclusive as to demonstrated benefits. At a minimum, further consideration of any tax increase to fund additional wage insurance, not to mention a $5 billion per year tax increase to be paid by employers, must await the completion of reviews of this program.

Chairman MCDERMOTT. Thank you. I want to thank you all. As I said earlier, your full testimony will be put in the record.

Let me begin, Mr. Rosen, by asking you a question. It has been suggested, I think on this panel, that wage insurance would force, or perhaps overly encourage, dislocated workers to take jobs with lower pay. I would like to know your response to that, because it's been suggested that wage insurance will crowd out of jobs lower-skilled workers who might have access to them by having people coming from above.

We have at least the experiment of the trade assistance, and I would like to hear from that experience what the real fact is.

Mr. ROSEN. Thank you very much, Mr. Chairman. First of all, let me say that Washington State is very fortunate in having Rob Mills, who is our Trade Adjustment Assistance (TAA) coordinator. He helped me identify people who are currently involved in the program. He is very committed to the program, and really, I wish every state had a person like him running the TAA program. We spoke to some people.

Unfortunately, I have to say publicly, the Department of Labor has not been very helpful in giving us access to these kinds of experiences. So, we have to go out on our own and talk to people, and I have done that.

Let me tell you about a couple, and then I can let you know about more of them at another time. A woman by the name of Mary lives in Vancouver. She was a project coordinator, and was laid off from Hewlett Packard, where she made $20 an hour. She wanted to take a job as a senior care provider, which initially paid $9.06. It's really hard, when you're listening to these experiences, not to respond. Later, that wage was increased to $12 an hour.

She said—and this is almost a quote—"I needed to get back to work right away for financial reasons." So, this is not a woman that was being forced back to work because of some arbitrary deadline. This is a woman who was looking for a job immediately. She said, the Alternative Trade Adjustment Assistance Program was very helpful, because it cut her losses in half. In fact, it gave her $4,000 more than she would have made, otherwise.

If you don't mind, I want to give you one other experience, because it's a little bit different, and that is we have a 63-year-old man who lives in Longview, laid off from Weyerhaeuser, where he earned $22 a week. Again, because he is 63, he did not want to just have unemployment insurance. He needed to go back to work to pay for, bills at home, and things like that, and, for his own esteem, he also wanted to be back at work.

So, he took a new job at a pulpmill in Kosmopolis—I learned a lot through this discussion—where he earned $17 an hour. He—and this, I think, speaks to Secretary Reich—he subsequently lost that job, and went back to Weyerhaeuser. However, the point is that alternative trade adjustment assistance helped close that gap when he was making $17 an hour, in that interim period, until he got back to his previous job.

So, here are two different cases of—one, a woman who needed to get back for financial reasons, and it's a good thing that Alternative Trade Adjustment Assistance (ATAA) was there and another case where Alternative trade Adjustment Assistance served as a cushion while the worker adjusted to the labor market conditions, which is, helping him get back to his previous job.

Now, we did hear from some people about the issue of training and wage insurance. Another person I spoke to lives in southeast Washington, and was laid off from Seneca Foods where he made $20 an hour. There weren't a lot of opportunities or there training programs there. So, basically he had no option but to find another job, which paid $14 an hour. Wage insurance helped him by topping off by about $3,000 for the 2-year period.

So, wage insurance kind of fits in there, and fills that gap. The only last thing I am going to say is—and I must say that I brought this to you back when you invited me to testify in the spring. I am totally in agreement that we need to know more about how this program is working. We have the luxury of having a program in place that we can study to find out more about how it would work more generally. Unfortunately, we have been unable to get that GAO study because of pressure from interest groups. However, I think we should plough ahead and get those studies, and learn something about the program, so that we can make public policy based on fact, not on—based on just impressions.

Chairman MCDERMOTT. Are you talking about information from the Department of Labor, or from the GAO?

Mr. ROSEN. Well, again, I lament having to say this, but I would be dishonest if I didn't say it to you. The Labor Department refuses to provide the kind of data we need to understand how these programs work. To make it even worse, I have recently learned that they have just started, after 5 years, collecting these data. So, they don't even have a lot of the data.

So, we cannot, unfortunately, count on this Department of Labor to tell us how labor programs work. So, what we do is we go to the Government Accounting Office. They do a great job, and they go out and actually interview workers.

Now, another option you could do is ask the CBO to do a study. Those tend to be more economic-oriented. However, I think the GAO study, which would really get to talk to people, I think that would be useful.

Chairman MCDERMOTT. Yes?

Ms. LEE. I would totally agree with what Howard Rosen said, in terms of the lack of data. It's very frustrating for us as well, we can't get data about how the program that is in place is working.

What I would say, in terms of the research that has been done by the Upjohn Institute, they have done some simulations, and they also followed the Canadian pilot program, that——

Chairman MCDERMOTT. Which organization?

Ms. LEE. The Upjohn Institute.

Chairman MCDERMOTT. Upjohn. Okay.

Ms. LEE. This is a 1995 study, a somewhat old study, which ran simulations that found that virtually all the employment gains experienced by dislocated workers as a result of the wage subsidy come at the expense of other workers. They raise the same question with respect to the Canadian pilot program, as well, that the possibility that gains from dislocated workers would come at the expense of other groups of workers.

So, I think that we have no information from the ATAA program. The little we know of the Canadian program, I think, is somewhat problematic.

Chairman MCDERMOTT. You are suggesting that there is a reason to do a good study?

Mr. ROSEN. Yes. I will respond very briefly. Those studies that were cited are based on a different structure of a program.

As I mentioned before, the program that you are considering, the program that is in place now under TAA, only the worker—the worker and the Federal Government have the relationship. The employer doesn't even know about it. No one else needs to know about it. So, the outcomes would be different.

Mr. EMSELLEM. That's not true, as far as I know. That study simulates a wage insurance program that provides $10,000 a year, exactly what is proposed here.

Our concern, to be honest, is even more than what's been documented in the Upjohn study, in their simulations, that when you get into the situation—take Michigan—where you have lots of layoffs, so have a lot of concentration of unemployed workers, that that creates even more pressure, this crowding out effect that we're talking about.

So, at the same time that you're trying to help those workers where there is a lot of need, you're hurting a lot more workers with a lot of need. That is—and we just don't know. I think the answer is—and that's why we are—have a lot of concerns about wage insurance. These are huge questions that we don't know the answers to. However, we——

Chairman MCDERMOTT. So, I am—have already abused my seat, so I am going to move to Mr. Weller. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman. Of course, you have the gavel, so I think you certainly have the privilege of going over your time, if you so wish. I thank you for this hearing, because I feel it's an important one.

Mr. Chairman, I think one thing that has come clear is I think people question sometimes, who pays the payroll tax? I think it's really important that we, as a Subcommittee, understand exactly who pays the payroll tax. Since payroll tax for unemployment insurance is different than the Social Security payroll tax. For the Social Security payroll tax, half is paid by the worker, half is paid by the employer.

In the case of the unemployment insurance tax, it is paid solely by the employer. Many would argue that when you tax the employer more, there is less money available to provide better wages, that that tax competes with the ability of that employer to give a pay raise, or salary increase, to the workers.

Also, I think it's important we understand how much we currently generate from the payroll tax. Right now, the permanent Federal unemployment insurance tax generates about $6 billion a year. Since the seventies, Congress—because we always need a revenue to disguise the deficit—has extended the temporary surtax from the seventies, and that generates about $2 billion a year.

The Chairman has proposed extending the surtax, and you're absolutely right, it was in the Administration budget, extending it. The Secretary of Treasury, when I asked why, he said, "Well, we put it in there," and would not explain that they wanted the revenue just to disguise the deficit, which is the reason they included it.

Also, the Chairman's proposal also adds an additional surtax on top of the permanent payroll tax, on top of the temporary surtax, of an additional $6 billion a year. So, we would go from collecting $6 billion from the permanent tax today, the additional $2 billion from the temporary surtax—that totals $8 billion—and then add on top an additional $6 billion more in new taxes. That would be a total of about $14 billion a year being collected each year for this expansion of the unemployment tax system, so more than doubling the current tax burden on employers. Again, I note that tax burden is not paid by the employee, the worker, it's paid by the employer.

We have a $35 billion surplus. If you look at annual uses, expenditures out of the unemployment system, out of that trust fund even, considering the so-called business, or economic cycle, that's about 7 years' worth of surplus that is currently in the system.

Mr. Rosen, Ms. Lee, and Mr. Emsellem have raised questions and concerns about the concept of wage insurance, which I think has real merit. I would ask, for the record, if you would submit answers from Ms. Lee's testimony, pages 9 through 11. It has a series of questions. If you would submit answers for the record answers, I would certainly appreciate it. Mr. Holmes?

Mr. HOLMES. Yes, sir.

Mr. WELLER. You are the one on the panel that raises concerns about the increasing taxes on employers, even though we have a $35 billion surplus.

First, this additional $35 billion, even if Congress were to decide to expand assistance to the states, do you feel we need to raise taxes in order to do that, considering the surplus that is in the current trust fund?

Mr. HOLMES. No. I think that the continuation of the FUTA tax at the existing level without the two-tenths, combined with the existing balances that are in the fund, is more than sufficient.

In fact, I would go further to suggest that the—some of that money, particularly that in the Federal unemployment account, is not needed, and could be used to assure that we didn't have tax increases in the—or need tax increases in the foreseeable future.

Mr. WELLER. Mr. Holmes, I have proposed in my legislation that states be given greater flexibility in designing unemployment programs. A possibility would be maintaining unemployment assistance, plus a wage insurance program.

Would you support giving states greater flexibility to experiment and design programs that may adapt to their particular states?

Mr. HOLMES. Thank you. Yes, Mr. Weller, I think that makes sense, from the standpoint of I know, from my own experience in administering these programs, that there is a need for a combination of re-employment services, and in certain circumstances, additional wage supplementation can be helpful in moving somebody into work.

Mr. WELLER. Yes. Mr. Rosen, how do you feel about giving states greater flexibility to experiment?

Mr. ROSEN. Flexibility in Washington translates into fiscal burden in states. I work a lot now with states, and they have heard about this word, "flexibility," and every time they do it, it means that they have to do more with less money.

So, I think that we have got to stop playing that game. We do need to open it up so, as I said, we have a system that is one size fits all. We need to have more flexibility in that system. However, we can't do that at the expense of the—at the provision of services at the state level.

Mr. WELLER. Mr. Rosen, under the Chairman's proposal—and he is well-intended; we disagree on some things—but his proposal provides, essentially, temporary assistance to the states, and then takes it away. So, how is that not imposing a future financial burden on that particular state?

Mr. ROSEN. Right. Well, I am not here to defend the Chairman's proposals.

Mr. WELLER. However, you can comment.

Mr. ROSEN. I can comment on them. As I said at the beginning, we have a very strong feeling about the program. We may differ about specifics.

The proposal that I have put forward is to raise the maximum income level in the FUTA tax, and that is how I would finance all of this. I will say this outright, that I am concerned about taking money out of the trust fund. We have already robbed the Social Security trust fund, why are we going to start robbing the UI trust fund?

So, I think we just need to do a correction that has been long overdue—over 25 years. You could actually raise the maximum income level. Let's say, over time, you took it from $7,000 to $45,000, which would be the inflation adjusted, and you could reduce the payroll tax. You could remove the 0.2 tax, if you just corrected——

Mr. WELLER. Mr. Rosen, we have $35 billion surplus in the fund, and it can only be used for one purpose, so——

Mr. ROSEN. That's why I would only use it for that purpose.

Mr. WELLER. However, the point is, if you want to argue about raiding the unemployment fund—no one has proposed doing that—if you just allow that surplus to stay there, it's used to disguise the deficit——

Mr. ROSEN. Again, let's——

Mr. WELLER [continuing]. In the same way that the Social Security trust fund has been used to disguise the deficit in the past.

So, based on that argument, Congress, over the decades, has already been raiding the unemployment trust fund, solely to disguise the deficit, as we have the Social Security trust fund.

Mr. ROSEN. As you, yourself, said——

Mr. WELLER. Short answer.

Mr. ROSEN. Excuse me?

Mr. WELLER. Short answer.

Mr. ROSEN. I am sorry. As you, yourself, said, the payroll tax actually is paid by people. That trust fund is not there for general revenue. That is people's money that they give to the Government, to hold in a bank——

Mr. WELLER. Paid by employers.

Mr. ROSEN [continuing]. To pay back for unemployment insurance. If I could just quickly, we do have to have this conversation based on facts—the amount of benefits paid in 2001 was $31 billion. In 2002, $40 billion. The esteemed previous head of the Fed is suggesting that we might move into a recession. No one knows when that's going to come. However, when it comes, I can tell you that unemployment is going to go up. The question is, are we going to have that money in the trust fund at that time?

So, it may look very nice right now, but the trust fund has not always looked that way. It looks nice now, because unemployment is at 4.5 percent.

Chairman MCDERMOTT. Thank you.

Mr. ROSEN. It could——

Chairman MCDERMOTT. We are going to move on to Mr. Lewis.

Mr. LEWIS OF GEORGIA. Thank you very much, Mr. Chairman. I will be very brief.

Mr. Holmes, you mentioned some concern in your testimony about the trend of increasing unemployment compensation duration. However, you seemed to miss the point. The real trend seems to be in increasing unemployment duration about 40-percent increase in duration from the fifties to the present.

Are you saying today that you disagree with your fellow panelists? Mr. Rosen, do you disagree with the Secretary of Labor, and others, who argue that changes in the economy have made employment less—temporary, and make structure of employment more——

Mr. HOLMES. Not at all. Thank you for the question, if I was unclear about that. I very much agree with what Mr. Rosen has laid out, in terms of increasing duration. I think that is something that is of a concern to us. I think it's also true that there has been a shift, as many of us know, in the numbers of individuals in the manufacturing sector. That's something that can be tracked, going back to post-World War II.

So, I think that's a concern for us, and I think that we would support strategy and resources to try and move people more effectively into work, once they become unemployed. Absolutely.

Mr. LEWIS OF GEORGIA. Well, let me ask—okay, maybe one of you can tell me. What happened to low-income workers? Lose a job, run out of benefits. Do you have data or research? What happened to that?

Mr. HOLMES. If I may, I think that the low-income workers are served through a number of systems, including unemployment insurance. If they do not qualify——

Mr. LEWIS OF GEORGIA. Years ago, I used to hear people say, "I am going down to the office to collect my pennies." That was many, many years ago, right? That was during the forties, the fifties, and maybe sixties, "I'm going to collect pennies." It was so small. Right?

Mr. EMSELLEM. Right.

Mr. LEWIS OF GEORGIA. It's still small, right? Are you agreeing, Mr. Rosen?

Mr. ROSEN. Well, one of the proposals——

Mr. LEWIS OF GEORGIA. Are people still collecting pennies?

Mr. EMSELLEM. Yes. Yes.

Mr. ROSEN. It's just directly deposited now, they don't collect it.

Mr. LEWIS OF GEORGIA. Well, okay. So,——

Mr. HOLMES. The percentages are similar to what they have always been, the 50 percent of their wages. If their wages are low, the amount——

Mr. LEWIS OF GEORGIA. Mr. Rosen is shaking his head.

Mr. ROSEN. You want to do it?

Mr. EMSELLEM. Yes. Low-wage workers, on average, probably get about $100 to $150 in unemployment benefits a week. One of the proposals that we put forth in our testimony was to help increase that by adopting what is called dependent allowances, because that's a special burden with low-wage workers with families. The dependent allowance provides an extra $15 to $25, per dependent, to raise that check, which would help a lot. A lot of states have done that, and that's a big priority, to raise the benefits.

Obviously, like Mr. Rosen said, it would be great to bring up the unemployment benefits for everybody. That's a tough sell in the states. However, we think a good place to start, because we're promoting state experimentation, not mandates on the states; none of this is about mandating any state to do anything, it's all about promoting the states that want to do good things with extra money. There is a real need, and a real opportunity to raise the benefits for low-wage workers, if the bill includes those provisions.

Could I comment on taxes real quickly, just because it's come up so much?

Mr. LEWIS OF GEORGIA. Yes.

Mr. EMSELLEM. I just want to set the record straight. Number one, the trust funds have $30 billion. The last recession, a mild recession comparatively, the extension cost $25 billion on its own. Then you take into account the loans that were made out of the Federal trust fund. That adds another $10 billion. There is your $30 billion, out the window. Take a more severe recession, it's all gone.

Employer taxes. Employer taxes, before the surtax in 1977, they were paying $25 per worker. Now they are paying $56 per worker. If you adjusted for inflation before the surtax to today, they would be paying $86 to $84 a worker. So, that's more, not including the surtax.

So, the burden on employers—and then the real story of the unemployment system, when you get behind some of what's been going on in congress is that the unemployment system has been subject to record employer tax cuts during the eighties, which puts a lot of pressure on the states to deny benefits. In the nineties, taxes went down 33 percent. In 2001, they hit a record all-time low of one-half of 1 percent of total wages, okay?

So, there is not a huge demand on employers right now, relatively speaking to prior years. In fact, I think it could be argued that they are not paying their fair share of unemployment taxes.

Mr. LEWIS OF GEORGIA. My time has run up. Mr. Chairman, if I could have just another 30 seconds, maybe for Mr. Rosen and maybe Ms. Lee to respond?

Mr. ROSEN. To this? In 1935, when the program was created—and this is documented—it was hoped that we would get a 50 percent replacement rate, meaning that the UI payment would be 50 percent of the previous wage.

We have almost never achieved that. The last time we came any kind close was in the seventies. Right now, the national average is a little bit above 30 percent. Some states do it better. Washington State does a really great job. There is almost double the national average. They give the family support that other states don't give.

We have a national phenomenon in this country right now. Unemployment rates are converging. We are all starting to look alike, we are all facing technology change, international trade, and demand changes. That's not something that hurts just the Midwest or the Northeast. So, why is it that we have this accident of where you live, and how much a state can pay? It should be based on if you lose your job we should come up with trying to help you readjust, regardless of why, or where you live.

Mr. LEWIS OF GEORGIA. Ms. Lee?

Ms. LEE. Nothing to add, thank you.

Mr. LEWIS OF GEORGIA. Okay. Thank you, Mr. Chairman.

Chairman MCDERMOTT. Thank you. Mr. English?

Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Rosen, just so I am clear from some of the testimony, fear has been expressed that wage insurance is some sort of a stocking horse for repealing TAA. Do you favor repealing TAA?

Mr. ROSEN. I certainly don't. In fact—and thank you very much, Mr. English, for that question. I just want to say, for the record, in this town there are a lot of people who take credit for things that they do. You don't. I will just say that you have been one of the champions of the trade adjustment assistance program, and thousands of people in this country should be grateful for what you have done.

I actually would argue that our general programs should start looking more like the trade adjustment assistance program. You don't need to go all the way, trade adjustment assistance gives you 2 years of unemployment insurance if you're in training. Okay, we may not need to go all that far. However, I think we need to move the general programs into that direction.

One of the great things the congressman brought into this program, in addition to wage insurance, was a health care tax credit. We are all lamenting here today what to do about health care for the unemployed. By the way, they account for about 25 percent of that 47 million people without insurance that we hear about. Having a health care tax credit could deal with that problem right away. IRS is——

Mr. ENGLISH. What sorts of changes would you recommend to make the health care tax credit more usable for more work?

Mr. ROSEN. The tax credit right now is at 65 percent. Again, they have come up with, I think, a wonderful way that it works. You don't get the credit at the end of the year, you get it in the month that you must pay your insurance, so you can do the cash flow. However, what we hear from people is that the 65 percent is too low. There, maybe we should raise it some. I think we should expand it to more people, at the same time.

However, back to this comment on flexibility, I don't think we should go 100 percent, because we should give the opportunity to states—and some states do—to top it off, if they want. If I could just take this as an opportunity?

Mr. ENGLISH. Sure.

Mr. ROSEN. The wage insurance program that was set up under Trade Adjustment Assistance was clearly the beginning. It was never meant to be the end. There are some things in there that need to be corrected.

For example, there is a 26-week requirement, under TAA, to opt into one or the other program. We have now had 5 years of experience. There are people who complain that that forces people to take jobs too early. There are Members of Congress who are seriously considering adjusting that requirement. We learn over time. We had to start somewhere.

The other second thing is this issue of training. Well, maybe we can provide training to people while they are in wage insurance at the same time. To me, that raises the question, is someone who is working full time going to take training at night?

Well, maybe then we think—and I'm sorry to use this opportunity to be even more bold——

Mr. ENGLISH. Very helpful.

Mr. ROSEN [continuing]. Maybe we provide wage insurance for part-time people, people who go back to jobs part-time, and then take training on their own. These are all things—my point is, the comments that are being made, I think, can all be addressed in the structure of the program, and I think that—not undermine the whole idea.

Mr. ENGLISH. On that point, the concern has been raised that an expansion of wage insurance is somehow—potentially could be financed at the expense of FUTA, or through FUTA. Isn't this something that, in fact, could be financed from general fund dollars, let alone by dedicated taxes unrelated to the financing mechanism for unemployment insurance?

Mr. ROSEN. I will be very brief, and I would be happy to provide you with more detail. However, the genesis of this is that Trade Adjustment Assistance was seen as a way to—and excuse me for using these terms—redistribute the wealth that we get from international trade to those people who pay a price.

So, it was understood—these programs have been in place for 40 years—it was understood that the Federal Government is the best way to do that. The Government gets the benefits for all people, so the Government would pay for trade adjustment assistance. It was a very small program. That's how it originally came out of general revenues.

It is an entitlement. Just so that you know, the budget, we're talking about $1 billion right now. I believe that, as a labor market program, it would make sense to start consolidating these things, and maybe we should think about moving these, looking at at least the funding part of Trade Adjustment Assistance, as part of a broader scheme.

Why is it that TAA is funded out of general revenues, but yet UI is funded out of a payroll tax? I'm not ready to suggest any one way to go about it. I am just giving you the history. The fact that the program, TAA, is now getting larger, I think we should think about that. Is it still the right way to do it, to come out of general revenues, or should we bring it out of trust funds, like or other labor market programs?

Let me just add—again, to put all this in context, another proposal that has been discussed is we should finance the trade-related assistance out of import tariffs. That's the tax that we impose on foreigners to import their goods. So, why don't we use that money to help those people who are adversely affected by those imports?

I am just putting this out there, so you know the quantity. Again, I am not advocating. We collect about $19 billion a year in import tariff revenues. So, we could take some of that money and use it to pay for adjustment assistance. It would be a very kind of logical way to do that——

Mr. ENGLISH. My time is up, so I am going to yield back to the Chairman.

Mr. ROSEN. Sorry, what did you say?

Mr. ENGLISH. I will leave it to the Chairman to——

Chairman MCDERMOTT. Well it's a——

Mr. ROSEN. What did you say, Mr. Chairman? I didn't hear what you said before.

Chairman MCDERMOTT. I said it's kind of a user fee.

Mr. ROSEN. Right, right.

Chairman MCDERMOTT. Ms. Lee, you had something you were going to say, and I would like to—in response to what Mr. English is talking about.

Ms. LEE. Just very briefly, in terms of this question about whether wage insurance is a stalking horse for the TAA program, it's certainly the case that the Heritage Foundation has explicitly proposed that if the aim of wage insurance programs is to help workers find new jobs, then TAA should be eliminated over time, and replaced by a program that provides incentives, not disincentives, for workers to do just that. So, it's not in only our mind that this has been a proposal. This is what many of the proponents of wage insurance have explicitly put forward.

In terms of the issues that Mr. Rosen raised, I certainly would agree with Mr. Rosen, that one issue is whether the ATAA is available only for workers not taking training. That has been one of our criticisms. We would like to see that issue addressed in the future, in terms of the ATAA.

The other issue that we have with ATAA pilot program is whether the age limit is reduced from 50 to 40. We would have objections to that. It's one thing for a 50-year-old worker, where maybe it doesn't make as much sense for that worker to invest in the training, but at the age of 40 it's more important, we think, that that worker get the new skills that he or she needs to get a better job in the future, and not the——

Chairman MCDERMOTT. Well, done at 50?

Ms. LEE. Excuse me?

Chairman MCDERMOTT. You're done at 50?

Ms. LEE. Not done at 50.

[Laughter.]

Ms. LEE. I hope not. I certainly hope not.

Chairman MCDERMOTT. Be careful, ma'am. Well, I want to say thank you to this panel, and I want to say that this bill will not pass in the next week, but I wanted to get this discussion started, because I think it's an issue that everybody on the panel cares about and wants to come to some kind of resolution that will benefit the workers of this country.

Both—the workers are Republicans and Democrats, and we really have to find a program that deals with what is best for the workers. Thank you all for your time.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

[Submissions for the Record follow:]

Statement of Jeffrey R. Kling

During the hearing on Increasing Economic Security for American Workers on Thursday, March 15, 2007, Mr. Weller asked for responses to questions posed in the written testimony of Thea Lee. My responses to these questions are provided below, assuming that the wage insurance program is structured as in the draft Worker Empowerment Act provided to witnesses for review.

Responses to questions

- To what extent would a universal wage insurance program shorten unemployment spells?

The introduction of wage insurance is anticipated to reduce unemployment duration for those with wage losses by a small amount. The incentives for shorter duration are two-fold. First, the wage of the new job is higher with wage insurance, making work more attractive than it is without wage insurance. Second, the amount of time during which a worker can collect wage insurance decreases for each day since the job loss that a new job is not found.

There is, however, a counter-acting incentive that total annual income is higher with wage insurance, which can motivate longer unemployment spells in some cases. For example, without wage insurance a worker previously earnings $42,000 per year may take a new job at $30,000 per year immediately after job loss in order to ensure making a minimum annual income (say, to pay a mortgage). If the worker has wage insurance, however, and is confident that a "fall-back" job at $30,000 per year will be available throughout the first several months after job loss, she can afford to search for up to two months for an alternative and still have at least $30,000 in income during the first year after job loss (with $25,000 in earnings from ten months of employment on the fall-back job plus $5,000 in wage insurance).

The evidence from the Canadian Earnings Supplement Project is the most directly relevant to this question, as it provided a form of wage insurance (although not exactly the same as that being considered in the U.S., as it had a requirement of finding a new job within 26 weeks, 75 percent earnings replacement, more generous unemployment insurance benefits, etc.). This project found that unemployment durations were reduced slightly, but not significantly. There was a significant increase in the percentage working full-time 26 weeks after job loss, likely driven by that program's requirement to have full-time work within 26 weeks in order to qualify for the wage supplement payments. A substantial part of this increase involved switching from part-time to full-time work and it was not comprised solely of switching from unemployment to full-time work.

- To what extent would a universal wage insurance program induce workers to accept lower-wage employment they might otherwise refuse?

There is evidence that when searching for a job, the unemployed place emphasis not only on the current market valuation of their skills, but also on how wage offers compare to their previous wages. The availability of wage insurance may help people overcome this psychological hurdle and more quickly accept prevailing market wages. This may also help avoid prolonged unemployment that can further depress wage offers—such as when longer duration is perceived as a negative signal by employers, when individuals become discouraged and reduce search effort, or when their skills deteriorate.

Evidence from tax rate changes and from demonstration projects including the negative income tax experiments and the Canadian Earnings Supplement Project do not provide significant evidence suggesting the availability of wage insurance payments would lead individuals to choose jobs with lower wages than they would in the absence of wage insurance.

- Would these lower-paying jobs lack benefits such as health insurance?

The formulation of wage insurance in the Worker Empowerment Act actually creates incentives for workers to prefer a mix of total compensation that includes relatively more fringe benefits in exchange for lower gross wages. For example, a worker earning previously earning $70,000 may be equally happy with a job paying $70,000 without employer-provided health insurance or with a new job paying $60,000 with the employer providing health insurance having post-tax value of $10,000. If wage insurance were available, the worker would prefer the job providing health insurance. While lower-wage jobs are less likely to offer health insurance in general, beneficiaries of the Worker Empowerment Act will tend to disproportionately seek out those jobs that do offer health insurance.

- What portion of wage subsidy recipients would have taken lower-paying jobs even without the subsidy?

According to the Displaced Workers Survey, one-fourth of those permanently laid off in 2002 had wages at least 25 percent lower than their previous job without any wage insurance.[1]

- To what extent would the employment of wage-subsidized workers displace other workers?

If unemployment durations for those with wage losses decrease as anticipated, then unemployment durations for others with skills similar to displaced workers (such as new labor market entrants) may increase, but total unemployment duration of all groups combined is anticipated to decrease. With increased search intensity among those with wage losses, the total number of jobs and the total output of the economy are likely to be higher, with this increased economic growth reducing any impact on the unemployment durations of other groups.

Davidson and Woodbury (1995) conducted a simulation of what might happen if wage insurance were introduced into their model of the economy, but there is no actual empirical evidence of any impacts on non-recipients of wage insurance.[2] Davidson and Woodbury claim that virtually all the employment gains experienced by dislocated workers as a result of the wage subsidy come at the expense of other workers. This claim comes about largely because the simulation in this study assumes the number of jobs is fixed and there is not any economic growth induced by the increase in work from the wage subsidy. The authors wrote that: "Other groups of workers could experience small increases in unemployment duration, and decreases in employment levels that almost fully offset the gains for dislocated workers ... the crowding-out results are quite sensitive to one of our assumptions—that the total number of available jobs (T) is fixed." The assumption of no economic growth is unlikely to hold true in practice.

- To what extent would employers provide subsidized workers with on-the-job training?

If wage insurance is offered for a specific time period, such as two years as in the draft Worker Empowerment Act, there is an incentive for firms to offer more jobs that have lower initial earnings that would rise more rapidly over time than in the absence of wage insurance. In order for workers to accept offers of lower initial earnings (in the absence of a credible long-term contract), the firm would need to offer some incentive to the workers (such as on-the-job training) that would reas-

[1] Kling, Jeffrey R. "Fundamentally Restructuring Unemployment Insurance: Wage-loss Insurance and Temporary Earnings Replacement Accounts." Hamilton Project Discussion Paper 2006-05, September 2006. http://www3.brookings.edu/views/papers/200609kling.pdf

[2] Davidson, Carl and Stephen A. Woodbury. "Wage-Rate Subsidies for Dislocated Workers." Upjohn Institute Staff Working Paper 95–31, January 1995 http://www.upjohninstitute.org/publications/wp/95-31.pdf

sure the worker that the firm will want to retain them at higher wages in the future.[3] This training would most likely be firm-specific, since otherwise the firm would tend to avoid training for fear of losing its investment in the worker's training if the worker left the firm.

- To what extent would any on-the-job training given by employers provide transferable skills?

In addition to training of workers receiving wage insurance, the existence of wage insurance is also an incentive for firms to offer more firm-specific on-the-job training to all workers. In choosing between a higher-wage job with firm-specific skills or a lower-wage job with transferable skills, the higher-wage job is more attractive to workers when there is wage insurance to help insure against the loss in the event of a layoff of higher wages that are firm-specific. Rather than through on-the-job training, wage insurance would be most likely to provide transferable skills in a situation where the wage insurance payments were used by a worker to attend a community college class providing general skills.

- To what extent would a large-scale universal wage insurance program subsidize low-wage employers such as Wal-Mart?

It would be difficult in most cases for an employer to game the system by paying a worker an artificially low hourly wage in order to increase wage insurance payments, because some of the firm's new hires would not be displaced workers and two pay rates would be needed for the same type of work. The gaming would be perceived as inequitable, transparently visible to many employees, and easily auditable if investigated. This is especially true in a large firm with a human resources department and established position descriptions and pay scales.

- To what extent would employers be able to capture the subsidy by paying subsidized workers less than they would otherwise?

If a firm did offer wages to a wage insurance recipient that were lower than their productivity value, another firm would have an incentive to pay a higher wage and hire that worker. In the absence of collusion by firms, it would not be sustainable for firms to attract workers by offering wages that were lower than their productivity value.

- To what extent would wage subsidies lower wages for non-recipients?

Increases in total labor supply from increased search intensity due to wage insurance may reduce wage levels, in the same manner as any other policy that successfully encourages work. The effect on labor supply is likely to be small, and the effect on wages is likely to be small in magnitude as well. Any effect on wages from increased labor supply would be an outcome for the entire market and would not be an employer capturing a government subsidy for themselves. In the presence of wage insurance, firms may offer more firm-specific training (with lower initial wages but higher average wages), or may also offer new higher-paying jobs with a greater chance of layoff that were not previously offered. These factors could offset or exceed the effect of increased labor supply and potentially lead to higher wages for non-recipients—although the average effect on overall wages is likely to be small either way.

- To what extent would the availability of a program designed to promote "rapid reemployment"—such as wage insurance—be used as an argument against strengthening programs serving displaced workers that have historically been attacked for prolonging unemployment? To what extent would it enable critics of programs serving displaced workers to make them less accessible or less attractive?

These final two questions posed appear to be outside the scope of economic analysis, and no responses are provided here.

Other comments

I recommend making some modifications to the draft Worker Empowerment Act (WEA).

- Introduce a gradual phase-out.

[3] In September 2006, I wrote that the impact of wage insurance "on types of jobs and on associated on-the-job training is likely to be negligible." The analysis in this section is more recent and reflects my updated thinking on this topic.

In WEA, someone whose old job paid $120,000 and whose new job paid $100,000 would receive $10,000 a year. If the new job paid $101,000, they would receive no wage insurance at all. This abrupt phase-out is inequitable, and has incentives for individuals to prefer lower earnings in the range from $100,000 to $110,000.

I recommend removing the eligibility criterion of earning not more than $100,000 per year, and replacing this with a gradual phase-out. One simple method of implementing a phase-out would be to determine the wage insurance payment based on an "insured wage" instead of the pre-separation wage alone. The insured wage would be the lower of the wages on the old job or some maximum value, such as $110,000.

Setting the maximum value of the insured wage involves a trade-off between inclusiveness of a program and the targeting of resources to those who have the greatest need. The use of $110,000 as the maximum value would be consistent with the WEA's current formulation as it pays no benefits to those whose new job pays $110,000 and full benefits to those whose new job pays $90,000.

- Make the cap on payments monthly.

WEA includes a maximum payment of $10,000 per year in each of the two years since separation from the employer. This cap could have some unintended effects for those with very large wage losses. For example, if an old job was $220,000 per year and a new job was $100,000 per year, then a worker could be unemployed for ten months, work two months earning $16,667, and also earn $10,000 in wage insurance for those two months. Since payments are to be made on at least a monthly basis, these unintended effects could be avoided by capping the maximum payment at $833 per month (and could still be accurately described as a $10,000 per year cap).

- Allow flexibility in the calculation methods for pre-separation wages.

In WEA, the wages received by an individual at the time of separation shall be computed based on the wages received by such individual for the 52-week period ending before the date of separation. It may be dramatically simpler to use the calendar quarter of separation and the preceding three calendar quarters, since all firms are filing reports on earnings on a calendar quarter basis.

- Allow flexibility in the calculation methods for pre-separation hours.

In WEA, an individual is eligible for benefits if she is reemployed for substantially the same number of hours each pay period as at the time of separation. There are likely to be considerable advantages in using a requirement such as "reemployed for substantially the same number of hours per week during the payment period as during the period used to calculate pre-separation wages." This would clarify that "at the time of separation" does not mean the hours worked in the single pay period prior to separation, which might not be representative of the period over which pre-separation wages were calculated. Moreover, the hours each pay period will necessarily differ for pay periods of different length, and the pay period duration may vary on the old and new jobs.

- Allow flexibility to potentially incorporate the value of fringe benefits into pre-separation compensation and post-separation compensation.

The underlying principle of wage insurance is to provide a supplemental payment when the compensation on a new job is lower than the compensation on a job from which there was an involuntary separation. When wage insurance payments are based on gross wages, there can be some unintended consequences. For example, a worker previously earning $70,000 with employer-provided health insurance having post-tax value of $10,000 taking a new job paying $70,000 without employer-provided health insurance is clearly worse off, but receives no wage insurance. Conversely, a worker previously earning $70,000 without employer-provided health insurance taking a new job paying $65,000 with employer-provided health insurance having post-tax value of $10,000 is better off, but does receive wage insurance. The extent of these unintended consequences could be reduced if the value of fringe benefits were included in the calculation of pre-separation wages and post-separation compensation.

The wage-loss replacement rate is one-half, and the duration is up to two years in this simulation. They write that "The results suggest that a wage-rate subsidy paid for two years after reemployment would shorten the unemployment spells of dislocated workers by nearly 2 weeks, and would increase employment of dislocated workers by about 900 to 1000 per 100,000 in the labor force. But the simulations also raise the possibility that the gains for dislocated workers could come at the expense of other groups of workers; that is, other groups of workers could experience small increases in unemployment duration, and decreases in employment levels that almost fully offset the gains for dislocated workers. Three factors may mitigate these crowding-out results—crowding out is widely dispersed over various groups of non-dislocated workers, the structural changes that result in dislocation of some workers (and drive the need for a policy like a wage subsidy) benefit non-dislocated workers, and the crowding-out results are quite sensitive to one of our assumptions—that the total number of available jobs (T) is fixed and exogenous." That is, the simulation assumes there cannot be any economic growth.

Statement of National Association of State Workforce Agencies

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to comment on the Unemployment Insurance Modernization Act (UIMA) and the Worker Empowerment Act (WEA). 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, labor market information, and other workforce investment programs.

SUMMARY OF THE UNEMPLOYMENT INSURANCE MODERNIZATION ACT (UIMA) AND WORKER EMPOWERMENT ACT (WEA)

To facilitate our comments on the Unemployment Insurance Modernization Act (UIMA) and Worker Empowerment Act (WEA), we summarize their key provisions below:

Unemployment Insurance Modernization Act

The Unemployment Insurance Modernization Act (UIMA) would:

- Extend the 0.2 percentage point FUTA surtax for five years through 2012.
- Provide up to $7 billion in special Reed Act distributions from the Federal Unemployment Account for UI Modernization Incentives to be distributed between 2008 and 2012 to states meeting specific criteria related to their UI programs and proportionate to FUTA taxes paid in each state.
- One-third of the $7 billion or about $2.33 billion would be available for distribution to states that include wages in the last completed calendar quarter when determining eligibility or after an initial determination of ineligibility.
- Two-thirds of the $7 billion or $4.67 billion would be would be available for distribution to states that include wages in the last completed calendar quarter when determining eligibility or after an initial determination of ineligibility and state law meets at least two of the following three conditions:
- The state does not deny UI eligibility because the claimant is seeking part-time work (State law may limit the application of this provision to former part-time workers.).
- The state includes in the definition of good cause for voluntary leaving employment for compelling family reasons to include at least: (1) avoiding domestic violence; (2) caring for a sick disabled family member and (3) following a spouse whose employment was relocated to a different locality.
- The state provides training assistance to claimants' at the regular weekly benefit amounts for at least 26 weeks who: (1) have been dislocated from a declining occupation; (2) have exhausted regular UI benefits; (3) are in a state-approved training program related to a high-demand occupation; and (4) are making satisfactory progress in such program.
- Provide $100 billion per year in special Reed Act distributions to states for 2008 through 2012 for covering the additional administrative costs of UI modernization and other improvements in administration of UI and employment services.

Worker Empowerment Act (WEA)

The Worker Empowerment Act (WEA) would establish a national wage insurance program to supplement the earnings of dislocated workers who become reemployed in lower-paying jobs. It has the following features:

- Workers would be eligible for wage insurance if they worked for at least two years in their previous job and lost employment through no fault of their own.

- Workers may not go to work with their former employers, must work a similar number of hours to that in their previous jobs, and must not earn more than $100,000.
- Replace half of a worker's lost wages compared to prior employment for two years up to a total of $10,000 per year.
- The program would be financed by a 0.1 percent tax an each employee's wages up to the taxable wage base in the Social Security program, which is currently just over $94,000.

CURRENT NASWA POLICY

Before commenting on the bills Chairman McDermott has drafted, we would like to set the stage by summarizing relevant current NASWA policy. These policies were developed before Chairman McDermott drafted his bills, but they have bearing on our comments. The following policies influence NASWA's reaction to these draft bills.

- Consistent with the National Governors Association (NGA) policy, NASWA opposes the extension of the Federal Unemployment Tax Act 0.2 percentage point surtax beyond 2007 as unnecessary to fund the current "employment security" system. The term "employment security system" is effectively defined by the Social Security Act and the Federal Unemployment Tax Act as UI, ES, and labor market information. A more general term used today is the "workforce development system," which includes the employment security system and other programs, such as those operating within the one-stop career centers.
- Consistent with NGA policy, NASWA supports reducing the ceiling on the Federal Unemployment Account (FUA) to 0.125 percent of covered wages paid in the last year, the ceiling that existed before 1988. This would fund fully the Extended Unemployment Compensation Account (EUCA) and cause an estimated $8 billion Reed Act distribution to the States if effective on October 1, 2007.
- NASWA supports current Reed Act provisions, which allow states to spend Reed Act funds on UI benefits, UI administration, employment services, and labor market information.
- NASWA supports Reed Act distributions of $800 million in each of the next two fiscal years to fund the proper and efficient administration and services of the "employment security system."
- NASWA supports a strong linkage between the unemployment insurance program and the Employment Service, both of which are funded by employer-paid FUTA taxes. These resources must continue to be made available to ensure UI claimants are provided with essential reemployment services and to provide for basic labor exchange activities within the states' workforce development systems. Further, the manner and extent to which these resources are integrated within a state's workforce development system and one-stop structure should be decided at the state level to ensure that they are effectively used in addressing the UI and employment service program needs on a statewide basis.
- NASWA supports appropriation of sufficient funds from the federal unemployment tax revenue to ensure every state will receive a minimum of 50 percent of the Federal Unemployment taxes paid each year by its employers. States currently granted more than 50 percent of federal unemployment taxes paid annually by their employers under current federal grant allocation methods should be held harmless.

COMMENTS ON THE UNEMPLOYMENT INSURANCE MODERNIZATION ACT (UIMA)

NASWA has long opposed another extension of the FUTA 0.2 percentage point surtax. This additional revenue is not needed to fund the "employment security system" fully. We understand the Administration and many Members of Congress propose to extend this tax to help make the federal budget deficit appear smaller and/or to meet pay-as-you-go requirements for funding new spending. Because it is one of the "easy" tax extenders Congress can pass, Congress often has included it in deficit reduction packages or in packages to finance new spending. NASWA believes other taxes should be used for these purposes.

Some have suggested Congress will pass the extension of the 0.2 percentage point FUTA surtax regardless of whether Congress also passes Reed Act distributions for state programs. This has happened in the past and could happen again this year. Recognizing this might even be probable, NASWA must consider the other provisions of the bill that could benefit and cost some workers, employers, states and society.

Without conducting a survey of the states, NASWA has no information on how states might react to the proposed modernization incentives. Such reactions might break down by whether a state has some or all of the provisions that would qualify for incentives. The following is a list of this breakdown:

First, only five states (HI, MA, NJ, NY, and NC) have state UI laws that meet the alternative base period and two of the three non-monetary eligibility provisions.

Second, seven states (AK, AR, CA, IA, KS, MI, and PA) have two of the three non-monetary eligibility provisions, but no alternative base period provision.

Third, fourteen state programs (CT, DC, GA, ME, MI, NH, NM, OH, OK, RI, VT, VA, WA, and WI) have state UI laws that meet the alternative base period provision, but do not have two of the three non-monetary qualification provisions dealing with part-time work, family reasons for leaving employment, and worker dislocation and training.

Fourth, twenty-seven state programs (AL, AZ, CO, DE, FL, ID, IL, IN, KY, LA, MD, MS, MO, MT, NE, NV, ND, OR, PR, SC, SD, TN, TX, UT, VI, WV, and WY) do not have an alternative base period, nor do they have two of the three non-monetary eligibility provisions dealing with part-time work, family reasons for leaving employment, or worker dislocation and training.

NASWA supports special Reed Act distributions for administration of the "employment security system." The bill's $100 million per year for five years totaling $500 million is well short of the NASWA proposal of $800 million over each of the next two years for $1.6 billion. NASWA believes states need these larger sums soon to modernize and improve out-dated administrative systems and to upgrade labor exchange services for UI claimants.

Finally, members of NASWA are frustrated and disappointed that the Federal government is collecting far more than it needs to fund the "employment security system" and returns a very low percentage of annual FUTA taxes to many states. In a given year, some states don't even receive one-third of what employers in their states are estimated to pay in FUTA taxes. This makes it very hard for states to administer their state UI programs in a proper and efficient manner as required by the Social Security Act and it erodes support from employers who pay excessive taxes in return for severely constrained services. As a result of this frustration, NASWA passed a resolution last year, which we mentioned earlier as part of current NASWA policy:

- NASWA supports appropriation of sufficient funds from the federal unemployment tax revenue to ensure every state will receive a minimum of 50 percent of the Federal Unemployment taxes paid each year by its employers. States currently granted more than 50 percent of federal unemployment taxes paid annually by their employers under current federal grant allocation methods should be held harmless.

COMMENTS ON THE WORKER EMPOWERMENT ACT

The stated goal of WEA is to "help respond to growing wage volatility and diminishing job security in the American workforce." NASWA members wonder if the evidence on wage subsidies supports the WEA program achieving this goal. Other approaches that have been effective in pilot demonstrations are assisting and providing incentives for workers to go back to work sooner, and providing training for workers who have enough years of work remaining to reap enough benefits to justify the costs.

Economists argue uniform payroll taxes, such as the 0.1 percent of the social security taxable wage base, are borne by workers even if paid by employers. Economic theory suggests the uniform payroll tax would be shifted to workers in the form of possibly less employment and lower wages. Lesser effects on employment and wages in the labor market might occur if the program were financed from federal general revenues instead. Of course, we recognize other programs, such as social security and medicare, are financed by uniform payroll taxes on the assumption the benefits outweigh the costs.

Based on limited evidence, it is not clear this type of wage subsidy induces workers to go back to work sooner than they would or that they would sustain employment longer than without the wage subsidy. A more cost-effective approach to achieve this end might be reemployment bonuses or reemployment services. States could provide such bonuses or services if more funds were appropriated from FUTA revenue for employment services to UI claimants.

Investments in training also might yield more net benefit than this type of wage subsidy. Investments in human capital in general, and in particular education and training for young persons and young workers, can yield substantial net benefit and stimulate economic and employment growth.

To control costs of such a program, a longer work history could be required for eligibility. However, the UI system currently does not retain wages back more than two years, so some provision for acquiring the data beyond two years would be needed.

The cap on earnings at $100,000 seems to create a "notch effect" in which a worker earning $100,000 gets the full wage subsidy, but a worker earning more than $100,000 loses the entire wage subsidy. Consequently, some attention to creating a phase-out range for the subsidy is needed.

The WEA program could carry a significantly greater administrative burden than UI because the maximum duration of claimants on the regular UI program is a half year compared to as much as two years on wage insurance. Paying wage subsidies for two years is four times longer than for only about a half year. During this two year period the WEA program might have to recalculate the wage subsidy many times as workers change jobs and as their wages change. This could cost states significantly more to administer depending on the ultimate size of the program.

Mr. Chairman, thank you for the opportunity to testify. NASWA greatly appreciates your interest in improving the UI system and empowering workers. Although this testimony has brought to bear current NASWA policy, basic facts, and some speculation on these draft bills, it does not provide specific answers to how individual states or groups of states would react to their provisions. For this, one needs the reaction of specific states at a minimum. NASWA stands ready to assist you in this process as you refine these draft bills and prepare them for introduction.

New York State Department of Labor
March 28, 2007

The Honorable Jim McDermott, Chairman
Subcommittee on Income Security and Family Support
House of Representatives
1035 Longworth HOB
Washington, DC 20515

Dear Congressman McDermott:

Thank you for the opportunity to provide written comments on two discussion drafts under consideration: the Unemployment Insurance Modernization Act and the Worker Empowerment Act. As Governor Spitzer's leader for the New York State Department of Labor, and with a long public service record of advocating for the rights of and benefits for workers, these comments are respectfully submitted for the Committee's consideration.

Unemployment Insurance Modernization Act

New York State has gone on record several times in support of distributions from the federal Unemployment Insurance Trust Fund to encourage, assist and reward states for modernizing and improving their UI programs.

The discussion draft legislation would tie that distribution of funds to various changes in state law which broadens eligibility for unemployment insurance benefits. New York law currently conforms to many of the modernization elements included in the discussion draft and, as such, New York would welcome the opportunity to receive increased funding to offset the costs of providing these benefits and services to unemployment insurance claimants. The language in the discussion draft would not preclude New York from receiving benefits as our law currently provides for broader UI eligibility and we would ask that this language be maintained so the benefits would accrue to all states currently meeting the standards, not just those who bring their state laws up to the standards set forth in the discussion draft.

While New York's law currently conforms to many of the "modernized" UI program elements in the discussion draft, the discussion draft is silent to the increased workload which has accrued to the states to deliver unemployment insurance in a modern, seamless manner with continued diminished UI administrative appropriations. Our past support for "Reed Act" distributions has been tied to using those funds to improve. technology infrastructure needs as well as other operational needs which would allow states to truly "modernize" their systems and maintain an emphasis on high quality services. Technology provides the opportunity for enhanced and real-time service; it does not come without a substantial cost, however, and current UI administrative funding to the states constrains our ability to upgrade and take advantage of these advances.

The discussion draft proposes supporting the distribution with an extension of the current 0.2% FUTA surtax for five years. Rather than continuing and increasing taxes on employers, New York believes that a distribution from the federal UI Trust Fund could be accomplished without continuing this tax and we would welcome the opportunity to explore with the Committee ways to accomplish our mutual objectives.

The Worker Empowerment Act

The discussion draft would establish a national wage insurance program through the imposition of a new employer excise tax to be deposited in the Wage Insurance Trust Fund. With approximately 500,000 tax rated employers in New York State whose excise taxes would subsidize this Trust Fund, New York believes the discussion draft requires much further dialog with the states, data analysis on who best could be served by such a program and how those costs could be estimated, and then how such a model might be implemented in a manner that synchronizes with existing state unemployment insurance programs. States possess a wealth of historical data on unemployment insurance claimants, Trade Act and Workforce Investment Act beneficiaries. The New York State Department of Labor would be willing to convene a group of states to provide some broad data analysis to the Subcommittee to provide a foundation for further discussion on a wage insurance model.

Although the draft has some similarities to the Alternate Trade Adjustment Assistance (ATAA) program under TAA as a wage supplement, it does not have some the reasonable limitations placed on recipients under ATAA. Without these limitations, New York believes the costs for the program may be greatly underestimated. Those distinctions include:

- The draft legislation does not limit eligibility as does ATAA which is limited to individuals at least 50 years of age.
- The cap on re-employment annual earnings is $100,000, ATAA is $50,000.
- Other specific comments and observations include:
- This program would require a separate application and determination process, independent of the UI program.
- A separate distinct payment process and determination process would have to be created and a tracking mechanism established to account for the payments.
- Significant creation or modifications of technological systems and programming would need to be created to avoid paper processing applications, forms, and determinations.
- Limited English Proficiency issues would have to be addressed.
- The draft legislation does not address or identify an appeal process which would be necessary when determinations denying eligibility are issued.
- The one year timeline for implementation from enacting is unreasonable considering the significant changes to systems which would need to be made to bring such a program to scale. New York's experience with implementing the ATAA program on a much smaller scale has shown an intensive amount staff time needed to provide the ATAA benefit.
- A benefit calculation formula and determination system would have to be created.
- Section 2B(i) stipulates that wages received at time of separation are computed based upon 52-week period ending before the date of separation. This would require employers and individuals to supply this information as current wage information is received in on a quarterly basis from employers. Additionally, an average weekly wage would have to be calculated to determine the annual wage from the separating employer.
- Section 2C (I) and (II) stipulate that the wages received by an individual from re-employment would be based on statement of earnings from the re-employing employer by the individual and that a periodic recertification to reflect any changes in wages at least on a quarterly basis. This would require continual verification of wages each quarter up to eight quarters (2 years) and any wage increase in that timeframe would result in a redetermination of the wage insurance payment.
- Section 2D(i) requires states to regularly conduct random audits to verify wage information which would require states to establish and staff an audit unit to assure compliance.
- Section 2E (iii) requires a special calculation when weekly wages from re-employment are less than 50 percent of median weekly wages within the individual state. This would require a separate calculation formula and, while not an impossible task, it adds to the complexity of the technological and individual processing tasks necessary to provide the benefit.
- Section(3)(A) stipulates that an individual is not eligible for benefits unless the individual is separated from employment for a *continuous* period for at least two years before the date of separation. This would require a verification process to be created to determine if the worker qualifies based upon length of employment with the separating employer.

- Section 3(A)(i) and (ii) stipulate that separation must be involuntary (other than for cause) and voluntary under circumstances which would by terms of a collective bargaining agreement result in eligibility for the states' unemployment compensation law. This would require a process to determine whether the involuntary separation was other than "for cause." That is an imprecise definition. Under the Trade Act law, for example, the separation must be due to a lack of work.
- Additionally, voluntary separations would be determined by applicable state law for eligibility for unemployment insurance benefits. However, the legislation limits this to terms under a collective bargaining agreement. There are many instances of reduction in force separations which result in voluntary separations under buy-out plans which are not part of a collective bargaining agreement.
- Section (b)(2) which reflects Payments to the States stipulates that payments of RAA benefits by the state shall be made by advance or reimbursement by the Secretary of Labor on a monthly basis. This would require a special benefit fund to be established at the state levels through state statute and various tracking mechanisms to keep an accounting of benefits paid and advances on reimbursements received from the Secretary of Labor.
- Section 3 on Administrative Costs stipulates that 100 percent of the *reasonable* expenditures of the state as are attributable to the costs of the implementation and operation of its re-employment adjustment program will be allocated by the Secretary of Labor. How are "reasonable" expenditures to be determined? Current state UI systems would not be able to integrate the RAA payment system as the RAA program is independent of any current UI program system, unlike other Federal programs such as TRA. For states to assume this new program responsibility, assurance would need to be provided that ample funding would be available to establish and maintain the systems being required.

In closing, I would like to reiterate the availability of the New York State Department of Labor to help provide Subcommittee members and staff with data analysis to help inform both of these discussion drafts. I appreciate the opportunity to comment and look forward to working with the Subcommittee on issues of critical importance to New York's workers and employers.

Sincerely,

M. Patricia Smith

Statement of Washington State Employment Security Department

Thank you for the opportunity to provide a state-level viewpoint on these two pieces of proposed legislation. Our comments focus mostly on implementation issues.

Unemployment Insurance Modernization Act

We recommend more leeway in how these incentives must be implemented to allow for differences in law and policy among the states.

Funding Flexibility

We have concerns about the proposed uses for Unemployment Insurance Modernization Incentives funds. The proposal would allow these funds to be used only to pay benefits, including training benefits and dependent allowances.

We recommend allowing state legislatures and governors flexibility to determine the most appropriate investments to make in their unemployment insurance systems, similar to the flexibility provided by the Congress to the states in the 2002 Reed act distribution. If this funding is intended to serve as an incentive for state action regarding benefit eligibility, limiting state flexibility in using these funds sharply limits their value as an incentive.

Regarding the special Reed Act distributions of $100 million a year proposed in the legislation, we appreciate the much-needed flexibility to the states the bill would allow. The fact that the bill would allow using these funds to improve unemployment benefit and tax operations and staff-assisted reemployment services for claimants is very helpful. However, the scale of the funding is very small compared to the needs of the states.

Unemployment Insurance Administrative Under-Funding

We recommend that the legislation address the ongoing and severe under-funding of states' administrative costs for the unemployment insurance system.

There is an ongoing national shortfall in unemployment insurance administrative funding. In federal fiscal year (FFY) 2003, the Department of Labor required states to use the Resource Justification Model (RJM) to document their operations costs. Each year since then, the states have provided actual information on the administrative costs of the unemployment insurance system. For FFY 2007, data from the states justified the need for $271.4 million more to process the unemployment insurance base workload than the amount appropriated.

But these actual costs do not show up in Administration budget requests. Instead, those requests applied 1995 staff compensation rates to actual state costs, significantly understating state administrative costs. The result has been to sharply under-fund state unemployment insurance systems.

It would be one thing if this funding shortfall reflected inadequate federal unemployment tax (FUTA) revenue from employer taxes to support administrative costs. In reality, the opposite is true. All three of the accounts in the Unemployment Trust Fund are significantly in surplus. For example, the balance in the federal Employment Security Administration Account is projected to be $3.4 billion at the end of FFY 2007; the balance in the Extended Benefit Account is projected to be $16.6 billion; and the Federal Unemployment Account is projected to reach $14.2 billion at the end of FFY 2007. These balances are enormous when compared to this year's $271.4 million administrative shortfall for the states.

This under-funding has significant effects at the state level. Washington State's unemployment insurance program is currently under-funded for its actual costs by roughly $8 million a year. Next year, that amount is expected to increase by approximately $4 million as a result of higher state salary levels. That figure does not take into account recent annual reductions in federal funding for the Employment Service or for labor market information that also have affected impacted the employment security system.

This shortfall continues to hamper department operations. The department has had to lay off nearly 500 employees in recent years. We have closed one of three telephone call centers, consolidated tax offices, delayed improvements to key technology systems and faced continued erosion of our technological infrastructure, despite the increasingly role automation has played in allowing us to continue to operate in the face of funding shortfalls.

Worker Empowerment Act

Implementation Problems for Washington State

Washington would face significant difficulties in implementing the proposed legislation as currently drafted because of the differences between the proposed wage insurance and current provisions of unemployment insurance. As a result, implementation would require significant changes in state operations and automated systems.

Here are some examples:

- The proposed Worker Empowerment Act would direct states to base benefits on 50 percent of the difference between pre-layoff wage and replacement wages. Our state unemployment-insurance system collects wage information by quarter. We do not know hourly, weekly or monthly wage levels, only the aggregate amount of wages in a quarter paid to an employee identified by Social Security number.
- To calculate wages under the proposed legislation, an administering state agency would have to be able to look at wages for the 52-week period ending before the date of separation from prior work. The department collects wage information by quarter, after the end of the quarter. Most other states also collect wage information in this way. As a result, weekly wage information is not currently available.

The legislation also requires separate benefit calculations for workers earning less from reemployment than median income, requiring weekly income information.

To meet the criteria in the proposed Worker Empowerment Act, significant additions would be needed in the department's benefit computer system and in the data it would collect from employers and workers applying for benefits. This would involve significant expense and significant time for computer system development to operate the program.

These issues all originate with requirements that rely on information on salary levels more detailed than those currently collected as part of the unemployment-insurance system. Administrative costs and start-up time would be reduced if the program included options for structuring the program to take advantage of current quarterly collection of salary information by the unemployment insurance system.

Other proposed elements of the legislation would be costly. These include certifying post-layoff wages and random audits.

We have an additional concern with the administrative funding for the proposed program. Under the legislation, this is an authorized activity. It is unclear from the legislative language how this funding is intended to be appropriated. If such funding were to be allocated through the Resource Justification Model currently used by the Department of Labor to allocate unemployment insurance administrative funds to the states, it is likely that state administrative costs would not be fully reimbursed.

Thank you again for the opportunity to comment on the proposed legislation.