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PRESIDENT'S UNEMPLOYMENT ADMINISTRATIVE FINANCING REFORM INITIATIVE

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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PRESIDENT'S UNEMPLOYMENT ADMINISTRATIVE FINANCING REFORM INITIATIVE

Tuesday, March 5, 2002

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

The Subcommittee met, pursuant to notice, at 12:00 p.m., in room B–318 Rayburn House Office Building, Hon. Wally Herger [Chairman of the Subcommittee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
February 26, 2002
No. HR–10

CONTACT: (202) 225–1025

Herger Announces Hearing on Unemployment Administrative Financing Reform Initiative

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the Nation's Unemployment Compensation system and the Administration's proposal for reform. **The hearing will take place on Tuesday, March 5, 2002, in room B–318 Rayburn House Office Building, beginning at 12:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives from the U.S. Department of Labor, employer and employee organizations, and State workforce officials. 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 Compensation (UC) program provides benefits to unemployed workers who have a history of employment. Within a broad Federal framework, each State designs its own benefit program and imposes taxes on employers to pay for regular unemployment benefits. A Federal tax also is imposed on employers to fund the Federal responsibilities under the system, including certain administrative expenses, loans to States, and the Federal half of extended unemployment benefit costs for certain workers. Taxes collected are kept in Federal unemployment compensation trust fund accounts that are part of the unified Federal budget. Since the 1950s, "surplus" Federal balances have transferred to State accounts (called "Reed Act transfers"). In recent years, a provision in the 1997 Balanced Budget Act (P.L. 105–33) retained most surpluses in Federal accounts in an effort to reduce Federal deficits. While this provision expires at the end of fiscal year 2002, the House has passed three "economic stimulus" bills in recent months to accelerate the transfer of at least $8 billion in Federal surpluses to States to assist in their administration of unemployment benefits and reemployment efforts.

In addition to accelerating the transfer of surplus Federal funds and temporarily extending unemployment benefits by up to 13 weeks in every State, President Bush's fiscal year 2003 budget proposes additional reforms of the administrative financing of the UC and Employment Service programs. The Administration's proposal would gradually reduce the current Federal Unemployment Tax Act payroll tax, while also lowering Federal transfers to States for the administrative costs of their unemployment insurance systems. Federal funds available for loans and extended benefits and remaining Federal administrative responsibilities are projected to continue to rise under the proposal. As under current law, States would have authority to raise taxes to provide for targeted administrative funding needs.

In announcing the hearing, Chairman Herger stated: "The unemployment compensation program provides much-needed relief to millions of hardworking Americans, especially in tough economic times. The Administration has built on proposals

developed in recent years to improve the administrative financing of these programs so States can do a better job getting unemployed workers back to work. I am excited to have the Administration come and explain the benefits of their proposal for employees, employers, and the economy."

FOCUS OF THE HEARING:

The hearing will focus on proposals in the President's fiscal year 2003 budget to reform the administrative financing of the nation's Unemployment Compensation and Employment Security programs.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to *hearingclerks.waysandmeans@mail.house.gov*, along with a fax copy to (202) 225–2610, by the close of business, Tuesday, March 19, 2002. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver 200 copies to the Subcommittee on Human Resources in room B–317 Rayburn House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will *refuse* sealed-packaged deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

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

1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to *hearingclerks.waysandmeans@mail.house.gov*, along with a fax copy to (202) 225–2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

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

3. Any statements must include a list of all clients, persons, or organizations on whose behalf the witness appears. A supplemental sheet must accompany each statement 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 HERGER. The Committee on Ways and Means, Subcommittee on Human Resources, will come to order. Good afternoon and welcome to our hearing. Today's hearing is on the Administration's proposal to improve the administrative funding of our Nation's unemployment insurance system. The unemployment insurance (UI) program provides relief to millions of hardworking Americans, particularly in tough economic times. This Subcommittee has spent several years considering whether to reformulize administra-

tive funding and if so, how. Organizations representing workers, employers, States, and now two separate administrations have devoted considerable time and effort to exploring that question. Here is a major reason why.

Let us say an employer pays $1 in Federal unemployment taxes. Washington is supposed to send most of that dollar back to the States to administer the UI programs. This money pays for costs of providing unemployment checks, supports anti-fraud efforts, and helps workers find new jobs. But here is what actually is sent back to the State and for the record, I have 46 cents here. Forty-six cents is what actually reaches the States, less than half.

Literally, billions of dollars each year remains in Washington accounts instead of serving workers and employers as intended. That is just not right. Under the current program rules, employers pay too much in taxes, workers give up too much in wages, and jobless workers get too little help finding new jobs because too many tax dollars sit unused in Washington accounts.

To his credit, President Bush has proposed a serious plan for reform. The Administration's plan is ambitious. It would reduce Federal unemployment taxes by 75-percent overtime. States would fill in some of the difference, but it is reasonable to assume that overall, taxes can fall while still providing better service to workers given the 54 cents out of every program dollar that sits idle today. And lower taxes mean more jobs, which is the UI's program's goals. States would also get $14 billion in special transition funds as well as additional funds for smaller States.

More extended UI benefits would be available in States with higher unemployment rates, making permanent a change that already has passed the House in our most recent economic stimulus bill. Federal responsibilities such as providing loans to States in need would continue. All the while, today's large Federal unemployment balances would continue to grow. Joining us today to review this plan are experts representing Federal and State governments, businesses and workers, who all have a stake in this debate. We look forward to everyone's testimony, which will help guide us as we consider the details of the President's proposal and the next steps we would take.

[The opening statement of Chairman Herger follows:]

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

Good afternoon and welcome to our hearing. The subject of today's hearing is the Administration's proposal for reform of the administrative financing provisions of the nation's unemployment system.

Our unemployment compensation program provides much-needed relief to millions of hardworking Americans, particularly in tough economic times. It operates as a unique partnership between the Federal Government, states, employers, and workers to help those who lose their jobs through no fault of their own as they transition to new jobs.

It is not a perfect system, and as Committee Members and those of you in the audience who follow the unemployment issue know, a series of hearings on this issue have been held over the past few years.

You also know that Members of this Committee have, over a number of years, introduced a variety of bills developed to improve the system and have a number of views on the best way top accomplish that goal.

With unemployment rates high, state trust fund balances shrinking, and a shaky economy, it is more important than ever that we take a look at the current system and find ways to make it better.

I was very encouraged when the President's fiscal year 2003 budget included a proposal to improve the administrative financing of our unemployment system and I am looking forward to the Administration's presentation.

The plan as outlined in the fiscal year 2003 budget material will allow payroll taxes to flow more directly to states, give states more flexibility to run their unemployment and employment services programs, lower the tax burden for businesses so they can create more jobs, continue federal support for the extended benefit and loan programs, and help workers by making the extended unemployment program more responsive.

Chairman HERGER. Without objection, each Member will have the opportunity to submit a written statement and have it included in the record at this point. Mr. Cardin, would you like to make an opening statement?

Mr. CARDIN. Thank you, Mr. Chairman, and thank you for holding this hearing today. Holding up the dollar, I thought we were going to do one of those ads for the long distance carrier. I was going to grab it because I know the value of the dollar. I think I should point out, though, that the whole concept of the Federal Government's participation in unemployment insurance is to create a reserve to use during recessionary times. And your 46 cents may speak to what we have been doing.

But if we extend the 13 weeks of additional unemployment benefits, the States will actually be getting back a dollar and a half for every dollar that we collect in Federal Unemployment Tax Act (FUTA) taxes. And the reason for that is because we are in a recession, and that is why we are trying to accumulate some funds in order to be able to respond to that recession. That is the partnership between the Federal Government and our States to make sure there are adequate resources to meet the unemployment insurance needs in all regions of our country, those particularly the most hardest hit as a result of the economic activities.

I guess, though, Mr. Chairman, my major concern is that we are holding this hearing today under a very dark cloud because we have not acted to deal with the extended benefits. The United States Senate has passed the 13-week extension. We have not seen fit to pass a clean 13-week extension bill. I regret that. Every week we wait, 80,000 more Americans exhaust their unemployment insurance benefits. We shouldn't be mixing that issue with other controversial issues that divide us. We should look for ways that we can work together in order to deal with the people who are hurting out there, the people, through no fault of their own, cannot find employment because of the economy.

Regarding the Administration's long-term proposals on administrative funding for the unemployment insurance system, I am concerned the plan would begin to dismantle the current Federal-State partnership in responding to unemployment. The proposal would eliminate payments now sent by the Federal Government to the States for administrative costs for the UI programs, and would eliminate three-quarters of the Federal FUTA tax, which finance extended unemployment benefits and loans to the States in addition to the administrative ground.

The Administration's plans leaves States with three options to make up for the loss of administrative payments they now receive from the Federal Government. They could raise taxes. That is certainly not a very pleasant option. They could cut benefits. That is not a very pleasant option, or they could reduce the solvency of their UI trust fund. That is also not a very pretty option. So none of these options are particularly attractive.

In addition, by draining money of Federal UI accounts and by eliminating the Federal authority to disburse grants, the plan may reduce the Federal Government's ability to respond to rising unemployment during recessions. I am very troubled that the Administration's proposal ignores one of the biggest problems of the UI system, the lack of coverage for many low wage and part-time workers. And we have had several discussions about that.

The U.S. General Accounting Office has informed us that low wage workers are only one half as likely to receive UI benefits compared to higher wage workers even when employed for similar periods of time. This inequity not only hurts many workers, but also has troubling implications for our welfare reform efforts. Congress and the States spent considerable time, money and efforts in attempting to break the cycle of dependency on welfare, but the UI system forces too many low wage workers back onto the welfare rolls when they are let off.

Let me conclude by urging both this Committee and the Administration to review the consensus proposal developed 18 months ago by the major stakeholders in the UI system. The plan would have guaranteed States mandatory spending for their administrative grants, but have eliminated one quarter of the FUTA tax on employers and would have improved UI coverage for low wage workers and would have allowed more people to collect unemployment insurance by using the most recent wage quarter.

Mr. Chairman, we could have passed those recommendations a year ago and have them in place for this current recession. I stated that in a previous hearing that we had. It was a major accomplishment to get the stakeholders to reach an agreement. We should have moved on those proposals well before now in the midst of a recession. In my opinion, such a balanced proposal has a better chance of achieving bipartisan support and eventual enactment, and I urge us to consider that proposal. Thank you, Mr. Chairman.

[The opening statement of Mr. Cardin follows:]

Opening Statement of the Hon. Benjamin L. Cardin, a Representative in Congress from the State of Maryland

Mr. Chairman, a dark cloud hangs over this committee today as we discuss possible reforms to our Nation's unemployment insurance system.

We have yet to enact an extension of unemployment benefits, despite the fact that more than 1.5 million jobless workers have had their regular benefits expire since September 11th, and despite the fact that Congress has routinely provided extended benefits during past recessions.

It is far past time to separate a simple extension of unemployment benefits from discussions about more controversial items. Every week we delay consideration of this issue, another 80,000 Americans exhaust their regular UI benefits. They do not need any more empty promises. Unemployed workers need and deserve immediate assistance in paying their bills and buying food for their families.

Regarding the Administration's long-term proposal on administrative financing for the unemployment insurance system, I am concerned the plan would begin to dismantle the current Federal/State partnership in responding to unemployment. The

proposal would eliminate the payments now sent by the Federal Government to the States for the administrative cost of their UI programs, and it would eliminate three-quarters of the Federal FUTA tax, which finances extended unemployment benefits and loans to the States, in addition to the administrative grants.

The Administration's plan leaves States with three options to make up for the loss of the administrative payments they now receive from the Federal Government—raise taxes, cut benefits, or reduce the solvency of their UI trust funds. None of these options are particularly attractive. In addition, by draining money out of the Federal UI accounts and by eliminating the Federal authority to disburse grants, the plan may reduce the Federal Government's ability to respond to rising unemployment during recessions.

I am also very troubled that the Administration's proposal ignores one of the biggest problems with the UI system—the lack of coverage for many low-wage and part-time workers. The Government Accounting Office has informed us that low-wage workers are only half as likely to receive UI benefits compared to higher-wage workers, even when employed for similar periods of time. This inequity not only hurts many workers, it also has troubling implications for our welfare reform efforts. Congress and the States have spent considerable time, money, and effort in attempting to break the cycle of dependency on welfare, but the UI system forces too many low-wage workers back on to welfare when they are laid off.

Let me conclude by urging both this Committee and the Administration to review a consensus proposal developed 18 months ago by the major stakeholders in the UI system. The plan would have: (1) guaranteed States mandatory spending for their administrative grants, (2) eliminated one-quarter of the FUTA tax on employers, and (3) improved UI coverage for low-wage and part-time workers.

In my opinion, such a balanced proposal has a better chance of achieving bipartisan support and eventual enactment. Thank you.

Chairman HERGER. I thank the Ranking Member.

Before recognizing the Honorable Emily DeRocco, Assistant Secretary of Employment and Training Administration at the U.S. Department of Labor, I would like to remind everyone that not only did this Congress pass extended benefits of 13 weeks once, we passed it twice, once in December 2001; again in February 2002; and we may very well do that again today, and that is in addition to the stimulus bill that we passed in October 2001. We were working on this, but we do need some help from our good friends in the Senate as well.

Mr. CARDIN. Would the gentleman yield on that point?

Chairman HERGER. I will.

Mr. CARDIN. I appreciate you yielding. The problem is that the package that we passed cost over $100 billion? It was included in a huge stimulus package which has controversy. The unemployment provisions don't have controversy. Why can't we bring out the extension of the 12 weeks as the Senate did by, I believe, a unanimous vote, and just pass that? We can get that done.

Mr. MCCRERY. Will the Chairman yield?

Chairman HERGER. The gentleman from Louisiana.

Mr. MCCRERY. I am always impressed by Mr. Cardin's remarks.

Mr. CARDIN. Thank you. I appreciate the Chairman yielding.

Mr. MCCRERY. And I would hope that the gentleman from Maryland would be consistent in his reasoning. It seems to me that there is not much controversy about the fact that States don't get enough money back from the Federal Government for administrative funding. And yet the gentleman, on the one hand, says we shouldn't mix something controversial with something that is taken for granted, and yet that is exactly what he is suggesting to do when those of us who want to get that money out to the States so

they can provide employment services and get people back to work, you want to mix it up with controversial things like covering part-time workers, low wage workers, all those things that you know are controversial. I would hope that the gentleman would take a look at the Administration's proposal, and maybe, at least, pass it and then we can go onto some of those——

Chairman HERGER. I think we should press on at this point. The Honorable Assistant Secretary DeRocco, if you would proceed with your testimony, please.

STATEMENT OF THE HON. EMILY STOVER DEROCCO, ASSISTANT SECRETARY, EMPLOYMENT AND TRAINING ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Ms. DEROCCO. Mr. Chairman and distinguished Members of the Subcommittee, I appreciate the opportunity to appear before you today to outline the President's Employment Security Reform Act of 2002. And I have slides to help along the way with my presentation. This proposal will reform the unemployment insurance and employment service programs, and it represents a new balance.

The Administration proposes short—and long-term strategies to strengthen UI and Employment Service (ES) for America's workers and businesses, encourage flexibility and promote economic growth. Our short-term strategy includes a temporary Federal extension of UI benefits for up to 13 weeks in all States and distribution of $9.2 billion in special Reed Act funds to States for expansion of benefits, better reemployment services, shoring up trust fund reserves, and/or cutting employer payroll taxes.

The Administration's long-term vision includes allowing States to finance UI and ES administration while providing a very responsible transition, reforming extended benefits, and reducing FUTA taxes. A key component of the proposal is the transfer of funding authority from the Federal to the State level, which would be phased in over several years to give States sufficient time to make necessary administrative and legislative changes.

As shown in the next two slides, in fiscal years 2003 and 2004, there would be full Federal appropriations supporting the Administration. In 2005 and 2006, States would receive partial Federal funding, and full State funding would commence in 2007. Federal appropriations would be made throughout the transition period, fiscal years 2002 through 2006, and Reed Act distributions would be made in fiscal years 2002, 2004, and 2005.

The next slide speaks to the impact on the Federal unemployment trust fund accounts. There would be adequate balances in the Federal unemployment trust fund accounts to fund a temporary 13-week extension of extended benefits as well as transfer of over $14 billion to the States during the transition period. Under current economic assumptions, Federal account balances would continue to build during this transition period, and the reserves would be available to fund extended benefits and loans in future recessions. As you can see, even with the Reed Act distributions and the proposed tax cut to two-tenths percent, the accounts reach their current balance of $39 billion, again by 2008.

We are proposing two important changes to the extended benefits program. The insured unemployment rate trigger would be reduced

from 5 to 4 percent. With this action, extended benefits would be available faster in recessions, more workers would get up to 13 weeks of extra benefits, and extended benefits would be more responsive as an economic stabilizer.

The chart to your right illustrates how the change would help more States and more workers. In addition to the insured unemployment rate change, the special Federal rules concerning eligibility would be repealed. States would use their existing eligibility requirements, and this would make extended benefits easier and less costly for States to administer.

In terms of the proposed Federal unemployment tax reduction, we are proposing a significant reduction. The rate would be reduced from eight-tenths to six-tenths in 2003, eliminating that two-tenths surcharge we heard much about in past years.

The rate would be further reduced to four-tenths in 2005, two-tenths in 2007, for a total tax reduction of 75 percent from the current level. The Federal tax savings for employers over a 10-year period would be $36.5 billion.

In terms of the advantages of this proposal, we firmly believe that the Administration's proposal has advantages for all major stakeholders. For States, the distribution of $14 billion in excess Federal funds would improve solvency, would cushion the administrative funding shift, and would be available for States to expand eligibility for, or levels of, benefits. The small States supplemental funding would assure good services and no tax increases in small States, and States would be able to determine administrative funding levels and target them where most needed.

For workers, eligible jobless workers would get an immediate 13-week temporary extension of UI benefits. The lower trigger and repeal of restrictive Federal requirements would make extended benefits (EB) available earlier in more States and to more workers in future recessions. And adequate funding would surely produce better services for workers.

For businesses, FUTA taxes would be reduced significantly. The shifting of administrative funding would not require a net unemployment tax increase in any State and streamlining quarterly filing of FUTA tax forms would save businesses valuable time.

I want to emphasize this proposal continues to recognize the national interest and the important Federal role in unemployment insurance and employment service programs. Specifically, the Federal Government would supplement funding for small States and fund Federal activities through State grants on an ongoing basis. We would continue to pay 50 percent of extended benefits in the permanent EB program. We would make loans available to States, if needed, for benefits or for administration. The Federal Government would continue to ensure State conformity and compliance with Federal requirements. Examples of these include prompt and proper payment of benefits, fair hearings, broad coverage for workers and a new requirement that States provide a public labor exchange service. The Federal Government would continue to monitor State performance against Federal standards.

Mr. Chairman and Members of the Subcommittee, we believe the States can do a better job of funding these programs and that the transfer of funding can be accomplished with no net tax increases

and no State losers. Improved funding means better services to workers and businesses and a stronger unemployment insurance and employment service system.

While the proposal shifts funding responsibility to States, it keeps a strong Federal-State system. We look forward to working with this Committee and with the stakeholders as we move forward. I appreciate the opportunity to speak with you this morning, and I will be pleased to answer any questions you might have.

[The prepared statement of Ms. DeRocco follows:]

Statement of the Hon. Emily Stover DeRocco, Assistant Secretary, Employment and Training Administration, U.S. Department of Labor

Mr. Chairman and distinguished Members of the Subcommittee, I appreciate the opportunity to appear before you today to outline the President's Employment Security Reform Act of 2002.

This proposal for reform of the unemployment insurance (UI) and the employment service (ES) programs represents a *New Balance*. It addresses short-term needs and provides long-term changes to assist economic growth, promote flexibility, and strengthen the critical services that states provide to America's workers and businesses. Together, the UI and ES programs represent core elements of the public workforce system. UI is key to the economic security of our nation, acting as a stabilizer during economic downturns by being the primary source of temporary, partial wage replacement for workers who have been laid off and are seeking jobs. ES helps unemployed workers find jobs and employers find new workers; it is the backbone of the One-Stop service delivery system established under the Workforce Investment Act of 1998.

Background

Over the past several years, all major stakeholders involved with the UI and ES programs have expressed dissatisfaction with some aspects of the present system.

- Worker advocates are concerned about responsiveness to worker needs during recessions.
- State program administrators are dissatisfied with what they see as continued under-funding of the UI and ES programs.
- Business leaders are frustrated with the level of UI taxes, and what they see as complicated paperwork, opportunities for program fraud and abuse, and the use of revenues for other than the intended purposes.

In response to these concerns, the President is proposing actions and reforms that would continue the federal-state partnership that has been responsible for these programs for nearly 70 years, but would strike a *New Balance* between the federal and state governments, empowering states to manage funds and direct policy with greater flexibility and freedom.

Short-Term Actions

Short-term actions are designed to meet the present needs of unemployed workers during the current economic slowdown. The Administration's proposal includes a temporary extension of unemployment benefits and an immediate distribution of excess federal unemployment funds (commonly called a Reed Act distribution).

Temporary Extended Unemployment Compensation (TEUC)

To aid unemployed workers who have exhausted regular state UI benefits during the economic downturn that began last March and to promote recovery, we are proposing a temporary extension of unemployment benefits. TEUC would be payable under agreements between the Secretary of Labor and states and would be in effect for weeks of unemployment beginning after the date of agreement and ending before January 1, 2003. There would be no state triggers under TEUC; benefits would be payable in all states. The program would be entirely federally financed, almost all from the federal Unemployment Trust Fund (UTF) accounts. Generally, benefits would be payable to individuals who filed an initial claim for regular compensation on or after the week including March 15, 2001, and have exhausted regular benefits. Eligible individuals would receive 50 percent of their regular compensation up to a maximum of 13 weeks as long as they meet the continuing eligibility conditions of state law.

Reed Act Distribution

Current levels of unemployment, exacerbated by the terrorist attacks on September 11, have strained the capacity of states to provide needed benefits and services. In response, we propose to distribute to states about $9.24 billion in excess federal unemployment trust funds, some of which are otherwise scheduled to be distributed on October 1, 2002. These funds could be used to enhance services to businesses and reemployment services to unemployed workers through One-Stop Career Centers, shore up low reserves in state trust funds accounts, allow a cut in state unemployment payroll taxes, or expand benefits. The funds would be distributed by the current-law formula, i.e., based on the state's share of federal taxable wages.

Long-Term Reforms

Consistent with these immediate actions, the Administration is proposing a long-term vision that would make UI and ES programs more responsive to the needs of workers and business by:

- allowing states to control administrative funding—helping improve the timeliness and accuracy of benefit payments, targeting more resources on preventing and detecting overpayments, and enabling improved reemployment services to unemployed workers;
- providing extended benefits to more workers—making the program more responsive to unemployment swings; and
- reducing employers' federal unemployment taxes—spurring economic expansion.

Administrative Funding

To address state concerns about inadequate federal funds for UI and ES services, we are proposing to transfer the administrative funding of UI and ES programs to states. Under current law, the Federal Government collects a **federal** unemployment tax, holds some of the revenue in reserve, and sends the rest back to states to operate their UI and ES programs. States have long complained that inadequate funds were returned to provide the services needed by employers and workers with ES levels basically "frozen" since 1984 and with UI levels falling 10 percent or more below need in the 1990's, even though plenty of money was available in the UTF. States already collect **state** unemployment taxes to fund benefits, so it makes sense to give the states responsibility for and control of administrative costs as well.

A question has been raised whether this could cause states to cut benefits and services to workers to achieve lower taxes for employers. States, under current law, already have the responsibility to determine UI eligibility for benefits and to set and collect experience-rated taxes, which will total about $30 billion for fiscal year 2003, for financing these benefits. Our proposal shifts administrative funding responsibility of about $3.5 billion to the states while also shifting a federal payroll tax cut of over $5.5 billion to their employers. We believe that the states have sufficient incentives to adequately fund the UI and ES benefits and services that assist workers and employers, and therefore, that the transfer of responsibility will have absolutely no negative effect on such benefits and services.

To give states sufficient time to make any necessary administrative adjustments or law changes, the transfer of funding authority from the federal to the state level would be phased-in over several years. Special Reed Act distributions would be provided in fiscal years 2004 and 2005. Federal transition grants would be provided in fiscal years 2005 and 2006. Beginning in fiscal year 2007, states would be responsible for full funding of state UI and ES programs.

We understand that small states are concerned that the proposed FUTA tax savings for a small state's employers may not equal the amount of the current federal UI and ES grants for such states. Our proposal would address these concerns by providing federal supplemental funding in such cases to states with a civilian labor force of fewer than 1,000,000. Currently 17 states meet this criteria. This funding would be available during the transition and thereafter.

Extended Benefit Program

We are also proposing two changes in the extended benefit (EB) program. The insured unemployment rate required to make EB available in states would be lowered from 5.0 percent to 4.0 percent. Also, the special federal EB eligibility requirements would be eliminated. State requirements for regular compensation would then apply, simplifying state administration and cutting "red tape" for workers. These changes combined would improve recession readiness and economic stabilization by making EB available sooner and to more workers in an economic downturn. Extending benefits when unemployment is high helps keep money flowing into local econo-

mies. Research shows that each $1.00 in benefits generates $2.15 in economic activity.

Federal Unemployment Tax Act (FUTA)

Employers have long complained that FUTA taxes are too high and too little of FUTA revenues are used for their intended purposes. Indeed, a 0.2 percent FUTA surcharge that was levied in 1977 fulfilled its purpose of repaying general revenue loans to the UTF in 1987. However, this "temporary" tax, which generates about $1.8 billion annually, has been extended through 2007. This has produced very healthy reserves in the UTF accounts of about $39 billion. These reserves would allow us to cut taxes without risking the availability of funds to make advances to states needing money to pay UI benefits or to pay the federal share of extended benefits.

The tax rate would be reduced to 0.6 percent in 2003, cutting taxes by 25 percent. The rate would be further reduced to 0.4 percent in 2005, and to 0.2 percent in 2007, and thereafter, for a federal unemployment tax cut of 75 percent from the current level. The 0.2 percent remaining FUTA tax would be used to make federal loans available to any state that runs out of funds to pay UI benefits or administrative costs, pay the federal share of extended benefits (EB), make state grants for, and pay for federal administration of, certain federal activities, and supplement administrative funding for "small states." In addition to the tax reduction, FUTA forms and filing requirements would be streamlined through a technical change to federal law, and employers would be required to deposit unemployment taxes no more frequently than quarterly.

The Federal Role in the "New Balance"

At this point, I want to emphasize that the *New Balance* proposal continues to recognize the important national interest in the performance of these programs; they are critical to our economy, and the proposal maintains a strong role for the Federal Government in their oversight. Examples of federal requirements that would be retained are, for the UI program, prompt and proper payment of benefits, impartial hearings, and broad coverage for workers who are subject to involuntary unemployment. For the ES program, states would be required to administer a free public labor exchange and deliver employment services for the benefit of businesses and job seekers.

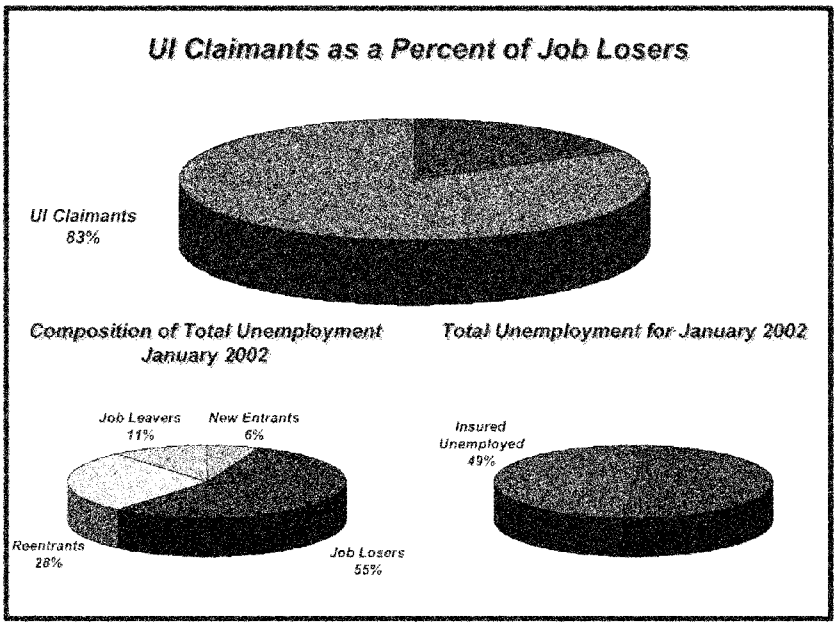
States would have to meet federal requirements for UI and ES in order for their businesses to qualify for a substantial credit against FUTA. Failure by a state to comply with the requirements would (after due process) result in employers in the state losing the tax credit. The potential for a large increase in employer rates is the current means by which many federal UI requirements are enforced. This proposal maintains this tax credit mechanism and extends it to the UI requirements currently applicable only to administrative grants and to the ES program. Specifically, the current total FUTA tax is 6.2 percent, the maximum credit is 5.4 percent, and the net tax is 0.8 percent. In 2007, the total tax and the net tax drop to 5.6 percent and 0.2 percent, respectively, but the maximum credit remains at 5.4 percent.

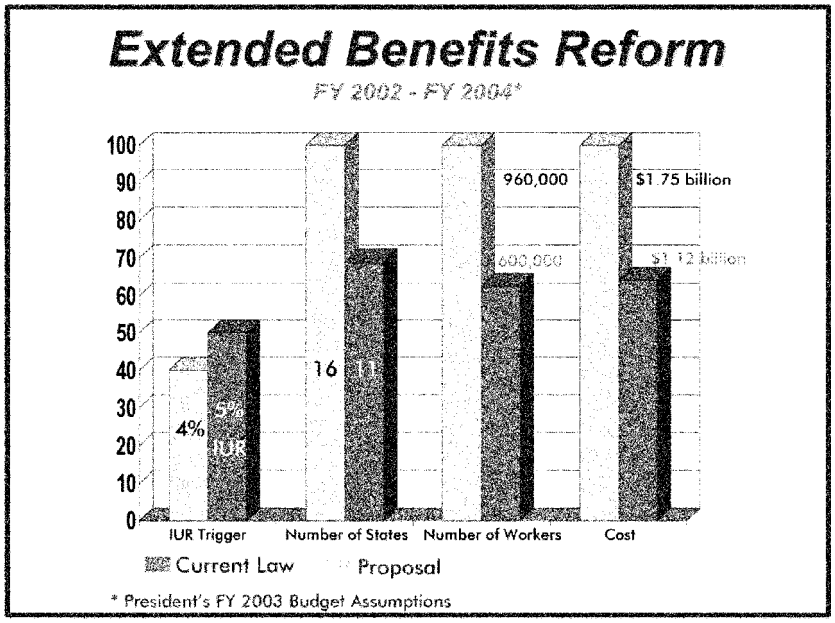
As noted previously, federal grants to states would continue for certain federal activities, such as federal unemployment claims, alien labor certification, various required reports, and to supplement small states.

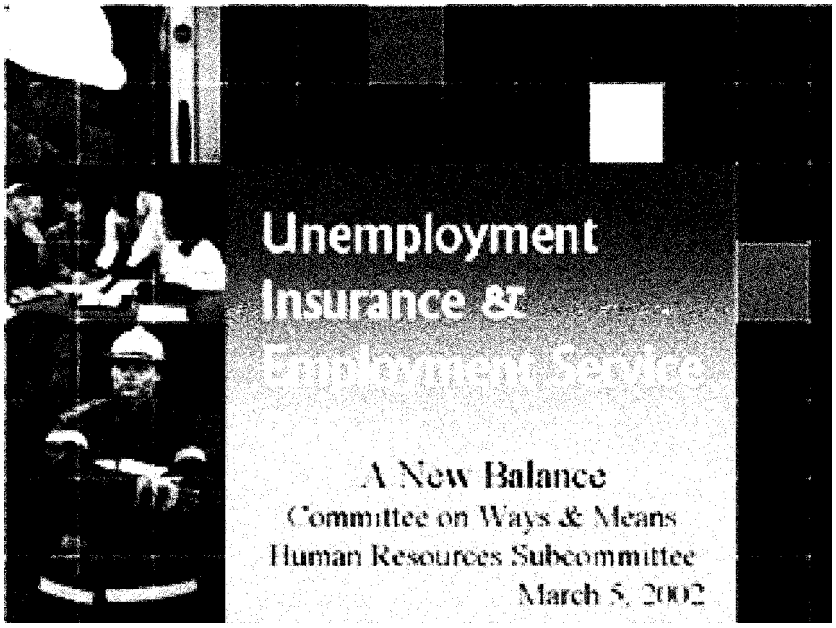
Conclusion

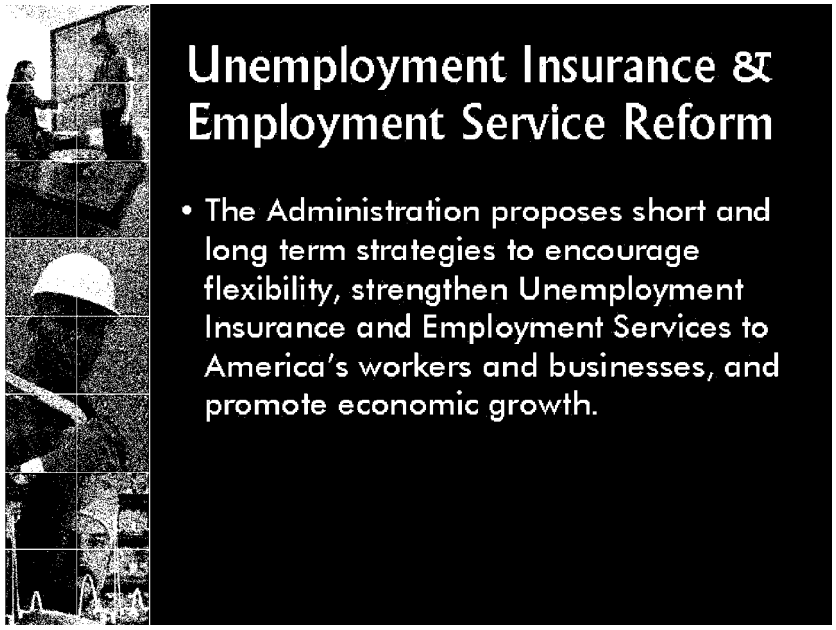
Mr. Chairman, we hope that we can count on your support for these reforms that, with federal assistance and commitment, provide sufficient funding and give states the autonomy to customize programs that best serve their businesses and workers.

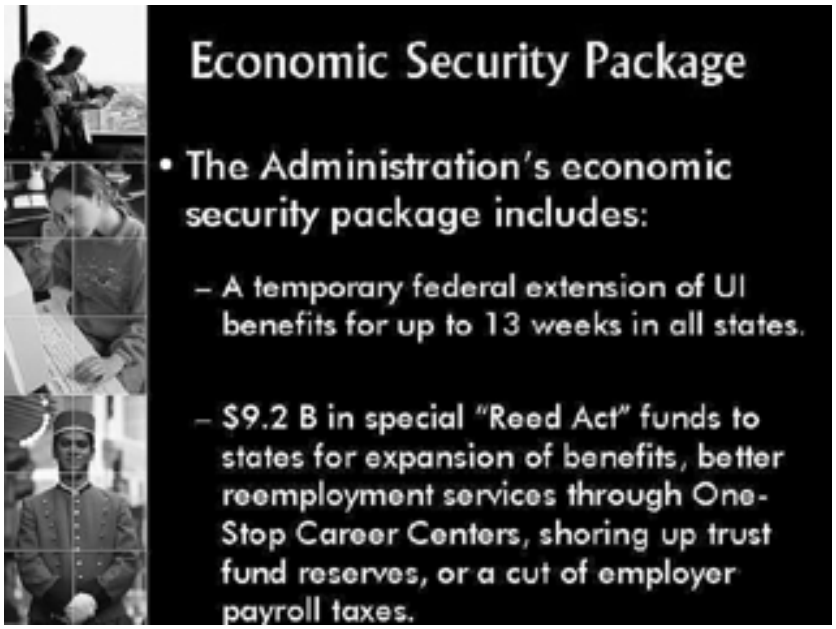
Thank you for the opportunity to testify today. I will be happy to answer any questions you may have about the *New Balance* proposal.


UI Claimants as a Percent of Job Losers
UI Claimants
83%
Composition of Total Unemployment
January 2002
Job Leavers
11%
New Entrants
6%
Reentrants
28%
Job Losers
55%
Total Unemployment for January 2002
Insured
Unemployed
49%

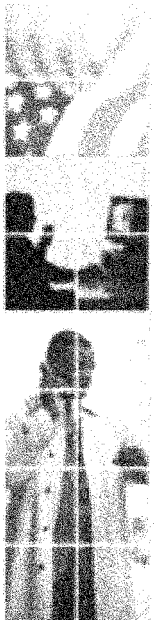

Extended Benefits Reform
FY 2002 - FY 2004*
100
90
80
70
60
50
40
30
20
10
0
4%
5%
IUR
16
11
960,000
600,000
$1.75 billion
$1.12 billion
IUR Trigger
Number of States
Number of Workers
Cost
Current Law
Proposal
* President's FY 2003 Budget Assumptions


Unemployment
Insurance &
Employment Service
A New Balance
Committee on Ways & Means
Human Resources Subcommittee
March 5, 2002


Unemployment Insurance &
Employment Service Reform
• The Administration proposes short and long term strategies to encourage flexibility, strengthen Unemployment Insurance and Employment Services to America's workers and businesses, and promote economic growth.

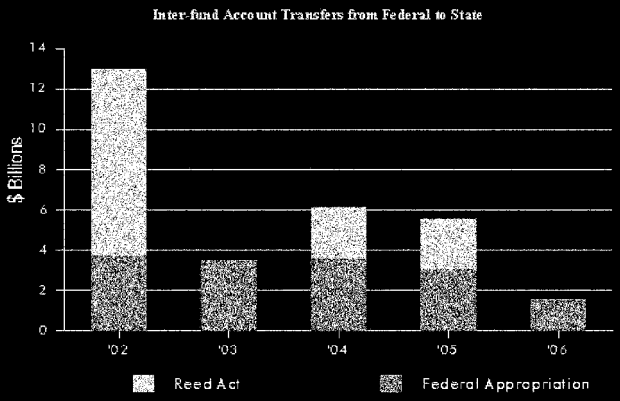

Economic Security Package
• The Administration's economic security package includes:
– A temporary federal extension of UI benefits for up to 13 weeks in all states.
– $9.2 B in special "Reed Act" funds to states for expansion of benefits, better reemployment services through One-Stop Career Centers, shoring up trust fund reserves, or a cut of employer payroll taxes.

Unemployment Insurance & Employment Service Reform
• The Administration's long-term vision includes:
• Allowing states to finance Unemployment Insurance and Employment Service administration while providing a responsible transition
• Reforming Extended Benefits
• Cutting FUTA taxes

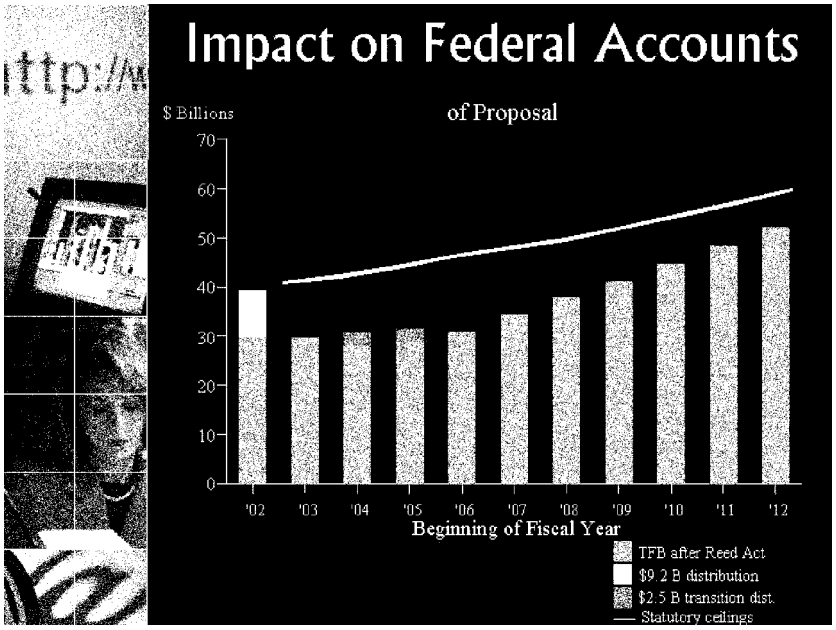


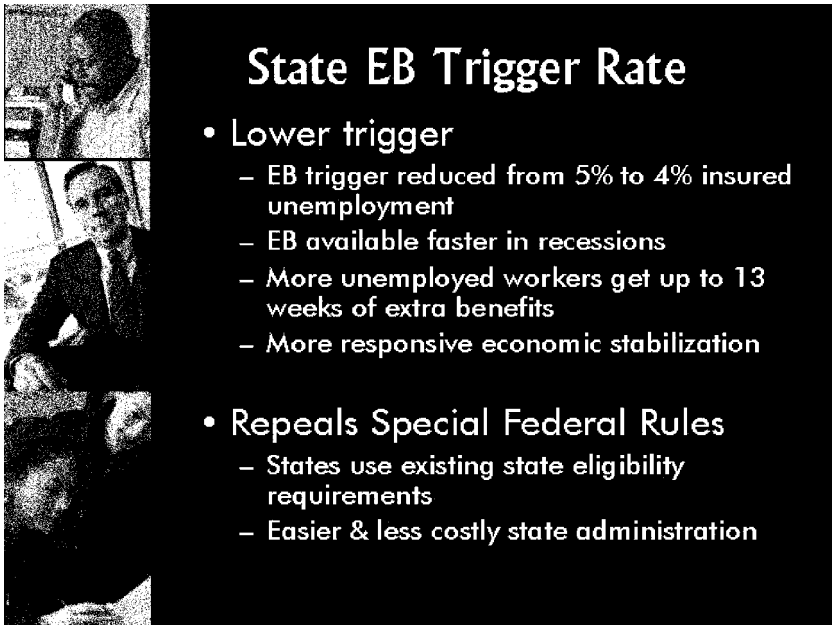
Administrative Funding
Transition From Federal to State

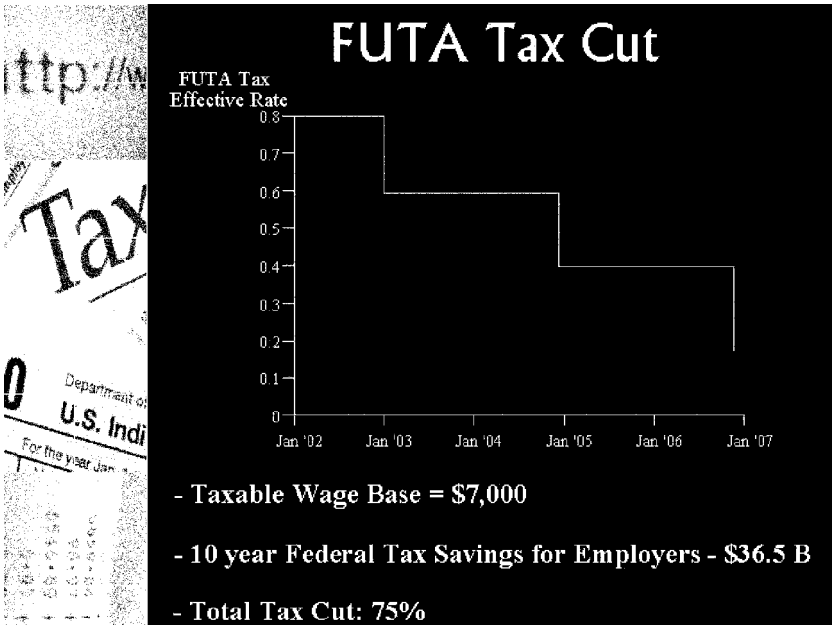
Easing the Transition to States



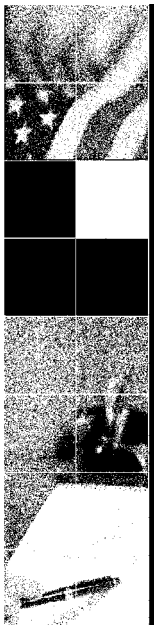
- Injects federal funds to aid state administration
- Improves state solvency levels


Impact on Federal Accounts
of Proposal
$ Billions
70
60
50
40
30
20
10
0
'02
'03
'04
'05
'06
'07
'08
'09
'10
'11
'12
Beginning of Fiscal Year
TFB after Reed Act
$9.2 B distribution
$2.5 B transition dist.
Statutory ceilings


State EB Trigger Rate
• Lower trigger
– EB trigger reduced from 5% to 4% insured unemployment
– EB available faster in recessions
– More unemployed workers get up to 13 weeks of extra benefits
– More responsive economic stabilization
• Repeals Special Federal Rules
– States use existing state eligibility requirements
– Easier & less costly state administration


FUTA Tax Cut
FUTA Tax Effective Rate
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
Jan '02
Jan '03
Jan '04
Jan '05
Jan '06
Jan '07
- Taxable Wage Base = $7,000
- 10 year Federal Tax Savings for Employers - $36.5 B
- Total Tax Cut: 75%

Advantages to States
• Distribution of $14 billion in excess federal funds will improve solvency, cushion the administrative funding shift, and be available for benefits.
• Small-state supplemental funding assures good services and no tax increases.
• States can determine administrative funding levels and target them where most needed

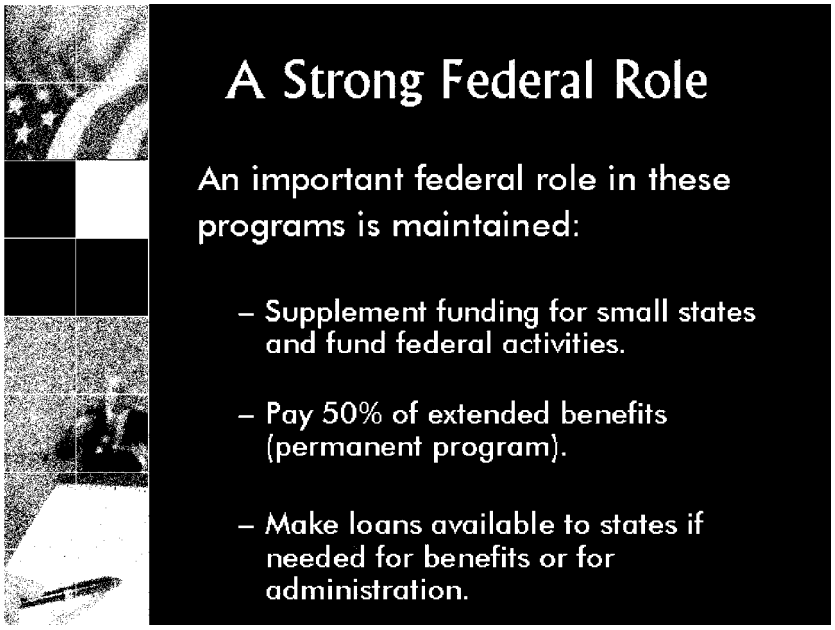


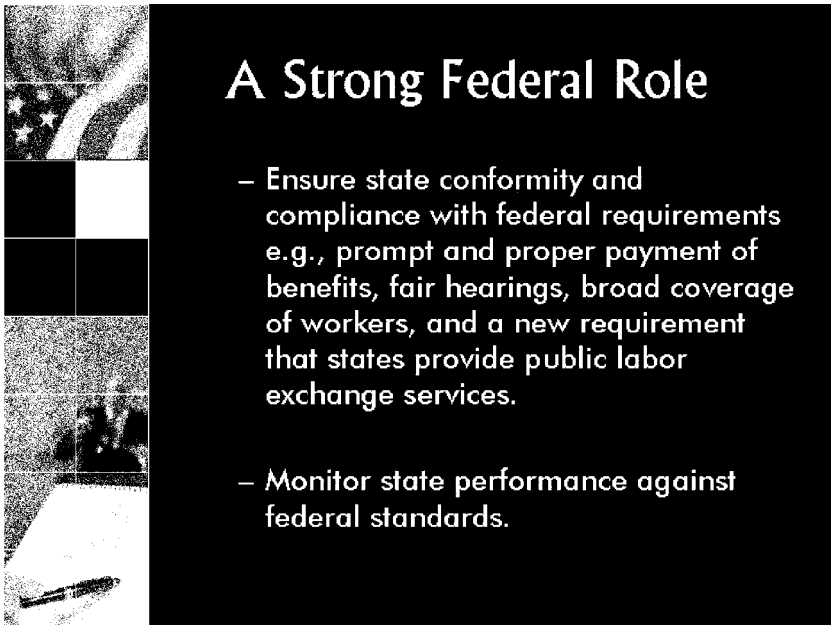
Advantages to Workers

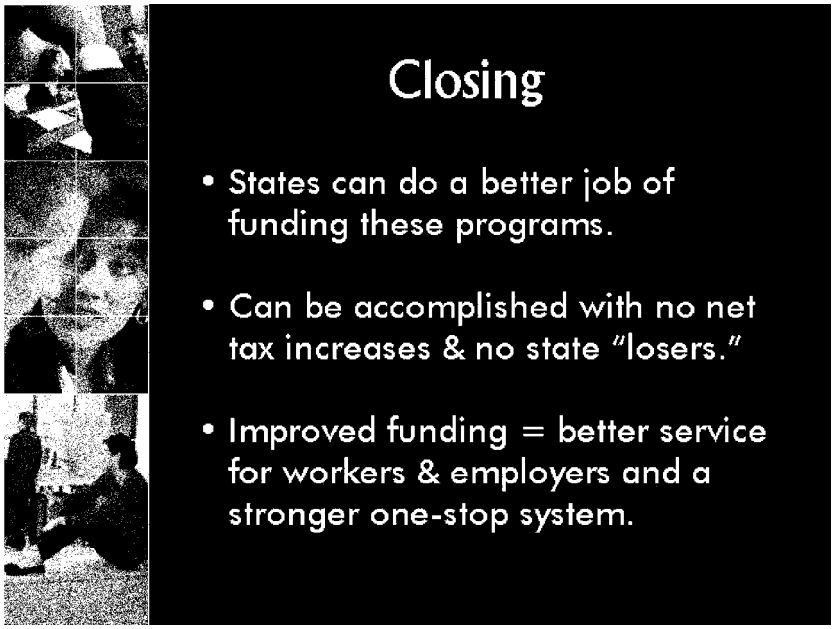
- Immediate 13 week temporary extension of benefits.
- Lower EB trigger & repeal of restrictive federal requirements will make extended benefits available earlier, in more states, and to more workers in future with less "hassle."
- Adequate funding will produce improved services for workers.

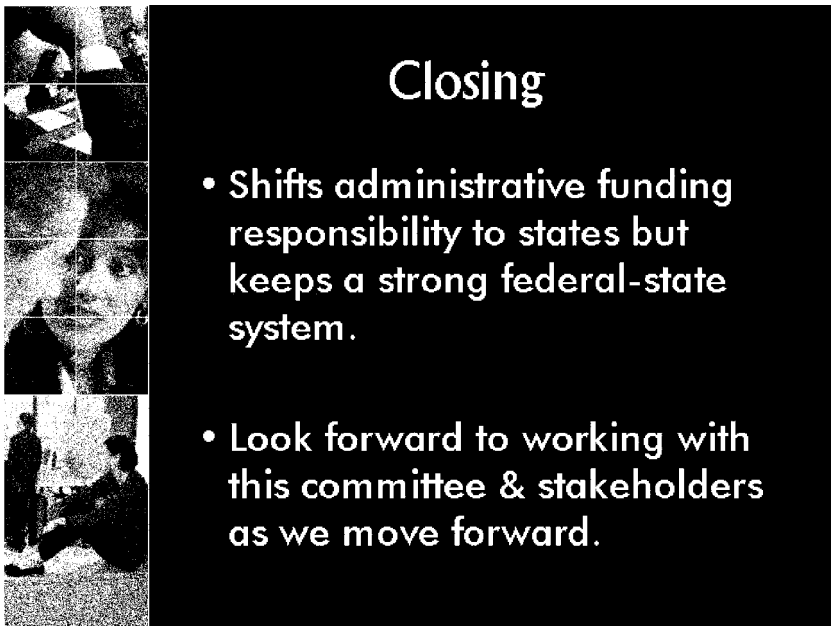
Advantages to Business

- FUTA taxes are cut significantly.
- Shifting administrative funding to states will not require a net unemployment tax increase (state + federal) in any state.
- Streamlined quarterly filing of FUTA tax forms will save businesses valuable time.


A Strong Federal Role
An important federal role in these programs is maintained:
– Supplement funding for small states and fund federal activities.
– Pay 50% of extended benefits (permanent program).
– Make loans available to states if needed for benefits or for administration.


A Strong Federal Role
– Ensure state conformity and compliance with federal requirements e.g., prompt and proper payment of benefits, fair hearings, broad coverage of workers, and a new requirement that states provide public labor exchange services.
– Monitor state performance against federal standards.


Closing
• States can do a better job of funding these programs.
• Can be accomplished with no net tax increases & no state "losers."
• Improved funding = better service for workers & employers and a stronger one-stop system.


Closing
• Shifts administrative funding responsibility to states but keeps a strong federal-state system.
• Look forward to working with this committee & stakeholders as we move forward.

Chairman HERGER. I thank you, Madam Assistant Secretary, and now we will turn to questions. I would like to remind the Members that they each have 5 minutes for witness questioning, and with that, would the gentleman from Louisiana, Mr. McCrery like to inquire?

Mr. MCCRERY. Yes. Thank you, Mr. Chairman.

Ms. DeRocco, let us talk about the need for administrative financing reforms. I said in my little conversation with Mr. Cardin that it is apparent to any of us who have looked at this, that the States are not getting back from the Federal Government sufficient funding for administrative purposes of the program, and some States like mine have had to exact additional taxes in order to fund administrative expenses because we are getting, I think, back 41 cents on the dollar for administrative expenses.

So I think that is apparent. But in your proposal, you shift really the responsibility to the States for collecting those taxes and using them for either administrative funding or increases in benefits or any of the other things they can use the money for. Some people say that this would destroy the safety net of the unemployment insurance system. How would you respond to that complaint?

Ms. DEROCCO. I think States have both the responsibility and the capability to ensure a strong safety net program for their workers and businesses. They have a tremendous incentive to continue a strong unemployment insurance program, because UI benefit payments enable workers who are temporarily unemployed to maintain their opportunities to look for new jobs, maintain their families, maintain stable communities at the same time stronger employment services could more readily move unemployed workers back to work into productive employment and livable wages. This UI and ES system is a critical component of every State's economic development agenda, and it is critically important for their employers as well. I spoke about the requirements that we would continue to impose on the States to maintain a quality unemployment insurance program, and we would do so by not changing the offset credit mechanism that is currently in place.

Employers would not want their State to lose the offset credit against the Federal tax and therefore, there would be tremendous interest and pressure on State legislators and Governors to ensure that the safety net program was strong in the State.

Mr. MCCRERY. So in other words, the safety net won't be gone under the Administration proposal. There will be Federal regulations that States will have to comply with. Is there any penalty under the Administration's proposal for States failing to comply with Federal regulations?

Ms. DEROCCO. Again, failure to comply jeopardizes the employer's offset credit (i.e., 5.4 percent). Although we talk about a reduction in the Federal unemployment tax to two-tenths, in fact the tax would be set at a rate which allows the employers in each State, which are adequately funding and supporting an unemployment insurance and employment system, to achieve that offset credit.

Mr. MCCRERY. Is the penalty for failure to comply with Federal regulations any different under your proposal than it is under current law?

Ms. DEROCCO. No, sir, it is not.

Mr. MCCRERY. And you talked about what employees or former employees would lose because of lack of administrative financing. They would lose access to good employment services. What about employers? If the State doesn't have an adequate employment services administration, what do the employers lose?

Ms. DEROCCO. As you know, I worked for 10 years under the State unemployment insurance and employment service system, and employers support a very, very strong system and an effective labor exchange. It is their source for new employees. It is a service that they need for their continued growth as they create jobs; they turn to the employment service for new employees, for a productive workforce, and they are most interested in a stronger employment service and the Federal Government has allowed them to maintain it through the return on their investment.

Mr. MCCRERY. What about their tax rate? Is it affected by poor employment services?

Ms. DEROCCO. Under our proposal?

Mr. MCCRERY. Under current law or your proposal.

Ms. DEROCCO. Actually, the employment service would be much stronger under the proposal.

Mr. MCCRERY. Are employers experienced rated?

Ms. DEROCCO. Yes.

Mr. MCCRERY. If they have laid off employees that get jobs more quickly it affects their tax rate?

Ms. DEROCCO. Absolutely.

Mr. MCCRERY. Both workers and employers have an interest in strong employment services?

Ms. DEROCCO. Absolutely they do.

Mr. MCCRERY. Unfortunately, Mr. Chairman my time has expired.

Chairman HERGER. I thank the gentleman. Now we will turn to the gentleman from Maryland, Mr. Cardin, to inquire.

Mr. CARDIN. Thank you, Mr. Chairman. First, let me say that last year, we were given certain projections on the state of our economy and what we thought was going to happen with the projected surplus, and Congress and our Committee, the Committee on Ways and Means, took definitive action based upon projections. So excuse me for being a little bit concerned about some of the projections that are currently being made.

You showed a chart on the impact on the Federal accounts based upon the enactment of the recommendations, and although the chart was difficult to read at the quick review, it looked like a healthy line for the reserves that were being held in case of need at the national level for a recession. Do you know how much you assume would be consumed during that period of time by the Federal Government on extended benefits shared with the States?

Ms. DEROCCO. For the 13-week extended benefits?

Mr. CARDIN. Not the 13 weeks of new benefits, the current extended benefit program that is in law with the easier trigger. How much are you projecting that the Federal Government FUTA taxes

will be used or consumed during that period of time in that chart on the Federal share of the extended benefits of current law, not the 13 weeks additional?

Ms. DEROCCO. One-point-seventy-five billion dollars, which is on the far right on this chart. The cost that is under the proposal, for 2 years.

Mr. CARDIN. I am asking you how much do you assume during the next 5 years in your chart. Not that chart.

Ms. DEROCCO. You are talking about the——

Mr. CARDIN. You had a 5-year projection where you showed the Federal FUTA funds staying healthy, and I guess if you could make available to our Committee how much you assume will be used for extended benefits and/or loans to the States in order to meet the needs during the next 5 years, I think that would be helpful.

I am concerned that you are taking a very rosy projection, and in fact, are not being realistic as to the need of that fund if our economy does not perform as well as you think it is going to perform, which was the case we saw a year ago. My second question deals with why is the Administration ignoring or walking away from the stakeholders' agreement of 18 months ago? I mean, that agreement dealt with the administrative costs. I agree with the gentleman from Louisiana. I think we have to do something about the administrative costs and predictability.

The stakeholders' agreement provided predictable financing. It reduced the surtax and the FUTA tax, and it also dealt with some issues that my friend thinks is controversial, but quite frankly the elimination of the surtax in some quarters is considered to be controversial but dealt with the fact that so few people unemployed receive unemployment benefits today—less than half. So it dealt with the part-time and dealt with more recent wage quarters. Why?

I mean, here you have people with different views who are the stakeholders in the system at last coming to an agreement, and the Administration walks away from it.

Ms. DEROCCO. This Administration was not part of the deliberations on that agreement, but let me give you two failings of that agreement. I think incredibly good work was done, in fact, hundreds of proposals were looked at by the stakeholders who eventually developed that particular proposal in 2000. But there are two principal problems from this Administration's standpoint. One, we stand on the principle of the unemployment insurance system as it was originally designed, which leaves to the States responsibility for determining eligibility for benefits and benefit levels.

We continue to believe that is a State prerogative and should remain a matter of State law, and we believe that the national association representing the States in this matter believe that as well.

Secondarily, that proposal for an administrative financing fix essentially moved to a very, very robust workload type formula, and then moved it to the mandatory side of the Federal budget. And both the Administration and many, many Members of Congress have essentially told us that they would not consider putting administrative funding on the mandatory side of the budget as an entitlement program. So those were the two principal failings in that proposal.

Mr. CARDIN. I am glad you didn't mention the expansion—well you did mention flexibility. I regret that. Let me ask one more question for the record, because my time is expiring, and the Chairman is very strict on the clock. If you could make available for our Committee how many States you think would actually reduce their funding for the administrative side, assuming the Federal Government uses the .2 for the Federal functions which is what you are assuming. I think the States would have to impose a .4 in order to stay about equal on their administrative support. How many States you project would actually have less funds available to deal with the more complicated administrative side of the UI system?

Ms. DEROCCO. We have done that analysis, and I will be glad to provide it for the Committee.

[The information follows:]

It is in a state's best interest to provide good service to its citizens, so they have motivation to properly fund administration of the Unemployment Insurance (UI) and Employment Service (ES) Programs. Combining that observation with the fact that administrative funding has not kept pace with the cost increases since at least the middle nineties for UI and the middle eighties for ES, it is not clear that any state would reduce funding for administration.

If states had to rely on the revenue equivalent of 0.4% on a $7,000 wage base, 26 states would not have generated enough revenue in 2001 to cover the grants they received from the FY 2001 appropriation. However, 14 of those states are "small" states which would be given supplemental funds under the proposal. While all 26 states would need to increase taxes above the 0.4% level, only 12 would do so without any supplemental funding from the Federal Government.

Chairman HERGER. I thank the gentleman. I just might note for the record that my understanding is that currently we have 14 States that have special State taxes to pay for the administration because the average is only 46 cents out of the dollar that they are receiving. Those States include Alabama, California, Colorado, Georgia, Idaho, Kentucky, Louisiana, Minnesota, Montana, North Carolina, New York, South Carolina, and Washington.

So it would seem to me that if we go ahead with this, those States will be able to lower, if not eliminate, those extra taxes that they already have. With that, I turn to the gentlelady from Connecticut, Mrs. Johnson to inquire.

Mrs. JOHNSON. Thank you and welcome. This is a very important subject and has received a lot of attention both in the private sector and by this Committee over a number of years now, and so I welcome your work in this area. The States, however, have raised a number of questions, which I am sure you must have seen about your proposal. Would you like to comment on any of them? Are you familiar?

Ms. DEROCCO. I am aware that they have a list of questions. I don't have them in front of me.

Mrs. JOHNSON. I thought maybe you might have seen them because they are substantial, and one of them does go to this issue of whether the funds—you know, how they would do over time under this funding change. And I think all of us will need to understand that.

Ms. DEROCCO. Is the question related specifically to the small States? I know there was a misunderstanding that the commitment

to supplementing the small State funding was only for a 10-year period, and that was a misunderstanding. We have a commitment to continue the grants to small States to ensure that they are not in a position of having to have tax increases.

Mrs. JOHNSON. And while I appreciate your comments about part-time employees and feeling that States should be setting those standards, we do have a number of States that have been covering part-time employees. And I would hope that, and I would ask that you do some research on what might be the definition of permanent part-time employee. I personally think it is extremely important that we allow, for example, a parent who is working part-time, desperately needs to work because one salary is no longer enough. But by working part-time, can adjust the schedule, so that the couple together do not have babysitting or day care costs.

You know that is better for the children. It is far more economical, and it is the only way that a lot of young families are surviving. So if you get laid off from your part-time job to be required as a condition of receiving compensation to be available for full-time work is counter effective to many of society's long-term goals.

So I would hope that you would begin looking at, do any States provide special benefits to someone who has small children or a disabled person at home. There are definable circumstances, at the very least, that I think if the Federal Government helped define, we could make progress on it. We could determine whether that should be mandatory or voluntary, but at least we need better criteria.

And I wonder on your work in unemployment compensation, you have done any review of how effective State standards are in overseeing whether people are really looking for work? Given our experience now with welfare reform, we have much better ways of helping people into the workforce, overseeing their progress in the workforce. And I know when I look at the new information management system that my Commissioner of Labor in Connecticut wants to put together. I mean, he has got it integrated in his computer, and it is going to cost $4 million. He could do a much better job in helping people in any situation into the workforce and then moving up the wage ladder.

I think that is an aspect of this whole system that your proposal doesn't focus on and that I think any reform needs to focus on. So while we may want to step back, I think there are standards that we need to begin to think about for States that will address the kind of workforce development that we need in the future. We don't just need unemployment compensation. We need workforce development. And so to make this big a change without any mandate on the States, so to speak, for which we are going to hold them accountable, is, in my estimation, not adequate to the future.

Ms. DEROCCO. If I may comment, Mrs. Johnson, on two points. One, I believe the State commissioners of Labor and the Governors have a very, very strong interest in taking a system-wide approach to serving workers and businesses in their States. And our proposal, in fact, provides to the States a greater opportunity to integrate and work through both the Workforce Investment Act and the unemployment insurance, and employment services to build an

integrated service system that speaks to the very issues you are speaking to.

Mrs. JOHNSON. Does it, in any way, strengthen that mandate in the law? Does it change wordings because I think that is what you need to get back to us on.

Ms. DEROCCO. Absolutely. We are proposing to make the employment services a conformity issue. We are continuing all the requirements of the Social Security Act, vis-à-vis the workers that are covered by unemployment insurance, and we are continuing the strong Federal role of oversight, national standards, and moving to a much more fully integrated system on behalf of businesses and workers in the country.

I think you will find that under this proposal, Connecticut and your Labor Department would take a very, very strong role in that integrated service, and in better recognizing the demographics of your worker population and better serving those workers who have family requirements or challenges be they physical or otherwise among the disabled community. We are cognizant of all of those and we are eager to work with the States to move to a much more integrated and effective system.

Chairman HERGER. Thank you very much. I thank the gentlelady from Connecticut. Now the gentleman from Michigan, Mr. Levin, to inquire.

Mr. LEVIN. Thank you. By the way, Mrs. Johnson, I very much agree with your statement about the need for unemployment comp to have a broader focus. But let me ask you this, who controls the expenditures for administrative expenses now, the Congress?

Ms. DEROCCO. Yes.

Mr. LEVIN. Now if the Congress wanted to appropriate adequate funds, it could do so, right?

Ms. DEROCCO. I assume it could, yes.

Mr. LEVIN. So one alternative is for you to come here and say to Congress, spend trust fund moneys the way they were supposed to for administrative expenses, right?

Ms. DEROCCO. I think every administration makes a request for administrative dollars for the system.

Mr. LEVIN. You can do that without talking about devolution, right?

Ms. DEROCCO. I don't believe I am talking about devolution now, but yes.

Mr. LEVIN. So essentially, it has been the failure of Congress to appropriate adequate funds, right?

Ms. DEROCCO. I think there has been a shared responsibility of the Administration and the Congress to make a determination on the amount of money that is returned to the States from this payroll tax.

Mr. LEVIN. Well, you have the irony that a lot of those who had responsibility for appropriating adequate funds in this Congress are now suggesting that we do something else instead of appropriating adequate funds. We don't need to change the system to appropriate adequate funds, do we? We just appropriate them.

Ms. DEROCCO. Well, I don't envy you the budget pressures that you have to deal with every year.

Mr. LEVIN. So, the answer is avoid the budget pressures and simply let the States do it?

Ms. DEROCCO. I believe the answer is let the States be the taxing authority on their employers and keep their payroll taxes from their employers at home.

Mr. LEVIN. So that is your basic assumption, and I am glad you stated that boldly. Now what happens when there is a recession nationally and there is a need for very substantial funding from one State to another? Let me just give you an example, and I use Michigan. In 1992, the Federal unemployment taxes were $188 million. The Federal—this is during the last recession—spent $719 million. That is in 1 year. Now if we have a serious recession, where is the funding going to come from Federally to help the States?

Ms. DEROCCO. We are proposing to maintain the unemployment trust fund, which is what you saw on the slide; it continues to grow even at a two-tenths FUTA tax; we retain the Federal unemployment account, which Congress created in order to make loans available to States when they ran into difficulties and deep recessions.

Mr. LEVIN. And this is Mr. Cardin's question. We need a very, very clear-cut answer. You are saying now we are taxing 8 percent, we can reduce it to 2 percent and that will have enough money in it to handle all of the functions including unemployment comp extension. We are now talking about a federally funded unemployment extension, a redone, extended benefit structure that with two-tenths of 1 percent that you can say to this Congress for the next 5 to 10 years that we are going to have adequate moneys?

Ms. DEROCCO. That is presently what our actuaries have reported to us.

Mr. LEVIN. You should give us all of the assumptions.

Ms. DEROCCO. We will do that.

Mr. LEVIN. Do you have them here?

Ms. DEROCCO. I will be more than glad to.

Mr. LEVIN. Have you made them part of your presentation?

Ms. DEROCCO. They were represented by one slide, yes.

Mr. LEVIN. It just stated the conclusion.

Ms. DEROCCO. It illustrated by a bar chart, the level of the unemployment trust funds Federally held through, I believe 2012.

Mr. LEVIN. Let me ask you this in terms of leaving it to the States. On the average today, what percentage of the unemployed people that become employed are covered for unemployment comp under State standards?

Ms. DEROCCO. Nationally—we have another chart that illustrates this. The number of job losers who are those, as you know, who are eligible for unemployment insurance, 83 percent in UI claimants.

Mr. LEVIN. No. But those who become unemployed, what percentage receive unemployment compensation?

Ms. DEROCCO. That is the figure that I believe someone heard used that was in the neighborhood of 40 percent, but that is really a misrepresentation of the unemployment insurance system which was designed as temporary wage replacement for individuals who are in the "covered" workforce; how many of those individuals are eligible for unemployment insurance.

Mr. LEVIN. So you are saying it is irrelevant that on average nationally, 40 percent for those——

Ms. DEROCCO. Forty-nine percent.

Mr. LEVIN. I am not sure. There is dispute about that. But that is the latest. It has been low, as low as 40 percent, has it not? You say it is irrelevant that 40 percent, or now 49 percent of the people who become unemployed, are covered with unemployment compensation?

Ms. DEROCCO. I am not saying it is irrelevant at all. I am saying that job leavers, people who leave their jobs, new entrants who don't have work attachment, the unemployment insurance system was not designed to cover that, never has been. And if there is a different design sought for an unemployment insurance system that would cover even a new entrant that spends a couple of weeks on the job and decides to leave and look for a different kind of job, that is not what the unemployment insurance system is all about.

Chairman HERGER. The gentleman's time has expired. Again, I want to thank you. I think the purpose of this hearing is to show and emphasize how inefficient the current system is. For example, the gentleman who was just inquiring in his State of Michigan of every dollar that is paid in unemployment taxes, only 50 cents is returned to your State.

Mr. LEVIN. Will the gentleman yield? What was the percentage in 1992?

Chairman HERGER. I don't know that, but we can certainly find out?

Mr. LEVIN. Is it relevant? Yes. And I will ask Ms. DeRocco, what is your hunch in 1992, what percentage of the dollars sent in from Michigan was returned to the State?

Ms. DEROCCO. I am sorry——

Mr. LEVIN. It would be several hundred percents, wouldn't it?

Chairman HERGER. Reclaiming my time, in my own State of California, we don't get as much back. Only 46 cents.

Mr. LEVIN. When California was in a recession in 1991, 1992, what percentage——

Chairman HERGER. Again reclaiming my time, the point is the system is not working. It should not be that only 46 cents out of a dollar is returned on average to a State, and that we actually have 14 States who were forced to put in their own tax and make up the difference—to be able to implement their unemployment programs. It shows that we have a major problem. And Ms. DeRocco, I would like to ask a question if I could, the President's plan calls for reducing Federal unemployment taxes. These Federal unemployment taxes are payroll taxes, which means they tax and thus discourage employment.

What effect would you project reducing these payroll taxes might have on businesses and their ability to hire new workers? And I might mention, you had a graph up here a little earlier when you were testifying, and maybe we could put that back up.

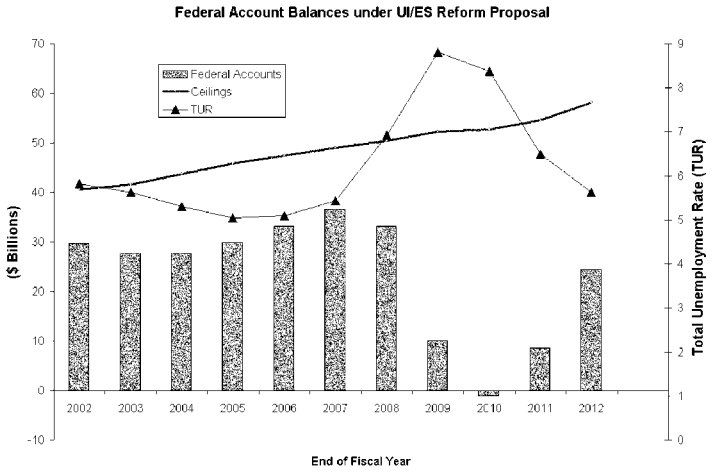
Ms. DEROCCO. This is the extended benefits graph.

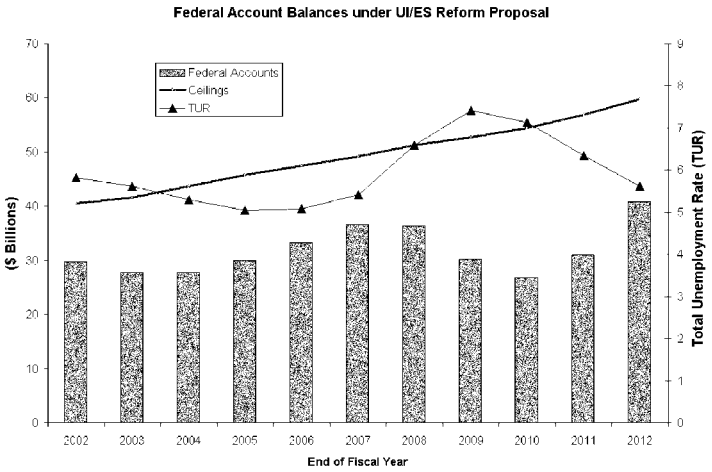
Chairman HERGER. Why don't we address the first question first.

Ms. DEROCCO. Clearly, and employers, as I know you will have represented on the next panel, will speak to their opportunities for job creation and job growth as payroll taxes on employers are less-

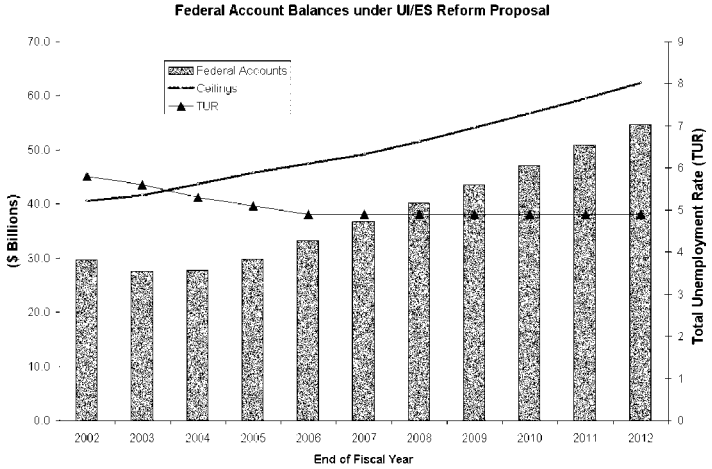
ened. And although we are shifting responsibility to the States for approximately $3.5 billion in administrative costs, that is about what it runs now, the payroll taxes we are reducing amounts to about $5.5 billion.

There is a lot of buffer in there for States to have the option of increasing extended benefits if, in fact, that is the State's decision or to further reduce the employer taxes, which gives to the employers the opportunity to expand production, to increase jobs and to be an economic development factor in their States. And I think that is an important opportunity that this proposal opens. Specifically, on the extended benefits chart you asked about, this depicts the number of States and workers that would be impacted by the proposal to lower the extended benefit trigger from 5 percent to 4 percent.





Simulated recession is similar to the 1990's recession, with a peak quarterly unemployment rate of 7.6% in the 3rd and 4th quarters of fiscal year 2009.



FY 2003 President's Budget Economic Assumptions.

Chairman HERGER. Thank you. The gentlelady from Connecticut.

Mrs. JOHNSON. I just want to follow up on some information that it would be helpful if you got back to us. This chart that you have, impact on Federal accounts, that really needs to show what under current law the Federal Government would collect and what portion of what we would collect would automatically be returned to the States, because I think that goes to my colleague from Michigan's question. If collections are going to go up, but they will automatically go back out to the States under the Reed Act, then what is the remainder and what will be the impact of your tax reductions? And then you will be down to that bar chart. And then if you could further accommodate that bottom line below the bar chart for—if there is a recession or, you know, various factors, at what point—how much economic damage would we have to sustain before we would not only begin to touch the growing reserves which will continue to grow but deplete them? So I think that is where we—because that is one of the big issues the States are asking you to know of. So thank you.

Chairman HERGER. I thank the gentlelady, and now the gentleman from Texas, Mr. Doggett, to inquire.

Mr. DOGGETT. Thank you so much and thank you for your testimony.

Do you share the general view of some that if unemployment and health care benefits for the unemployed are too generous it will discourage people from seeking employment?

Ms. DEROCCO. I know we have some studies that indicate more benefits or higher unemployment benefits tend to increase duration. But, however——

Mr. DOGGETT. You mean to increase the——

Ms. DEROCCO. Duration on unemployment. The extended benefit provision sometimes increases duration in unemployment. I would like to believe, however, that most people would much prefer a job.

Mr. DOGGETT. Can you forward those studies to the——

Ms. DEROCCO. Yes.

Mr. DOGGETT. Committee?

Ms. DEROCCO. Yes, sir, we will.

[The study is being retained in the Committee files.]

Mr. DOGGETT. Do you believe that it is prudent for a State to cut taxes during periods of prosperity and to double them during periods of recession on their unemployment tax?

Ms. DEROCCO. That is a very general question, and I do believe that States are competent administrators of their financial situation and that some choose to leave money in the economy to keep their businesses growing and create jobs. Others might choose to——

Mr. DOGGETT. It is actually intended to be a very Texas-specific question.

Ms. DEROCCO. I thought it might.

Mr. DOGGETT. And not general, and I guess you have answered the question, that you consider a program of cutting taxes, unemployment taxes at the State level, during periods of prosperity and

doubling them during periods of recession, which appears to be what it is going to take in Texas, is an example of prudent administration of the State plan by the State?

Ms. DEROCCO. I am not aware that the State of Texas needs to double its taxes, but you are probably better——

Mr. DOGGETT. That is what is reported on Texas, but then just take it as a hypothetical. Do you think if a State cuts taxes on unemployment during periods of prosperity and doubles them during periods of recession that is an example of prudent administration?

Ms. DEROCCO. I think that, particularly as it relates to the State unemployment tax and the level of the State's reserve, that should be and has been a State decision. And if it was Texas' decision or New York's decision to keep money in their economy rather than to increase the taxes on businesses in order to keep their economy growing and then to take advantage of the fact that the Congress and the Administration created a loan account for the very purpose of those States who chose to seek a loan during periods when their reserves did not—were not adequate to——

Mr. DOGGETT. Then you applaud the decision and cite it as an example of their competence?

Ms. DEROCCO. That is not the Employment and Training Administration's preferred approach to trust fund reserves. We do have guidance that indicates that there should be an average high-cost multiple in their reserves of 1.0. There are many States who do not maintain that.

Mr. DOGGETT. I believe that is true, and given the short time that I have, is it correct, then, that under the Administration plan, that in less than 5 years when States like Texas assume all the administrative cost, unless they choose to raid their trust fund, regardless of the economic conditions that exist in 2007 and beyond, that they will have a choice of either cutting benefits or raising taxes?

Ms. DEROCCO. No, I do not believe that. As I indicated earlier in answer to another question, we are shifting responsibility to the States for about $3.5 billion in administrative costs. Sixty-five percent of those administrative costs are not related to benefit levels. We are at the same time reducing the payroll tax at the Federal level by $5.5 billion. So there is ample opportunity for the States to adjust their tax level to ensure they can provide the same level of service.

Mr. DOGGETT. So you think basically a little like last year's budget proposal. They can have it all, they can keep taxes low, they can provide the same level of benefits and satisfy all of their administrative needs?

Ms. DEROCCO. I believe States have the fiscal capability and the administrative capability to manage administrative funding for this system.

Mr. DOGGETT. As to the point that Mr. Levin was just making, isn't it correct that taking a snapshot of a State's return on its unemployment tax dollars in a single year without regard to the economic conditions is not very insightful, since the entire purpose of having a Federal backstop involves the Federal Government sometimes providing hundreds of percent return on the Federal unem-

ployment tax dollars and sometimes providing only a fraction of the return of the dollars, depending on economic conditions?

Ms. DEROCCO. I can only tell you that for 10 years of working with the States, specifically on their return on the dollars their employers are putting in the Federal Unemployment Trust Fund, that they have spoken for a decade about inadequate return of their payroll dollars.

Chairman HERGER. I thank the gentleman, and I can see why the gentleman from Texas is concerned. Currently the State of Texas is only receiving 32 cents out of every dollar of the FUTA taxes collected in Texas. So there would be money left over so that even if Texas was to begin collecting their own taxes there would still be a lot of money left over.

Mr. CARDIN. Would the gentleman yield?

Chairman HERGER. Yes.

Mr. CARDIN. I know you keep and will continue to mention the impact on each of one of our States. I would just ask that we have made available for the record the last 10 years, the last 20 years how much money has been returned to the States through these funds. If you pick 1 year where there has been very little use of the funds for dealing with a recessionary problem, obviously it is going to be impacted in a negative way.

Also I might say, Mr. Chairman, many of us have been urging, including, I believe, the gentleman from Louisiana, that the Congress do the right thing on the administrative cost, and we haven't done the right thing on the administrative cost. One thing is clear, that if this proposal were to be enacted, it would mean a $16 to $18 billion loss of revenues at the Federal level.

The question whether the States will make that up or not is uncertain, and I know we can keep on talking about our individual States. Many of us are concerned that our individual States have enough administrative support, and we don't know what is going to happen. We know under current law the structure is in place. It has not worked the way it should, but I think it is just unfair to keep on mentioning 1 year we should have the historical number.

Mr. MCCRERY. Would the Chairman yield?

Chairman HERGER. Yes.

Mr. MCCRERY. I appreciate the gentleman's point, and I don't think anybody would deny you that information. However, I do believe it is irrelevant. The system is designed to provide States much more money during times of high unemployment. Extended benefits shouldn't be in the mission of administrative funding for the States. Year after year after year after year there is inadequate administrative funding for the States, and, yes, it is our fault, we the Congress, because we have not appropriated sufficient funds for them, but don't mix that up with the extended benefits program, which is designed to be Federally funded to the tune of 50 percent. So it is just mixing apples and oranges. So——

Mr. CARDIN. I agree.

Mr. MCCRERY. You all can keep making that point. It is irrelevant. I object.

Mr. CARDIN. I agree with you.

Chairman HERGER. I would like to request that information.

Ms. DEROCCO. Yes, sir.

[The information is being retained in the Committee files.]

Chairman HERGER. The fact that we do know is that these numbers are accurate now. They are numbers that would appear to be growing. It would appear that the trust fund, rather than becoming smaller, continues to grow, and with that, I will turn at this time to the gentleman from Michigan——

Mr. DOGGETT. Could I just inquire of you, Mr. Chairman, to broaden the request to include one other factor? And that is along with that, in that same table, that she would give us for however many years you are going to do it, show as to each State how many of the people who are actually unemployed in that State are covered by the system. In Texas it is about one out of four, and since the administrative costs are related to the workload, one of the reasons we have such a low return is that we are covering so few people that are unemployed and it would be useful to have that——

Chairman HERGER. Again, reclaiming my time, that is the State's decision to make that. If we could just get the original question answered, we would appreciate it.

Again, now I turn to the gentleman from Michigan, Mr. Camp, to inquire.

Mr. CAMP. Thank you, Mr. Chairman. I have a question really that kind of follows up on Mr. McCrery's comments, and that is that the President's budget is making suggested changes in the administrative financing of the unemployment insurance program. Is there any discussion of changing the benefit levels involved?

Ms. DEROCCO. The weekly benefit levels? Again, we believe that is a matter of State law, has always been a matter of State law, and should continue to be a matter of State law.

Mr. CAMP. The only change would be then in changing the rate at which the extended benefits would be triggered. Is that correct?

Ms. DEROCCO. Correct. We do propose lowering the trigger rate for extended benefits.

Mr. CAMP. From 5 to 4 percent?

Ms. DEROCCO. Correct.

Mr. CAMP. And would that be a permanent change under the President's plan?

Ms. DEROCCO. Yes.

Mr. CAMP. So that would then incorporate the temporary extension of unemployment benefits that were in the House-passed stimulus bills in December and February?

Ms. DERROCCO. Yes. The President has supported the 13-week temporary extension of benefits as a short-term strategy. The long-term strategy envisioned is to lower the trigger rate so that more States trigger on in a recession, covering more workers.

Mr. CAMP. All right. Thank you very much. Thank you, Mr. Chairman.

Chairman HERGER. I thank the gentleman from Michigan. The gentleman from Oklahoma, Mr. Watkins.

Mr. WATKINS. Mr. Chairman, I don't have any questions. I will apologize to you and the panel and all. I just got here just a while ago on the airplane. I normally leave at a 3:00 a.m. flight out of—I leave Stillwater about 3:00 a.m. and get to Oklahoma City, but this morning after the snow and ice I scraped a little bit of that

before I left, and I left on the 5:00 a.m. something flight or a little later flight. So I apologize. I don't have any questions. Glad to be here, though.

Chairman HERGER. I thank the gentleman from Oklahoma. Your participation is always appreciated. With that, we thank you, Assistant Secretary.

Mr. CARDIN. Mr. Chairman, I know you have been very generous of time. Could I just ask one more question today? Would that be possible?

Chairman HERGER. Yes, a quick question.

Mr. CARDIN. It will be a quick question. The question will be very quick. But my question is, if the House were to pass the exact same bill the Senate has passed on the 13-week extension, would the Administration sign it?

Ms. DEROCCO. I am sorry. I am not here to state the Administration position on the ultimate result of the economic security deliberations.

Chairman HERGER. Again, for the record we have passed it out of the House three times, almost four, and the Senate is yet to act. With that, I would like to excuse you and thank you for your testimony and ask our next panel to come to the witness table, please.

On the second panel this afternoon we will be hearing from Chuck Yarbrough, Chairman, Board of Directors of UWC—Strategic Services on Unemployment and Workers' Compensation; Christine Owens, Director of Public Policy, American Federation of Labor and Congress of Industrial Organizations, AFL–CIO; Dan Blankenburg, Manager, Legislative Affairs, National Federation of Independent Business; and we also, I understand, have a constituent of the gentleman from Oklahoma. Would you like to introduce the witness, Mr. Watkins?

Mr. WATKINS. Mr. Chairman, Members of the Committee, it is my honor, really very much so, to introduce the gentleman. He is our Executive Director of the Oklahoma Employment Security Commission, but Jon Brock is more than that this year. He is now President of the National Association of State Workforce Agencies. So I am very proud of the fact of his position and of the distinction there. I think it shows what credibility he has got and the reputation he has got with his colleagues in the workforce area.

So I am very pleased that he is with us today. Jon, I am glad that plane got down so I could get here.

Chairman HERGER. Thank you, Mr. Watkins. With that we will begin the testimony with Mr. Yarbrough.

STATEMENT OF CHUCK YARBROUGH, DIRECTOR, CORPORATE HUMAN RESOURCES, TYSON FOODS, INC., SPRINGDALE, ARKANSAS, AND CHAIRMAN, BOARD OF DIRECTORS, UWC—STRATEGIC SERVICES ON UNEMPLOYMENT & WORKERS' COMPENSATION

Mr. YARBROUGH. Thank you, Mr. Chairman, and members of the panel. I appreciate the opportunity to be here today.

My name is Chuck Yarbrough, and we were very pleased to learn that the Committee was having hearings today on President Bush's proposal on Administration finance reform.

We hope to acquaint you with some of the employer concerns, and as Chairman of UWC, I would like to first talk about a few things that we support. First of all, we do support a strong unemployment insurance and employment service system with a limited Federal role.

Second of all, we support a strong UI/ES system that provides fair and affordable benefits to the citizens of our State. UWC supports moving the FUTA trust fund moneys to the States so that we can have more local control regarding how benefits are determined and taxes are assessed.

The UWC supports a two-tenths reduction in the FUTA tax rate. This two-tenths surtax has been in effect for more than 25 years and is due to expire in 2007. But UWC members are concerned that many States may increase their UI taxes to compensate for the six-tenths reduction in FUTA taxes contained in the Bush Administration proposal. The UWC wanted to amend the proposal to prohibit the States from increasing their UI taxes by more than $28 per year.

In general, we support the Administration's proposal to transfer the financial responsibility for administering the UI/ES system to the States. But we also believe that including any expansion of benefit eligibility in the proposal will threaten the solvency of State trust fund accounts. A risk of insolvency will create pressure to decrease benefits.

I am a member of the Governor's Workforce Agency Advisory Council at home, where it is made up of business and labor and public members. I have a letter of support from our Governor on the President's proposal. One issue that our State, Workforce Investment Agency, and employers have experienced is that while we have continued to pay a 25-percent surtax, our employment service staff has been reduced. We have seen our State UI agency lay people off in order to give other employees merit increases.

Employment offices are also no longer certifying that the workers they refer to us are eligible to work in the United States. We have seen continued limited monies for services, both for employees and employers who go to UI offices for help. We have had to open up our own Main Street recruitment offices to provide the labor and workforces that we need, while UI offices continue to reduce the number of their employees who could refer trained workers to us.

And again some employer communities have struggled with the employment verification process that has been delegated to us when the States could have definitely provided that service for us.

We also support allowing States access to the National Director of New Hires to prevent fraud. We feel like that would certainly help us, but also I would like to say if they could use—the agency could use that, the wage history that is involved and the person's work history that has a claim and also add the basic pilot program from the Justice Department, then that would ensure that all workers referred by the Employment Security Department would be eligible to work in the United States. That would be a real plus for the Employment Service to be able to hang that banner outside. This means that all work being performed on government contracts would be done by workers who are eligible to work in the United States.

We have been here several times to talk about many different proposals in the last 10 years, from Shaw, to McCrery 1, to McCrery 2, to the current President's reform. All I can say, help. We are overtaxed. We are understaffed. We are underequipped. And 50 percent of our employment security employees will be retiring within the next 2 or 3 years. Some agencies haven't made hires in over 15 years, and they are not going to have anybody or any knowledge to carry on the system. We have got to cut some money loose.

We need to elevate the statewide services of first choice to refer trained workers coming out of the Workforce Investment Act 1998. We need to be able to refer laid off workers as soon as possible as a first choice, and we need to be able to guarantee the eligibility of the workers that they refer.

Three things I want to leave with you: Universal agreement to reform administrative funding. Everyone agrees that needs to happen. Congress should take a strong look at the Administration's proposal, because it does bring a workable solution to this problem, as have many other things brought to this panel.

We have sought reform for 10 years, but don't let this Congress close without taking action on behalf of the workers and the business community, because we are waiting. Because my Governor said in his last paragraph to the Secretary this proposal is not only good for States but, more importantly, it is good for American workers and business.

As a debate on the reform for UI insurance and unemployment insurance proceeds, I hope that we can all work together to benefit America's workers and business. Thank you.

[The prepared statement of Mr. Yarbrough follows:]

Statement of Chuck Yarbrough, Director, Corporate Human Resources, Tyson Foods, Inc., Springdale, Arkansas, and Chairman, Board of Directors, UWC—Strategic Services on Unemployment & Workers' Compensation

Good afternoon, Mr. Chairman and Members of the committee. My name is Chuck Yarbrough, and I am Director of Corporate Human Resources for Tyson Foods, Inc., the nation's leading producer of protein consisting of poultry, beef and pork, as well as other convenience food products.

I am testifying on behalf of UWC—Strategic Services on Unemployment & Workers' Compensation. I am proud to serve as the Chairman of the UWC Board of Directors. UWC, which was founded in 1933, is the only business organization specializing exclusively in public policy advocacy on national unemployment insurance (UI) and workers' compensation issues. UWC is intimately acquainted with UI laws; our research arm, the National Foundation for Unemployment Compensation & Workers' Compensation, publishes numerous materials on UI, including the annual Highlights of State Unemployment Compensation Laws. I have also been a member of the National Employers Council (NEC). I served as NEC's elected representative for employers in the Department of Labor's Region VI (Arkansas, Louisiana, New Mexico, Oklahoma, and Texas). In this capacity, I represented employers before the Department of Labor (DOL) and state employment security administrators.

We are pleased that the Human Resources Subcommittee is holding these hearings today on the Bush Administration UI reform proposal. We appreciate the opportunity to acquaint you with the concerns of employers and provide our recommendations on how to maintain a sound UI and employment services system, especially relating to proposals for administrative financing reform.

UWC supports a strong UI/ES program through which employers provide fair and affordable insurance benefits for a temporary period of time to workers with a strong attachment to work who are temporarily and involuntarily jobless when suitable work is no longer available. UWC believes that a sound UI program is best

embodied through the state UI/ES system, with a limited federal role where uniformity of state law is considered essential.

The principal federal role in the UI system is to provide administrative financing. Unfortunately, the present administrative financing system is not working effectively. Workers are under-served, employers are over-taxed, and state UI/ES agencies are under-funded. Under the current system the Federal Government holds 100% of Federal Unemployment Tax Act (FUTA) receipts but returns only 50% to the states.

Major employer concerns with the present federal role in the UI system can be summarized as follows:

- **The FUTA tax rate is excessive and resulting FUTA surpluses are not being returned to state UI trust accounts as required by the Reed Act**.

Under current law, the Federal Unemployment Tax Act (FUTA) rate is 0.8%. This rate is 25% too high as the result of a 0.2% "temporary" surtax which is no longer needed. Although FUTA funds are held in a trust account and may be expended only for limited purposes spelled out by statute, the surtax is now being maintained only because inclusion of FUTA funds in the unified federal budget makes more money available to meet budget targets for other spending programs. The practice of counting FUTA funds for spending on other programs, leaving only an IOU and an accounting entry behind, is contrary to the very reason why Congress placed these funds in the Unemployment *Trust Fund* in the first place. In effect, the budget rules allow the misuse of FUTA funds for purposes unrelated to the UI/ES system.

Congress originally imposed the surtax more than 25 years ago to pay for a temporary federal program of supplemental unemployment benefits. The surtax was to expire upon the retirement of this deficit. The deficit was paid off in 1987 but the surtax has been extended 4 times and now expires at the end of 2007.

Despite the fact that the ceilings on the FUTA accounts in the Unemployment Trust Fund were doubled when the surtax was last extended, balances in these accounts now far exceed their statutory ceilings. When the FUTA accounts are all at their maximum, as they are today and into the foreseeable future, a law known as the "Reed Act" requires any amount above the ceiling to be distributed into the state UI benefits accounts. Last October DOL reported to Congress that over the next 10 years, Reed Act distributions will total $43 billion. While these projections have now been somewhat reduced, a substantial Reed Act distribution of $3.2 billion is projected for FY 2003. These Reed Act funds are urgently needed to replenish state UI benefits trust fund balances that have been drawn down in the aftermath of September 11 and the recession. Reed Act funds may also be used by states, upon state appropriation, to supplement state UI/ES administrative funding, eliminating or reducing the need for supplemental state UI taxes.

Let me repeat: The revenue from the FUTA surtax is not needed for the UI program. Only 50 cents out of every FUTA dollar is being spent as intended on administration of the UI program and state employment services. Furthermore, no additional accumulation of funds in the account used to pay the 50% federal share of extended benefits (EB) is necessary to meet foreseeable needs, including temporary extensions of UI duration that have recently passed the House and Senate.

- **State administrative grants are inadequate for efficient administration, resulting in quadruple taxation of employers.**

To effectively serve their customers, UI/ES agencies must be efficiently administered. In recent years, this goal has been frustrated because federal appropriations for state UI agencies have been inadequate, leading to a reduction in services for jobless workers and employers. UI claimants in turn draw additional weeks of UI benefits. This situation results in higher state UI benefit costs and in turn, higher payroll taxes to finance the additional weeks claimed. Because state UI taxes and benefit payments are also included in the unified federal budget, inadequate funding for administration also increases federal outlays.

The hidden consequences of inadequate administrative funding also results in more fraud and abuse. The latest Department of Labor statistics show that 9.5% of UI payments are estimated to be improper. Last year the Senate Government Affairs Committee issued a report called "Government at the Brink" that included UI fraud as one of "The Federal Government's Top 10 Worst Examples of Mismanagement."

Because of inadequate federal administrative grants for state UI/ES agencies, employers have been asked to pay a second, third, and fourth time for the same service

for which FUTA taxes are assessed—amounting to *quadruple* taxation. The inadequate federal grants have directly increased the state tax burden on employers in several ways.

- Many states have been forced to dip into their own general revenues or impose new add-on payroll taxes on employers—above and beyond the state tax used to finance UI benefits—to make up some of the shortfall in FUTA funding from Washington. Most of the additional tax burden directly or indirectly falls on employers.
- In addition to the add-on taxes, basic state UI taxes are inflated because workers are collecting additional weeks of UI benefits. A recent estimate showed that the average duration was 2 weeks longer than expected at comparable levels of unemployment.
- On top of paying higher state taxes, many employers are forced to expend additional resources for employment services they have already paid for through FUTA but don't receive because states have been forced to close offices and eliminate employment counselors and other services. This has been an acute problem for workers in rural areas and others who are costly to serve. My own company has actually paid the rent to keep the local employment service office open in Carthage, Texas.

Freeing FUTA funds *already* contributed by employers for the very purpose of providing efficient and effective UI and ES services will eliminate the need for supplemental taxes and unnecessary indirect expenses.

SOLUTIONS

To fix these problems, UWC has been a staunch advocate of reform of the administrative financing system for state UI and employment services (ES) agencies. This reform is urgently needed to strengthen the state unemployment insurance and employment services (UI/ES) system and deliver the services for which business has paid through our Federal Unemployment Taxes. Reform will also provide funds needed to implement the Workforce Investment Act.

Although there is great controversy regarding proposals for federal expansions of UI eligibility and benefit levels, there is a consensus in support of administrative financing reform. Reform will help jobless workers return to employment more quickly, reduce payroll taxes, and alleviate the financial pinch on state administrators. Now that's what I'd call a "win-win-win" situation.

However, while there is agreement on the need for administrative financing reform, a consensus regarding the right way to achieve it has not yet formed. There are several proposals to improve and simplify UI/ES administrative financing reform which recently have been under active consideration.

In evaluating these proposals, UWC believes there are 3 core ingredients:

1. Eliminate the unnecessary "temporary" 0.2% Federal Unemployment Tax Act (FUTA) surtax on employers, which should have expired in 1987.
2. Impose employer taxes to finance system administration consistent with sound UI operations needs rather than inflexible federal budget rules.
3. Financing for UI/ES administration is provided at adequate levels, avoiding both under-funding and excessive taxes.

Specific criteria which should be applied in implementing these principles are attached to this state.

One approach, on which we testified before this subcommittee on February 29, 2000, was introduced in the 105th Congress and reintroduced in the 106th by Rep. Jim McCrery, with bipartisan support. This approach had the support of an informal coalition of more than 100 business organizations and 34 states and is therefore known as the Coalition approach. UWC launched and served as the business leader of this coalition.

The McCrery bill eliminated the 0.2% FUTA surtax but preserved the remaining 0.6%. However, instead of pooling all FUTA payments in a single federal UI/ES administration account (ESAA), subject to Congressional appropriations and an allocation among the states theoretically based on workload, FUTA taxes paid by employers in each state are credited to a new administration account set up for each state. Each state legislature, rather than Congress, determines how much it needs to administer its own UI/ES program. A small amount is transferred into a special account to be used for supplemental grants to small states which need additional funds to administer their program, and a small amount is set aside for U.S. Labor Department operations related to UI. Under this approach, FUTA funds that are not needed for administration—and excess FUTA funds that have already been accumulated—automatically flow into the state's UI benefits account.

The Department of Labor (DOL) has now proposed another approach to administrative financing. We are looking forward to seeing the actual DOL proposal and all of its elements, but we can make some general comments about the DOL approach pending our review of bill language. DOL proposes to reduce the FUTA tax rate to 0.2% and states will be responsible, after a transition period, for raising the revenue needed for system administration.

The DOL approach has the potential for significant benefit to the UI program. We are pleased that it includes a repeal of the FUTA surtax and believe it will provide the opportunity to improve funding needed for state UI/ES agencies. It is a great virtue that the DOL approach eliminates the fatally flawed federal appropriations mechanism. We believe adequate funding for administration is much more likely to occur using this approach, because state legislatures are of necessity closer to their own state agencies and UI programs than Congress, and because UI/ES administrative funding will no longer have to compete with other federal spending priorities. Additional savings are possible through the release of surpluses in FUTA receipts into state benefit accounts and through the repeal of state tax diversions and add-on taxes on employers, which will no longer be necessary. A reduction of as little as one week will save another $1.5 billion a year for employers by reducing their state unemployment tax.

There are two respects where we believe refinements to the DOL approach are necessary. While giving states the responsibility for administrative funding provides an opportunity for a net reduction in the total administrative cost burden on employers, it may also allow states to impose higher administrative taxes on some or all employers than under current law. For example, if states levy a new administrative tax using their existing wage base, many employers in states with a wage base over $7,000 could face a significant tax increase.

The DOL approach also leaves open the possibility of commingling UI benefits and administrative revenue. Such commingling could lead to the diversion of revenue needed for benefit payments and ultimately lead to higher benefits payroll taxes.

UWC will work with Congress to provide appropriate protections against net increases in administrative taxes and against commingling of benefits and administrative moneys.

CONCLUSION

UWC supports a strong UI system and the concept of a federal-state partnership, under which the UI system has been a general success. However, the present UI/ES administrative financing mechanism is not working effectively. The federal budget process as now applied to FUTA taxes and UI/ES administrative funding is detrimental to a sound, efficiently administered program. Considering that federal stewardship of program administration now over-taxes employers and yet under-finances UI/ES administrative agencies, we believe that workers, employers, and the public will be better served if *states* are allowed greater control over administrative funding. There are several different ways to accomplish this objective. The Department of Labor has made a significant proposal with potential to solve the problem, and UWC looks forward to working with the Bush Administration and Congress to enact positive administrative financing reform this year.

UI/ES ADMINISTRATIVE FINANCING REFORM POLICY

FEBRUARY 28, 2002

Proposals to reform the state unemployment compensation and employment services (UI/ES) administrative financing system have the potential for significant cost savings for employers while improving the integrity of the unemployment insurance (UI) system, which is also important to employers. To satisfy those objectives, administrative financing reform must be in accordance with the following principles:

- The 0.2% FUTA surcharge is discontinued.
- Employer taxes used to finance the UI system are imposed consistent with sound UI/ES operations needs rather than federal deficit reduction.
- Financing for UI/ES administration is provided at adequate levels, avoiding both under-funding and excessive taxes.

IMPLEMENTATION PRINCIPLES

Any new administrative financing system must include the following protections:

1. Federal law must continue to require that states maintain a UI program and a public employment service.

2. Federal requirements for due process, payments when due, etc., are retained.
3. States are required to continue responsibility for the interstate compact.
4. To the extent that states are responsible for imposing and collecting an employer payroll tax to finance their own administrative agencies
    1. The tax should be collected as a line item on the state UI tax form.
    2. To maintain the relative share of contributions from high-wage and low-wage employers, the state tax rate for this purpose, when applied to the taxable wage base, shall not generate an amount exceeding $28 per full-time employee/year.
    3. States are required to reserve for future administrative needs but must have the right to borrow from federal general revenues (with interest) if necessary.
    4. Funds for administration are not commingled with revenue used for benefits.
    5. Dedicated funding must be maintained for essential federal UI/ES functions, such as Department of Labor oversight, the federal share of extended benefits (EB), and supplemental funding for small states. This amount could be collected by continuing a reduced FUTA tax which we estimate should not exceed .2% on the $7,000 FUTA wage base, or a comparable amount collected as a surcharge on state UI taxes.
5. To enhance the accountability of state UI agencies, states must provide to the state legislature, the U.S. Department of Labor, and the public annual data and reports on employment services provided to UI claimants. The initial report would be due within 90 days after completion of the first fiscal year in which the new administrative financing system is implemented, and then annually thereafter. UWC believes that rather than impose federal performance standards, it is preferable to give each state the maximum latitude to determine how best to serve its own claimants, while providing information on agency performance needed by employers and others interested in the UI program through these reports.
6. The full cost (including administrative costs) of Federal programs such as Trade Adjustment Assistance, emergency unemployment assistance, and UCFE and military programs should be funded by the Federal Government out of general revenues rather than FUTA revenue. Congress has recognized that benefits under these program should not be an employer financial responsibility and has provided general revenue funding. UWC believes that it is also inappropriate to tax private employers for the administrative costs of these programs.
7. There is no need for a pre-funded loan account. States may borrow from federal general revenues, subject to interest, or borrow from other sources.
8. The Reed Act should be maintained, allowing FUTA dollars exceeding an actuarially determined cap based on UI program needs to be returned to state UI benefits trust accounts.
9. UI taxes may be collected no more often than quarterly.

Chairman HERGER. Thank you, Mr. Yarbrough. Now we will hear from Mr. Jon Brock, President, National Association of State Workforce Agencies. Mr. Brock.

STATEMENT OF JON BROCK, EXECUTIVE DIRECTOR, OKLAHOMA EMPLOYMENT SECURITY COMMISSION, AND PRESIDENT, NATIONAL ASSOCIATION OF STATE WORKFORCE AGENCIES

Mr. BROCK. Mr. Chairman, Members of the Subcommittee on Human Resources, I am Jon Brock, President of the National Association of State Workforce Agencies (NASWA) and Executive Director of the Oklahoma Employment Security Commission. Thank you for inviting me to testify today for NASWA and its members.

The NASWA represents 53–State and territorial workforce agencies in general, and the Unemployment Insurance and Employment Service programs in particular.

Most of our State members also administer the programs authorized under the Workforce Investment Act and welfare-to-work programs.

I thank the Chairman for scheduling a hearing on President Bush's New Balance proposal. The NASWA stands ready to begin work immediately on enacting reform legislation this year.

Mr. Chairman, NASWA believes there are five major problems that call for Unemployment Insurance and Employment Service reform legislation. First, the Federal Government has been overtaxing employers under the Federal Unemployment Tax Act.

Second, the Federal Government has been underfunding employment services, labor market information services, and unemployment insurance administration.

Third, the permanent Federal-State Extended Benefits program barely works.

Fourth, States need certain technical amendments to Federal law.

And, fifth, worker representatives believe the unemployment insurance recipiency rates and wage replacement rates are too low in many States, and they want the Federal Government to expand eligibility and benefit levels.

In addressing these problems, NASWA believes in the following principles: That the Federal Government should collect only enough Federal unemployment tax revenue to fund the system and maintain solvent trust fund accounts. The NASWA strongly supports repeal of the temporary .2 percent Federal unemployment surtax.

Unemployment taxes should fund fully employment services, labor-market information services, unemployment insurance administration, and the Federal half of the Extended Benefits program. This funding should be stable, predictable, and equitable. States have been struggling to stay afloat in this system. In fiscal year 2001 alone, they added nearly $300 million to our system from their own funds.

Mr. Chairman, at this time I would like to ask permission to submit for the record a copy of the NASWA State supplemental funding survey which shows the contributions to this system made by each State in their own funds in fiscal year 2001.

Chairman HERGER. Without objection.

[The information follows:]

NASWA STATE SUPPLEMENTAL FUNDING SURVEY SUMMARY

Final Results June 2001

	Unemployment Insurance	Employment Services	Labor Market Information	Job Trng. and/or One Stop Implementation	One Stop Implementation	All Programs*	Grand Total
FY94							
State Penalty and Interest Funds	39,332,955	38,952,596	983,645	—	—	—	79,269,196
State General Funds Appropriated	231,800	5,127,609	2,424,229	—	—	—	7,783,638
State Administrative Tax Revenues	16,617,534	54,998,329	3,924,130	—	—	—	75,539,993
Other Sources	266,575	153,200	45,300	—	—	—	465,075
Total for State	56,448,864	99,231,734	7,377,304	—	—	—	163,057,902
FY95							
State Penalty and Interest Funds	45,608,874	50,449,154	1,353,873	—	—	—	97,411,901
State General Funds Appropriated	231,800	4,050,039	1,943,315	—	—	—	6,225,154
State Administrative Tax Revenues	13,101,378	50,706,946	4,179,190	—	—	—	67,987,514
Other Sources	713,268	376,100	4,179,190	—	—	—	1,402,668
Total for State	59,655,320	105,582,239	7,789,678	—	—	—	173,027,237
FY96							
State Penalty and Interest Funds	42,945,536	56,154,594	1,219,084	—	—	—	100,319,214
State General Funds Appropriated	7,469,372	3,737,098	1,625,381	—	—	—	12,831,851
State Administrative Tax Revenues	11,188,751	47,297,773	5,129,667	—	—	—	63,616,191
Other Sources	2,044,745	401,800	48,900	—	—	—	2,495,445
Total for State	63,648,404	107,591,265	8,023,032	—	—	—	179,262,701
FY97							
State Penalty and Interest Funds	43,838,305	41,478,113	796,394	3,929,113	796,666	5,212,806	96,051,397
State General Funds Appropriated	12,994,348	8,449,124	451,300	14,972,282	843,100	550,500	38,260,654
State Administrative Tax Revenues	10,519,433	30,401,249	485,144	16,806	—	3,942,000	45,364,632
Other Sources	1,443,500	20,280,568	561,428	500,000	356,492	16,470,347	39,612,335
Total for State	68,795,586	100,609,054	2,294,266	19,418,201	1,996,258	26,175,653	219,289,018
FY98							
State Penalty and Interest Funds	52,383,481	41,797,237	660,209	6,088,374	606,156	8,007,332	109,542,879
State General Funds Appropriated	13,978,493	17,227,236	1,358,900	10,868,549	6,577,035	4,002,693	54,012,906
State Administrative Tax Revenues	14,803,927	37,719,957	728,736	17,500,000	173,839	8,425,575	79,352,033
Other Sources	1,711,803	31,170,742	868,677	5,800,750	46,092	2,150,058	41,748,122
Total for State	82,877,704	127,915,172	3,616,612	40,257,673	7,403,122	22,585,658	284,655,940
FY99							
State Penalty and Interest Funds	53,322,298	51,661,400	1,158,050	12,276,225	776,943	7,443,310	126,638,226
State General Funds Appropriated	15,947,031	15,609,761	1,361,558	12,320,470	4,150,000	4,649,321	54,038,141

State Administrative Tax Revenues	39,491,786	43,258,391	1,147,526	24,500,000	60,182	1,792,155	110,250,040
Other Sources	3,313,463	26,646,158	1,054,839	6,625,940	—	2,954,600	40,594,999
Total for State	112,074,578	137,175,710	4,721,973	55,722,635	4,987,125	16,839,386	331,521,407
FY00							
State Penalty and Interest Funds	46,604,531	57,455,166	1,392,635	26,490,885	700,000	6,178,122	138,821,339
State General Funds Appropriated	24,234,384	9,950,723	3,207,769	120,827,171	4,597,998	9,993,393	172,811,438
State Administrative Tax Revenues	66,536,223	54,139,765	1,217,306	125,899,617	1,298,428	4,035,709	253,127,048
Other Sources	3,691,919	30,092,881	1,288,298	4,617,100	4,899,799	1,715,305	46,305,302
Total for State	141,067,057	151,638,535	7,106,008	277,834,773	11,496,225	21,922,529	611,065,127
FY01							
State Penalty and Interest Funds	56,548445	52,993,792	1,732,000	20,968,239	—	6,006,844	138,249,320
State General Funds Appropriated	5,362,516	15,970,307	3,053,348	114,137,665	4,874,000	2,632,490	146,030,326
State Administrative Tax Revenues	65,100,812	52,656,392	989,665	133,830,889	1,273,444	4,323,108	258,174,310
Other Sources	1,800,427	31,286,500	1,380,664	7,683,800	—	4,056,267	46,207,658
Total for State	128,812,200	152,906,991	7,155,677	276,620,593	6,147,444	17,018,709	588,661,614
TOTAL FY94–01							
State Penalty and Interest Funds	380,584,425	390,942,052	9,295,980	69,752,836	2,879,765	32,848,414	886,303,472
State General Funds Appropriated	80,449,744	80,121,897	15,425,800	273,126,137	21,042,133	21,828,397	491,994,108
State Administrative Tax Revenues	237,359,844	371,178,802	17,801,364	301,747,312	2,805,893	22,518,547	953,411,761
Other Sources	14,985,700	140,407,949	5,561,406	25,227,590	5,302,383	27,346,577	218,831,604
Total for State	713,379,713	982,650,700	48,084,550	669,853,875	32,030,174	104,541,935	2,550,540,946

*Denotes that funding could not be broken out

Mr. BROCK. Continuing with NASWA's principles, the Extended Benefits program should be reformed as proposed previously by NASWA and now President Bush. The Federal Government should enact technical amendments as proposed previously by NASWA and now President Bush. States, not the Federal Government, should make decisions about benefit eligibility and benefit levels.

The NASWA strongly supports an immediate extension of the unemployment insurance benefits for up to 13 weeks, and a $9.2 billion Reed Act distribution to the State accounts in the Unemployment Trust Fund.

Many of those who claimed unemployment insurance benefits in September or later are now beginning to exhaust their regular State benefits. They need additional help, and many States need additional help with funding State benefits and administrative costs of their programs.

Mr. Chairman, it is imperative that you enact the proposed Reed Act distribution. If the Federal Government enacts only the 13-week extension, it will consume projected Reed Act distributions for at least the next 2 years and make it very hard for the Federal Government to reform this system in the future.

Under the President's long-term reform, NASWA strongly supports many specific provisions, such as giving States access to the national directory of new-hires.

Now, with respect to the .4 percent cut in the Federal unemployment tax rate and administrative funding reform, our Members have a number of questions. After the Federal unemployment tax rate is cut by .4 percent, will State law require States to enact new State unemployment taxes to fund the system? Will certain States such as California, Colorado, and Washington be required by their State Constitutions or laws to hold a voter referendum on the new State taxes to fund the system and can the Federal Government assure small States will receive the funding they need if the small State supplement is discretionary spending? Could the Administration and Congress accept treating the small State supplement as mandatory spending?

Mr. Chairman, on behalf of the State workforce agencies, we thank you for the opportunity to testify. The enactment of unemployment insurance and employment service reform is critical. We want to work with all interested groups in coming up with meaningful reform. Please do not let this vital Federal-State system wither any further. Please act now.

Thank you.

[The prepared statement of Mr. Brock follows:]

Statement of Jon Brock, Executive Director, Oklahoma Employment Security Commission, and President, National Association of State Workforce Agencies

Mr. Chairman and Members of the Subcommittee on Human Resources, I am Jon Brock, President of the National Association of State Workforce Agencies (NASWA) and Executive Director of the Oklahoma Employment Security Commission. Thank you for inviting me to testify today for NASWA and its Members. NASWA represents 53 state and territorial workforce agencies in general and Unemployment Insurance and Employment Service programs in particular. Most of our state members also administer the programs authorized under the Workforce Investment Act,

welfare-to-work programs and some administer public assistance programs, such as Temporary Assistance for Needy Families or "TANF."

I want to thank and commend the Chairman for scheduling a hearing on President Bush's "New Balance" proposal. NASWA appreciates the attention the Administration has brought to this critical issue through its effort to develop this proposal and stands ready to begin work immediately on enacting reform legislation this year.

Mr. Chairman, NASWA believes there are five major problems that call to the need for Unemployment Insurance and Employment Service reform legislation:

- The Federal Government has been overtaxing employers under the Federal Unemployment Tax Act (FUTA).
- The Federal Government has been under funding employment services, labor market information services, and unemployment insurance administration for many years.
- The permanent federal-state Extended Benefits program barely works.States need certain technical amendments to federal law to help them better administer their unemployment insurance programs.
- Worker representatives believe the unemployment insurance recipiency rate and wage replacement rates are too low in many states and they want the Federal Government to expand eligibility and benefit levels.

In addressing these problems, NASWA believes in the following principles:

- The Federal Government should collect only enough federal unemployment tax revenue to fund the system and maintain solvent trust fund accounts. NASWA strongly supports repeal of the temporary 0.2 percent federal unemployment surtax.
- Unemployment taxes should fund fully employment services, labor market information services, unemployment insurance administration, and the federal half of the Extended Benefits program. This funding should be stable, predictable, and equitable. Mr. Chairman, states have been struggling to stay afloat in this system. In fiscal year 2001 alone, they added nearly $300 million to our system from their own funds. In fiscal year 2001, the State of California alone added $43 million of its own funds.
- The Extended Benefits program should be reformed as proposed previously by NASWA and now President Bush.
- The Federal Government should enact technical amendments as proposed previously by NASWA and proposed by President Bush that will help states better administer their unemployment insurance programs.
- States, not the Federal Government, should make decisions about benefit eligibility and benefit levels.

In general, NASWA strongly supports the President's short-term reforms described in his New Balance proposal. NASWA also supports many of the provisions in the President's long-term reform proposal, but has many questions and some concerns about the proposed federal tax cuts and administrative financing reform.

NASWA strongly supports an immediate extension of unemployment insurance benefits for up to 13 weeks *and* a $9.2 billion Reed Act distribution to the state accounts in the unemployment trust fund. We know the recent economic news has been promising and that many economists now say the recession might be over, but we also know that unemployment lags economic recoveries and could stay high well into 2002. Many of those who claimed unemployment insurance benefits in September, or later, are now beginning to exhaust their regular state benefits. They need additional help, and many states need additional help with funding state benefits and the administrative costs of their programs.

Mr. Chairman, it is imperative that you enact the proposed Reed Act distribution along with the 13-week extension of benefits. If the Federal Government enacts only the 13-week extension, it will consume projected Reed Act distributions for at least the next two years and make it very hard for the Federal Government to reform this system in the foreseeable future. Indeed, this could be the last year in which the Federal Government can reform our system during the careers of most of the individuals in this hearing room.

Under the President's long-term reform, NASWA strongly supports:

- Giving states access to the National Directory of New Hires for quick detection of individuals who have gone back to work, but continue to collect unemployment insurance benefits.
- Permitting states to pay certain tax collection activities by maintaining compensating balances in the banks performing the activities.
- Making technical changes so that states will follow state, rather than federal requirements, for Reed Act appropriations by state legislatures.

- Clarifying unemployment insurance claimants are not required to present proof of citizenship in person when they claim benefits that include federal funds.
- Making technical changes to the Short-Time Compensation program, which will allow states to continue operating these programs as they currently exist.
- Permitting states to use proceeds from sale of federal equity in real property for program purposes.
- Repealing a provision that results in certain federal employees being denied unemployment insurance benefits in cases where other workers would be eligible.
- Prohibiting states from reducing benefits due to rollover of pensions.

With respect to the 0.4 percent cut in the federal unemployment tax rate and administrative funding reform, NASWA has a number of questions before it could take an official position:

- After the federal unemployment tax rate is cut by 0.4 percent, will state constitutions or state law require states to enact new state unemployment taxes to fund employment services, labor market services, and unemployment insurance administration?
- In the Administration's analysis of "gains and losses" to state resources in its proposal, shouldn't the Administration have used the 0.4 percent cut in the permanent federal unemployment tax rate instead of 0.6 percent? NASWA believes employers want a permanent 0.2 percent cut in unemployment taxes and will not want to give back the repeal of the temporary 0.2 percent federal unemployment surtax in additional permanent state unemployment taxes.
- Should the Federal Government reduce the ceiling on the federal loan account to a nominal amount and distribute the nearly $20 billion in the account to state accounts? The Federal Government does not need these balances for the system because the loan account can borrow from the general fund and federal law virtually makes certain states will repay these loans with interest.
- Should the ultimate federal unemployment tax in the proposal be lower than 0.2 percent? Does the Federal Government really need all of that revenue?
- Will certain states, such as California, Colorado, and Washington, be required by their state constitutions or laws to hold a voter referendum on new state taxes to fund employment services, labor market services, and unemployment insurance administration?
- Can the Federal Government assure small states will receive the funding they need if the small-state supplement is discretionary spending under annual federal appropriations? Could the Administration and Congress accept treating the small-state supplement as mandatory spending?
- Will employers object to funding our system with state taxes that use a higher taxable wage base than the federal $7,000 base?
- Will co-mingling of benefit and administrative funds adversely affect the funding of administration or benefits?
- Are there enough federal and state benefits in the President's proposal to gain support from those concerned about worker benefits?

Mr. Chairman, I realize this is a long list of questions, and normally it is the Subcommittee, not witnesses, who ask questions. However, NASWA needs answers to these questions from the Administration and other interested parties before we can say more about the New Balance proposal.

On behalf of the state workforce agencies, we thank you for the opportunity to testify before this subcommittee today on this important issue. We want to work with all interested groups in coming up with meaningful reform.

Enactment of unemployment insurance and employment service reform is urgent and critical. I hope we can find answers quickly to all of our questions. And, I hope Congress will consider reform immediately. Please do not let this vital federal-state system wither any further. Please act now.

Thank you.

Chairman HERGER. Thank you very much, Mr. Brock. And now we are pleased to hear from Ms. Christine Owens, Director of Public Policy, American Federation of Labor and Congress of Industrial Organizations, AFL–CIO.

STATEMENT OF CHRISTINE OWENS, DIRECTOR, PUBLIC POLICY, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Ms. OWENS. Thank you, Mr. Herger. It is good to be here today with this Subcommittee and the representative of my home State of Maryland, though I have spent plenty of time in Oklahoma and Louisiana just last week. So it is nice to be here with all of you.

I think we all agree that fixing the UI system is long overdue, and recent discussions have focused in the past several months and today on extension of UI benefits for unemployed workers. With 80,000 workers exhausting their benefits every week, 1,600 a day, that action is crucial and should be taken immediately, but it is no substitute for a careful and thoughtful examination of how to change the program to better enable it to meet its intended goals of providing income support for jobless workers and job search service and helping to stabilize the national economy during times of economic downturn.

We fear that the Administration's proposal does none of these. The Administration's plan turns over to the States a primary Federal responsibility, which is the administrative financing of State operations. The upshot of this proposal could well be to place funding for benefits in competition with funding for administration at the State level, potentially imperiling both.

The plan would also significantly reduce Federal unemployment insurance premiums for employers, but does so without insuring any corresponding increases in coverage and benefits for workers.

I would like to elaborate on our concerns. First, as several Members have addressed, too few of today's unemployed workers receive too little in UI benefits for too short a period of time. These system inadequacies reflect the failure of the system to modernize in order to keep up with changes in the economy and in the workforce and with technological changes that allow for up to date reporting of workers' tenure and wages. And it also reflects the pressures on States to cut taxes and to trim budgets. Consequently, nationally fewer than 4 in 10 unemployed workers receive UI benefits, and benefit levels replace only 33 to 39 percent of former earnings.

In part to address these shortcomings, the stakeholder process, which Mr. Cardin has referred to several times, came up with a proposal which did not provide everything that every participant wanted, but it provided something of real value to every participant. For workers it provided a mechanism to extend coverage to low-wage workers and to women working part time. For employers, it cut the FUTA tax by the .2 of a percent, and for States it transferred administrative financing to the mandatory side of the budget and created a formula which reflected need and recipiency rates and good performance at the State level.

The Administration's proposal walks away from this deal. In fact, the proposal will likely exacerbate the shortcomings in coverage and benefits for workers who are not currently covered. When States have to rely on their own employer tax base for administrative financing, as they will in 5 years, they will be pressured to either raise taxes or cut benefits.

The experience of the boom times of the nineties, when we had nearly a full employment economy, indicate just how strong the

pressures are to reduce taxes. Those pressures will grow in recessionary conditions.

We believe that the Administration's proposal ultimately undercuts States. We have attached a chart to our testimony which shows that a number of States, if we assume that States were to increase their own State tax by .4 of a percent to make up for the loss of the FUTA tax, that a number of States that have high recipiency rates will actually fare less well under the Administration's proposal than they currently fare or than they would have fared under the stakeholders' proposal.

Finally, we are concerned that by eliminating the Federal role, the Administration's plan would also damage the counter-cyclical and national risk sharing elements of the national Federal-State partnership. Now Federal grants are allocated among States according to workloads, and the Federal Government automatically releases additional administrative funding if national unemployment rises above certain levels and the State's number of claimants also rise. Individual States would not have the capacity to replicate this national funding scheme.

I will close now and be glad to answer questions later.

[The prepared statement of Ms. Owens follows:]

Statement of Christine Owens, Director, Public Policy, American Federation of Labor and Congress of Industrial Organizations

Chairman Herger, Ranking Member Cardin, and distinguished Members of the Human Resources Subcommittee, on behalf of the 13 million working men and women of the AFL–CIO, I appreciate the opportunity to join you today to present our views on the Administration's proposals for changing the nation's unemployment insurance (UI) and employment services (ES) system.

The AFL–CIO believes that legislative debate about how best to fix the nation's unemployment system is long overdue. The only recent debate concerns extending benefits for workers who have exhausted their regular UI benefits. While such relief is critical, especially now, when 11,000 workers are exhausting their UI benefits daily, it is no substitute for a careful and thoughtful examination of the ways in which the program should be changed to meet its intended purposes, while providing greater certainty of funding and more flexibility for states and reducing some burdens for employers.

Regrettably, however, the Administration's proposal—which gradually cuts employer federal unemployment taxes 75 percent and transfers the responsibility for administrative financing to the states—falls short of these goals. The Administration's flawed approach would unravel a careful balance that has served national, state and individual interests for over 60 years. The proposal puts worker benefits in direct competition with UI administration, placing both at risk. The plan turns over to the states a primary federal responsibility, the administrative financing of state operations. It would significantly reduce employer premiums but fails to address the long-term decline in coverage of unemployed workers, and, in fact, may exacerbate the problem. In short, instead of strengthening this important economic security system, the President's proposal could weaken it further.

The Unemployment System Fails to Meet the Needs of Today's Working Families

The UI and ES systems are in substantial need of repair and reform. Too few of today's unemployed workers receive too little in benefits for too short a time with too little help in securing new employment. In most states, UI eligibility rules mirror decades-old labor market conditions, when most workers were men in full-time manufacturing jobs. But the workforce has changed dramatically over the past thirty years, with more women, more "contingent" workers and more part-time workers than ever before. The current UI system fails many of today's workers for three main reasons.

First, most states do not use the "alternative base period" for determining UI eligibility and instead, continue to count only the first four of the last five completed quarters of employment, thus excluding a worker's most recent work experience and

wages. As a result, an average of 13 to 25 weeks' pay is disregarded in eligibility determinations. Base period calculations disqualify not only those with limited work histories, but even those who work consistently but who cannot qualify without having their most recent wages counted. The impact of this method for determining eligibility falls disproportionately on low-wage workers. This group also includes many women who have recently left welfare for work, but who are among the first to lose their jobs during downturns.

Second, in the majority of states (around 30), unemployed workers seeking part-time employment are not eligible for benefits. Again, this exclusion falls most heavily on women, who are 70 percent of all part-time workers. Millions of workers who seek part-time jobs do so in order to accommodate family caregiving and other responsibilities. For many single mothers, a part-time job is the family's sole source of income. Individuals seeking part-time work should not be penalized with a denial of UI benefits simply because they are unable to work full-time.

Finally, UI benefits are too low. Nationally, UI benefits replace somewhere between 33 percent and 39 percent of recipients' former wages. Average weekly UI benefits range from $157 in Mississippi to $269 in Massachusetts, but these amounts do not take into account the reduction resulting from federal taxation. Estimates of the income needed to meet basic family needs dramatically underscore the inadequacy of UI benefits. A single parent family with two children in Biloxi needs $1153 a month to meet basic needs; average benefits equal only slightly more than half that amount.

In part to address these systemic failings, a multi-year "stakeholder" process produced a set of consensus UI reform proposals less than two years ago, which offered substantial improvements over the status quo for all participants: employers, workers, state UI administrators, and the Federal Government. The "stakeholder" consensus proposal did not contain every reform to the UI and ES systems sought by participants, including worker advocates. It omitted many crucial improvements, such as lowering earnings thresholds, increasing the federal taxable wage base, eliminating the federal taxation of UI benefits, expanding coverage of workers who separate from employment due to compelling personal circumstances, eliminating non-monetary disqualifications, and prohibiting states from tying laid-off workers to their former temporary help agencies. Nonetheless, the consensus proposal offered a road-map to a fair, balanced compromise that would improve the UI and ES systems in many ways. It promised eligibility reforms that would benefit millions of low-wage and part-time workers. It guaranteed states adequate funding by moving administrative financing to the mandatory side of the budget and applying a formula to reward states for running good programs. And it repealed the 0.2 percent FUTA surtax and reduced paperwork requirements for employers. Employer representatives, however, walked away from the proposal before Congress could enact the reform package.

The Administration's UI Proposal Fails Unemployed Workers

In contrast, the Bush Administration's proposal preempts the consensus process and proposes changes that offer employers a substantial tax cut but largely ignore workers' needs. For employers, the President proposes to phase out 75% of the Federal Unemployment Tax (FUTA), which finances administration of the UI system and helps insure program stability. Under the Administration's proposal, states would have to raise the funds for UI administration on their own, with the federal financial role eliminated due to the proposed FUTA repeal.

The Bush proposal contains no reforms to ensure that the UI system meets the needs of today's working families. There are no benefit increases, no coverage for part-time and low-wage workers, and no alternative base periods for determining eligibility and benefits. The Administration proposes to lower the extended benefits (EB) trigger, but this change will provide no assistance to workers currently unable to access the UI system—a major worker priority. In addition, few workers will benefit from the modest proposed reform of lowering the EB trigger from an Insured Unemployment Rate (IUR) of 5 percent to an IUR of 4 percent. In the 1990's recession, only 10 states triggered on to the permanent federal Extended Benefits program; under the Bush proposal, only 15 states would have been able to use this program, which would remain an inadequate response to national economic recessions.

As the Members of the subcommittee well know, the national UI system is already failing to provide adequate wage replacements for most workers and preventing many laid-off workers from accessing benefits at all. The Administration proposal will exacerbate this problem. By eliminating the "firewall" between UI benefit payments (determined by states) and UI administration (financed with federal grants), the Bush plan would create a competition that would force many states to cut worker benefits or reduce access to the UI system in order to pay for administra-

tive costs. Under the current needs-based allocation system, states with higher recipiency rates (those that pay benefits to a higher percentage of their workforce) receive a higher percentage of administrative dollars than those with lower recipiency rates. When states have to rely on their own employer tax base, employer interests will put pressure on these states to reduce their recipiency rates or cut benefits in order to avoid tax increases and keep administrative costs down.

It is not mere speculation to forecast further reductions in state benefits as a consequence of saddling states with additional financial responsibilities for the UI system. During the economic expansion of the 1990s, far too few states acted to modernize their UI systems, increase benefits, or cover more workers. On the contrary, many states reduced employer taxes and failed to build up prudent trust fund surpluses during the boom years that would have been available during the current recession.

Nor would the promise of a sizable Reed Act distribution, as contemplated under the President's plan, ensure that states enact legislation to treat low wage and part-time workers more fairly. In a recent survey by the National Association of State Workforce Agencies, a majority of states said they would not use funds from a Reed Act distribution to expand coverage to low-wage and part-time workers, even though these are the workers at greatest risk of being laid-off. In many states, these workers are now paying for a UI system from which they cannot benefit, since they have already had unemployment insurance taxes withheld from their wages (like any other payroll tax, workers pay in the form of reduced wages; employers simply write the check).

The UI System Will be Weakened and State Governments Will Suffer

Over the past decades, state governments have repeatedly called attention to the fact that the Federal Government has been underfunding UI and ES administration, to little avail. The "stakeholder" consensus proposal would have provided guaranteed "mandatory" federal funding for state administrative costs. In contrast, the Administration proposal does not solve the problem of administrative funding and offers a bad deal for many of the states. Although the Administration proposes transferring $14 billion from the Federal trust fund into state trust funds during the five-year transition period, there will be no federal administrative funding after that.

States would have to raise over $3.5 billion annually in new state revenue simply to make up for the loss in federal funding. The Administration promises employers a 75 percent FUTA tax cut (from 0.8% to 0.2% of the first $7,000 earned by each employee), but remains silent about the amount that states will be able to raise through corresponding state tax increases levied on employers to pay for administrative costs. Employers cannot be expected to complacently accept a dollar-for-dollar restoration of the federal tax on the state level; in fact, employers have already "claimed" the first 0.2 percent reduction in the FUTA tax as a permanent elimination of the temporary 0.2 percent FUTA surtax. States would therefore have the potential of raising taxes on employers by only 0.4 percent (half the current FUTA rate), and will face constant employer pressure against the necessary taxes to pay for administration. For instance, California currently receives $459 million in annual federal grants to pay for administration costs, and it would have received $598 million under the stakeholder proposal. California employers currently pay $814 million in FUTA taxes, and thus, the most the state would likely be able to collect under the Administration's proposal is $407 million. To make up the administrative financing shortfall, the state would either have to cut benefits or raise taxes above the level employers expect to pay. Many other states would face similar prospects.

Worse yet, many states with higher recipiency rates fare better under the existing financing mechanism than they would under the Administration's proposal, while conversely, those with lower recipiency rates often stand to benefit from the Administration's plan, assuming they impose a 0.4 percent tax on employers. (See Attachment 1). Almost without exception, states with above-average recipiency rates would fare better under the stakeholder proposal than under the Administration's plan. For example, Texas, Oklahoma, Florida and Alabama have recipiency rates of less than 30 percent, and all would fare better under the Administration's plan (assuming they impose a 0.4 percent tax). On the other hand, Connecticut and Massachusetts, with recipiency rates of 73 percent and 71 percent, respectively, would fall millions of dollars short of the funding they need.

By severely curtailing the federal role in the UI system, the Bush plan would damage the counter-cyclical and national risk-sharing elements of the national federal-state partnership. The Administration would sever the connection between administrative funding and workload needs, since federal grants are currently allocated among the states according to their workload, and the Federal Government automatically releases additional administrative funding if national unemployment

rises above certain levels and the state's number of claimants rise. Individual states would not be able to replicate this national financing mechanism effectively. Furthermore, some states have mismanaged their trust funds by failing to build up adequate reserves and choosing instead to give their employers tax cuts. Most notable are New York and Texas, which will be borrowing $1.5 billion from the Federal Government because their benefit trust funds are running out of money. Unless the states build adequate reserves during economic expansions, they will not be able to increase their administrative resources easily when claims surge during recessions, instead borrowing from the Federal loan fund with interest and unnecessarily increasing the cost of their operations.

Finally, the Bush plan undercuts the primary enforcement mechanism for Federal protections. With the Federal Government's authority to award administrative grants eliminated, the justification for federal involvement in administrative matters will become extremely weak since no federal money will be involved in state operations. There will be irreparable damage to the Federal Government's ability to maintain and enforce core national standards relating to state administration of their programs, including requirements to maintain proper and efficient administration, pay benefits accurately and promptly "when due," and provide a fair and impartial hearing process.

Conclusion

For the foregoing reasons, the AFL–CIO opposes the Administration's proposal to repeal virtually all of the employer FUTA tax and to turn over the responsibility for administrative financing to the states. We believe that such an approach abrogates a critical federal role and makes it less, rather than more likely that unemployed workers will collect benefits in the future. We encourage the committee to advance real, comprehensive UI and ES reform that provides a national economic safety net for all unemployed workers and an effective path to re-employment, while enhancing administrative financing for states and easing employer burdens. The touchstone for reform, however, should be enhancing protections for workers, and in this regard, the Administration's plan fails completely.

Attachment 1

STATES WITH EFFECTIVE UI PROGRAMS LOSE MILLIONS UNDERTHE BUSH UI REFORM PROPOSAL

(Millions of dollars)

State	2001 Grants	0.4% Maximum Tax Employees will Pay	Stakeholder Proposal Workload Formula	Recipiency Rates (CY'00)
CONNECTICUT	57	44	73	73
MASSACHUSETTS	82	84	106	71
RHODE ISLAND	18	12	23	60
ALASKA	30	7	39	59
NEW JERSEY	113	105	146	54
PENNSYLVANIA	163	147	209	54
WISCONSIN	74	72	93	51
VERMONT	10	7	12	50
NEVADA	30	29	38	49
IOWA	28	36	38	48
OREGON	54	43	68	48
WASHINGTON	94	73	118	46
MICHIGAN	132	127	169	44
ARKANSAS	30	28	38	44
MISSOURI	57	70	73	42
CALIFORNIA	459	407	598	41
TENNESSEE	47	70	61	39
NORTH DAKOTA	14	7	17	39
IDAHO	23	14	30	39
NORTH CAROLINA	73	104	93	38

STATES WITH EFFECTIVE UI PROGRAMS LOSE MILLIONS UNDERTHE BUSH UI REFORM PROPOSAL—Continued

(Millions of dollars)

State	2001 Grants	0.4% Maximum Tax Employees will Pay	Stakeholder Proposal Workload Formula	Recipiency Rates (CY'00)
PUERTO RICO	28	21	37	38
ILLINOIS	150	163	196	38
US AVERAGE RECIPIENCY				**38**
MAINE	19	14	24	37
DIST. OF COLUMBIA	15	11	18	37
DELAWARE	10	11	15	36
NEW YORK	208	213	270	36
SOUTH CAROLINA	41	47	52	36
MINNESOTA	51	71	67	35
MONTANA	14	8	18	34
HAWAII	16	13	22	34
INDIANA	54	75	70	32
KENTUCKY	34	45	45	32
WEST VIRGINIA	20	16	26	31
OHIO	106	149	135	31
KANSAS	25	34	33	30
UTAH	34	27	42	30
ALABAMA	45	48	58	30
VIRGINIA	54	1	70	29
WYOMING	10	5	14	28
MARYLAND	63	62	82	27
FLORIDA	107	194	141	27
NEBRASKA	20	21	25	27
MISSISSIPPI	26	28	35	26
TEXAS	167	257	218	25
OKLAHOMA	29	35	37	25
COLORADO	44	62	57	25
NEW MEXICO	20	17	26	24
SOUTH DAKOTA	10	8	14	24
ARIZONA	42	62	55	23
GEORGIA	70	108	92	23
LOUISIANA	35	45	47	22
NEW HAMPSHIRE	12	17	16	16
VIRGIN ISLANDS	4	93	5	N/A
TOTALS	**3171**	**3467**	**4104**	

Chairman HERGER. Thank you very much, Ms. Owens.

Now we will hear from Dan Blankenburg, Manager, Legislative Affairs, National Federation of Independent Business, NFIB. Mr. Blankenburg.

STATEMENT OF DAN BLANKENBURG, MANAGER, LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. BLANKENBURG. Thank you, Mr. Chairman. It is a pleasure to be here today. On behalf of the 600,000 members of the National Federation of Independent Business, I appreciate the opportunity to testify and present the views of small businessowners on the subject of reforming the Nation's unemployment system.

The NFIB represents small employers. Our typical member employs five people and reports gross sales of around $350,000 per year. Our average member's net income is about $40,000 to $50,000 annually, so they are pretty small guys out there.

We believe it is important to distinguish the type and size of small business that NFIB represents, because too often Federal policymakers view the business community as one monolithic enterprise that is capable of passing taxes and regulatory costs on to consumers without suffering negative consequences.

For small businesses, this is not the case. The NFIB members are not publicly traded corporations. They are independently owned and operated. They don't have tax departments or payroll departments or attorneys on staff. They are responsible for taking out the garbage and inventory and hiring employees.

So for small businesses, the current system presents several problems. First, the tax rate is too high. We often hear from critics that cutting the tax will do little for small businessowners, since the cost per employee is only $56 per year.

I would ask the Committee to consider that the average NFIB member has five employees, and we have 600,000 members nationally in our association alone. Reducing the FUTA tax as the Administration proposes would result in $126 million remaining in the hands of entrepreneurs.

While the difference between an .8 percent tax and a .2 percent tax sounds small, our average member would save $210 a year.

Second, the unemployment system, under the current system, employers are required to pay two unemployment taxes to the State and the Federal Government. It is twice the forms, twice the complexity and twice the collection point. It is too many forms for them to handle when you consider some of the other forms and payroll taxes they must deal with.

Third, the taxes raised for UI programs are rated or used for deficit reduction, and this fact perhaps more than any other infuriates small business owners. They would like to be taxed honestly and have their money spent on what Congress says they are being taxed for. As an overall package, we are pleased with the Administration's proposal, and NFIB strongly supports the proposal to cut the unemployment tax by 75 percent through 2007.

The tax reduction will be particularly gratifying to small businessowners, because as had been testified before, the tax was supposed to be a temporary tax in 1976, and the Congress promised to remove it once the loan was paid back to the Federal fund. And since then—well, in 1987 the loan was paid off and the taxes remained, and it has been extended five times.

We are very pleased to see an effort to reduce the complexity of Form 940 in the Administration's proposal by eliminating many of

the information requests and calculations. However, we think the Administration proposal could go one step further. Small businessowners know that a great deal of time is wasted by having to provide the same information on different forms to Federal and State agencies. We would urge the Administration and the Congress and this panel to consider eliminating all of the overlap between the State and Federal forms and simply coordinate the filings in a combined form that only needs to be filed once.

With regard to the Reed Act transfer, NFIB believes returning these dollars to the State employment offices is a very positive decision. As mentioned, the money has been misappropriated for years, and we also understand the Administration's proposal reduces the trigger for extended benefits and eligibility and would allow States to determine extended benefits as they would apply. This change will increase the number of people that will qualify for benefits, resulting in higher demand on the program in an economic downturn.

While we are not comfortable with these provisions entirely, we view this in the context of the compromise and we would be willing to accept them if the Congress chose to move in that direction.

So those are our main points, and I would be happy to take any questions.

[The prepared statement of Mr. Blankenburg follows:]

Statement of Dan Blankenburg, Manager, Legislative Affairs, National Federation of Independent Business

On behalf of the 600,000 members of the National Federation of Independent Business (NFIB), I appreciate the opportunity to present the views of small business owners on the subject of reforming the nation's unemployment system.

NFIB represents *small* employers. Our typical member has five employees and reports gross sales of around $350,000 per year. Our average member nets $40,000 to $50,000 annually. While there is no benchmark used to define a small business, our membership is very much a reflection of American small business when compared to data compiled by the United States Census Bureau.

We believe it is important to distinguish the type and size of businesses NFIB represents. Too often, federal policy makers view the business community as one monolithic enterprise that is capable of passing taxes and regulatory costs onto consumers, without suffering negative consequences. For small business this is not the case. NFIB members are not publicly traded corporations; they are independently owned and operated. They do not have payroll departments, tax departments and attorneys on staff. Being a small business owner means, more times than not, you are responsible for everything—taking out the garbage, ordering inventory, hiring employees, and dealing with the mandates imposed upon your business by the federal, state and local governments. That is why simple government programs, particularly when it comes to the tax code, are so important. The less time our members spend with "government overhead," the more they can spend growing their business and employing more people.

Growing businesses lead to job creation, which is one of the major roles small business plays in our national economy. Small business is the leader in job creation because it is the embodiment of the entrepreneurial spirit. Small firms with fewer than 500 employees employ 52 percent of the non-farm private sector workforce as of 1998, and are responsible for 51 percent of the private sector business share of the nation's gross domestic product. From 1994 to 1998, about 11.1 million new jobs were added to the economy. Small businesses with 1–4 employees generated 60.2 percent of the net new jobs over this period and firms with 5–19 employees created another 18.3 percent. It is because small businesses have such deep impact on employment and the national economy that we feel it is critical that the policies you shape account for the impact the law will have on small business.

Year after year, NFIB researchers have found that the two biggest challenges facing small businesses are health care and taxes. Our members are overwhelmed by the complexity of the tax code and their responsibilities, not just for income taxes,

but also for the variety of federal and state payroll tax filings—including federal and state UI. They very much want to comply with the law, but its sheer size makes understanding the law nearly impossible for the average business owner. NFIB strongly supports efforts to simplify and cut taxes for our small business owners, and that is why we are pleased to testify on the Administration's proposals in this area. In our opinion, the federal unemployment system is ripe for reform.

The Current System

The Unemployment Insurance (UI) system is a joint state-federal program, created with the passage of the Social Security Act of 1935. The Federal Unemployment Tax Act (FUTA), contained within the U.S. Internal Revenue Code, effectively mandates that the states maintain an unemployment insurance program in conformity with certain federal requirements. The UI system is financed by two taxes levied on employers—one state and one federal. The state UI tax is used to fund unemployment compensation benefits. The State tax is experience rated, meaning that an employer's tax rate is based upon past incidence of successful unemployment claims by his or her employees. The federal tax is a flat-rated tax, levied on a $7,000 taxable wage base. The federal tax is used to fund: (1) state and federal administration of the system; (2) the 50% federal share of extended benefit costs; and (3) loans made available to states when their trust funds are depleted.

Both state and federal UI taxes are housed in the federal Unemployment Trust Fund, which is part of the unified federal budget. Each state has its own account in the federal trust fund into which state taxes are deposited and out of which state benefits are paid.

State unemployment compensation benefits are an entitlement and are not subject to the appropriations process, but administrative funds are appropriated by Congress and distributed to states through grants from the Department of Labor. For many years state UI agencies have complained that the Congress is under funding administration of the program in order to mask the size of the federal deficit or to spend the dollars through the appropriations process. States have responded to this funding shortfall by reducing services to claimants, and in many cases enacting separate new taxes on employers to fund administration of the program.

For small business, FUTA presents several problems. First, the rate is too high. Often we hear from critics that cutting this tax will do little for small business owners since the cost per employee is "only $56 per year." I would ask the Committee to consider that the average NFIB member has five employees and that we have 600,000 members nationally. In our association alone, reducing the FUTA tax, as the Administration proposes, would result in over $126 million that would remain in the hands of entrepreneurs. While the difference between a .8% tax and .2% tax sounds small, our average member (with an annual income of $40,000–$50,000, five employees) would save $210 annually under this proposal. I would further point out that there are approximately 17 million full-time, self employed people in the country today. If they were all average NFIB members with five employees, this tax savings would represent roughly $3.57 billion annually.

Second, under the current system, employers are required to pay two unemployment taxes—the federal tax and the state tax. That means twice the collection points, twice the payments, and twice the complexity. Payroll taxes were listed as the most costly tax in an NFIB tax survey, just ahead of personal income taxes. And 53 percent of those surveyed said payroll taxes are less fair or much less fair than business income taxes.

Third, the taxes raised for UI programs are raided for deficit reduction or spent on other Federal Government endeavors other than UI programming. This fact, perhaps more than any other, infuriates small business owners. Like the American consumers' desire to see gas tax revenues spent on transportation, NFIB members desire all UI taxes to be spent on UI programs or be sent back to them to use in their business.

Finally, when considering the cost and impact of the FUTA tax, it is important to remember that the federal FUTA tax is not the only tax on payroll for which small business owners are responsible. In addition to federal FUTA taxes, the business owner is paying State FUTA taxes and federal Social Security and Medicare taxes. In addition the business owner is responsible for the cost of filing quarterly state and federal payroll tax forms, making scheduled federal and state payroll tax deposits, making regular federal and state unemployment tax deposits in addition to filing the appropriate forms. These are real costs of hiring employees, that an individual who has never had to make a payroll takes for granted, but that involve real costs to small business owners and that add up to real dollars for a small business owner.

The Administration's Proposal

As an overall package, we are pleased with the Administration's proposal and have included specific comments on some of its the key components:

FUTA Tax Cut

NFIB strongly supports the proposal to cut the federal unemployment tax by 75% through January 2007. Today the federal tax is .8% and under the proposal the tax will be reduced to .2% by 2007. This tax reduction would be particularly gratifying to small business owners because .2% of this .8% was imposed in 1976 as a temporary surtax. Congress promised to remove this temporary tax once the loan from the federal trust fund to the States was repaid. In 1987, the loan was paid off, but the tax remained. Since then, the Congress has extended this tax five times. Last year, this extension resulted in a $1.75 billion tax burden on the nations' employers.

We also applaud the reduction to the total FUTA tax beyond the surtax because the FUTA collects far more than it needs. FUTA raised $6.1 billion in 1998, but only $3.5 billion was spent on FUTA-related expenses. The balance was used to pay for non-related government programs.

Streamlined Filing of FUTA Tax Forms

We are very pleased to see an effort to reduce the complexity of Form 940 in the Administration proposal by eliminating a many of the information requests and calculations in Part II that is already reported on the state UI forms. Federal paperwork complaints ranked eighth in NFIB's "Problems and Priorities" survey. The majority of paperwork coming from the Federal Government is tax-related, so any effort to streamline or eliminate forms or steps on forms would be welcomed with open arms.

However, we think the Administration proposal could go one step further. Small business owners know that a great deal of time is wasted by having to provide the same information in different form to federal and state agencies. We would urge the Administration and the Congress to consider eliminating all of the overlap between the federal and state forms and simply and coordinate the filings into a combined federal state form that must only be filed once.

Reed Act Transfer

The Administration's budget has proposed 13 weeks of additional temporary federal extensions of unemployment insurance be provided to workers. The Federal Government would fund this benefit. They have also proposed returning $9.2 billion in "Reed Act" funds to the states for expansion of benefits, or enhancements in reemployment services, shoring up trust funds or cutting employer payroll taxes.

NFIB believes returning these dollars to the State employment offices is a positive decision. As mentioned above, the Congress has failed to spend this money on its stated purposes in the past and we do not believe this is likely to occur in the future. This misappropriation of funds has lead to a degradation of employment programs and inefficiencies that have resulted in tax increases in some states. We believe the taxes raised for unemployment programs should be used solely to fund unemployment programs. In the event that the taxes raise more dollars than is needed to run the unemployment programs, the taxpayers should be refunded their dollars. Neither the Congress nor a State Legislature should spend the surplus dollars on other programs.

Temporary 13–Week Extension

NFIB does not have a position on the 13 weeks of additional unemployment insurance. We do believe that the temporary nature of this benefit is appropriate and that it would only become a concern if the proposal became a permanent benefit that NFIB members would be required to finance.

Triggers and State Eligibility

We also understand the Administration's proposal reduces the "trigger" for extended benefits eligibility and would allow States to determine when extended benefits would apply. This change will increase the number of individuals that will qualify for benefits, resulting in a higher demand on the programs in an economic downturn. While we are not completely comfortable with these provisions, they are acceptable when viewed together with the reduction of taxes and the increased responsibilities of the State governments. We feel that the respective State governments

know their workforces best, and that they will be able to react quickly and efficiently to the demands of their workers. Empowering the States will move the unemployed back to work quicker, result in less demand on the system and ultimately eliminate future need to impose higher UI taxes on employers.

Conclusion

In conclusion, NFIB believes that the proposal advanced by the FY 2003 Administration budget is positive. The current system is too expensive, too complex and too unfair. It is time we pink slip the current unemployment tax system and pass this sweeping reform plan, which will ease the tax burden on Main Street and restore some integrity to the system. Thank you, Chairman Herger and Ranking Member Cardin, for soliciting the views of NFIB on this matter. We look forward to working with the Congress and the Administration on these important reforms in the coming months.

Chairman HERGER. I thank you, Mr. Blankenburg, and each of you, and now we will turn to our panel for questions. First to inquire is the gentleman from Louisiana, Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. Mr. Cardin spoke about the stakeholders that got together a couple of years ago and worked out a deal, and why didn't—why can't the Administration support that? Well, I was involved very much in the discussions at the time trying to put together something that we could pass, and unfortunately, at least it was my impression, at the end of the whole thing we did not have an agreement among all of the stakeholders. I thought, by the way, that organized labor, AFL–CIO, and the business community both acted in good faith and worked hard to come up with an agreement in which everybody got something and nobody got everything, and I thought that was a good description, Ms. Owens.

But the fact is at the end of the deliberations, we did not have an agreement among all of the stakeholders. Mr. Yarbrough, I know you were around during that. Isn't that your impression that we did not have agreement among all the stakeholders?

Mr. YARBROUGH. I served as the business representative with UWC on that, and although we had maybe a total overall program, we didn't really support all the things, just like other people that were in there didn't support everything that we had in it. I think what came to this Committee to be considered had some different formula things and that, and we did not, I guess, line up to support that. We had something that we had done earlier that we gave to them, and then there were some other minor changes in the funding——

Mr. MCCRERY. Mr. Blankenburg, NFIB didn't support the final draft?

Mr. BLANKENBURG. Yes, I am glad you brought this up——

Mr. MCCRERY. I have got limited time.

Mr. BLANKENBURG. We did not.

Mr. MCCRERY. And there were other groups that didn't support it. So as much as I would have liked to have gotten an agreement among all the stakeholders, we just didn't do it. So the Administration is trying to come up with something, I think, that bridges the gap among the various disparate interests and at least addresses some of the fundamental questions, or shortcomings I should say, of the current system.

Ms. Owens, you talk about if the Administration's proposal were to go into effect, there would be this competition between tax revenue for benefits and tax revenue for administrative funding. Isn't that the case right now?

Ms. OWENS. Well, there is a firewall now, because the benefits are set by the States. The administrative funding comes from the Federal Government and grants, and let me just back up and say we don't disagree that the State UI and ES services are badly underfunded and that Congress should appropriate more resources for those programs. I don't think there is any disagreement in this, and we certainly don't disagree with that, but we do think that the firewall that exists between administrative funding that comes from the Federal Government in the form of grants as opposed to benefits that are at the State level provides a degree of insulation and protection that would be eliminated were administrative financing turned over to the States, especially if ultimately it is turned over to the States down the road without resources.

Mr. MCCRERY. But the firewall does little good if the States are getting insufficient funding for the administrative purposes and they have to look to their employer community as my State has done for increased taxes to fund administrative expenses rather than doing some of the things you would like to do for benefits, perhaps part-time workers, most recent quarter earnings, all of those things. The State can't do that because they are having to raise taxes to pay for the administrative funding. So you have already got that competition. That is all I am trying to say. And, yes, it would still exist, but it exists now.

And just for fun, I would like to examine one other part of your testimony. In your testimony——

Ms. OWENS. I hope I enjoy it as much as you.

Mr. MCCRERY. Oh, I am sure you will. In your testimony, you talk about how—and I think you are referring to part-time workers particularly—how some workers are now paying for a UI system that they get no benefit from. What do you mean by paying workers that are paying for the system? How are they paying—they don't pay taxes for UI, do they?

Ms. OWENS. Well, I mean, I think actually Members of this Committee and certainly the Labor Department in some of its publications that I have read have taken—have argued that the premiums that are paid for unemployment——for the unemployment insurance programs in the States actually reflect lost wages to workers.

Mr. MCCRERY. But it is the employer that is—the tax is exacted against the employer. Is that right?

Ms. OWENS. Sends them a check. That is right.

Mr. MCCRERY. So it is not an explicit tax on the employee?

Ms. OWENS. It is not taken out of the employee's check.

Mr. MCCRERY. But because the employer has to pay it, I mean, the theory is it comes out of the pockets of the employees?

Ms. OWENS. Right.

Mr. MCCRERY. Well, wouldn't the theory hold true for, say, corporate income taxes?

Ms. OWENS. Is that the topic of today's hearing?

Chairman HERGER. The time is expired.

Mr. MCCRERY. I just told you I was just having some fun.

Ms. OWENS. It was fun.

Mr. MCCRERY. Thank you, Mr. Chairman.

Chairman HERGER. You are welcome. The Ranking Member from Maryland, Mr. Cardin, to inquire.

Mr. CARDIN. That is an interesting thought. I think, though, the point is that we don't differentiate in law between the premiums paid by part-time workers. Why do we differentiate on the benefits that they are entitled to receive? I think that is the point that many of us have been trying to make.

First of all, I appreciate all of your testimony. I think all four of you have added to the record here, and I thank you for that. I regret that I think we have really lost ground over the last year. I thought a year ago we had more consensus than we do today, and Mr. McCrery is absolutely correct. We have a problem that we have to deal with, in that we impose—we were collecting too much revenue at the Federal level for what we are returning to the States, certainly on the administrative side. There is no question about that. We tried to do something about it.

What concerns me is I think we are using the wrong numbers here. There is no disagreement that we should deal with the .2 percent. There is no disagreement about that. It is the .4 percent we seem to have a little different view as to what impact that will have. If we follow what Mr. Brock is saying, and I am trying to follow his testimony because you are the one who is going to have the bottom line responsibility. If the States impose that .4 percent—and I understand they may not be able to because of constitutional restrictions or political considerations, but if they impose the .4 percent then what Ms. Owens is saying, some States are going to be worse off than they are today under the current system as far as recouping their administrative costs. It is going to be different per State, and Mr. Blankenburg's concern about reducing the overall tax by .6 percent is not going to happen. It is going to only be a .2-percent reduction, which is nothing to be embarrassed about. The $14 we save per employee is still important to be done, and we should do it, but I think we should use the right numbers, and I think it is $14, not the other numbers we are using per employee, because we assume that the administrative burdens are going to be met and the taxes are going to be imposed locally in order to deal with it.

My concern is it might not be enough, and that is why I come back to the stakeholders, and Mr. Yarbrough, I appreciate your response to Mr. McCrery. You did a great job, and, of course, the UWC was at the table and was part of the process, as was the local government people, as was the AFL–CIO. I think the NFIB came later in the stages in the process and never did agree on the agreement. I accept that.

But there was an agreement reached by the stakeholders, and it was not easy, because we had a history, a long history on UI of not being able to even sit at a table let alone reach an agreement on what we should do as far as Federal policy is concerned, and I think, Ms. Owens, you expressed it correctly, and so did Mr. Yarbrough. Nobody was totally happy with that agreement. There was—you had a give and a take. That is what usually happens on

an agreement. You are not totally happy, but we were able to get the permanent reduction of the tax, which was important.

We were able to get the administrative costs funded so, Mr. Brock, you knew how to—you are right. You need a reliable funding source, and that is what the stakeholders' agreement gave you, a reliable funding source. It is not reliable if you have to wait every year for the appropriations of this Congress, in all due respect. That is why there is risk in what we do here. If you have it on the mandatory side, because we are collecting the revenue, we have the money, it should be mandatory spending. I disagree with the Administration. If we collect the money for that purpose, we should return it to you for that purpose and you should have the reliable funding, and that was part of the stakeholders' agreement, which I thought, by the way—Mr. McCrery thought was a pretty good idea at least a year ago, that part of the overall agreement.

And of course we get to the issue that Mr. McCrery has difficulty with, and that is trying to deal with people who are trying to pay according to the rules. They are working. Many of these people come off the welfare system, and many of these people are low-wage workers. Many of these people don't have the long wage history that more seasoned workers have had, and now they are coming off the employment rolls because of a recession, and they are not qualifying for unemployment benefits. So we wanted to do something—and a large percentage are women, and we wanted to do something about it. And the stakeholders amazingly 18 months ago recognized that as an issue, before we got into the recession as an issue, and we were able to work out the politics between State flexibility and national policy, and I applaud you for that.

I happen to believe in State flexibility, but I think this is one area that we should act at the national level. So you were able to reach an agreement. So I don't think it is fair to say that we didn't have an agreement 18 months ago. We had an agreement 18 months ago, and that agreement was brought to Congress, and there were people who were unhappy with parts of it, but collectively you said don't pull it apart. Keep it as a unit, keep it together, and we will keep our coalition together. And true, there were some elements that were opposed to it, such as the NFIB, and you were. There is no question about that. But the many groups within the business community supported it, and my regret is that we have lost a year, and now it looks like we may not get anything accomplished.

Chairman HERGER. I thank the gentleman. Now would the gentlelady from Connecticut, Mrs. Johnson, wish to inquire?

Mrs. JOHNSON. I think it is imperative that we get something done, and I don't think we can let the perfect be the enemy of the good. We need to do what we can get agreement on.

Mr. Blankenburg, one of the reasons that consensus of the other group failed was because small business was not at the table, and so there wasn't any ability by that group to talk through some of the problems that have a unique and heavy impact on small businesses. I mean, certainly the urgency of the administrative reforms you point to were something we all understand and can all agree to. I think the concerns about whether the funding is going to be

there through ups and downs is something that we can address when we get additional information back.

And I absolutely agree that States are going to continue to set benefits and benefit levels, whether you like it or not. We are not going to change that in this environment this year and maybe not for a long time. We didn't change that under the Democrats, and the likelihood of changing it now—so let us not let that impede progress, but this issue of part-time employment is something that is very important to small business. You need smart, educated women who need to take time off to raise their kids to be willing to work half-time and as things get worse in the future in terms of the balance between the number of workers and number of retirees, you are going to need that even more. So we need to look at what is the criteria for permanent part time. How long could it last? It doesn't have to be mysterious, but if we could just do a demo, if we could do something to encourage States so that we would get better information. The States that have done this have not seen an increase in cost.

So I think there are a couple of issues here that are particularly relevant to contemporary society, to our goals as a society of family strengthening, as well as to appropriate compensation to people who are unemployed and unemployed under certain circumstances for a good reason that we do need to tackle.

And then I think the other thing—and I don't know—I was just talking to the staff about this—there are terrible jurisdictional problems here, because really the system was constructed for a whole different era, and I think some of the questions of my colleagues that pointed out what percentage of those who are unemployed this system actually serves is a case in point. But we are not going to change the fundamental structure right now, but we could—we may be able to think of some way that under this rubric we can remind States that in administering we are looking not just for you to administer the delivery of the check. For too long that was catastrophic in the area of welfare. We need for you to deliver a check accompanied by services, and those services have to be services small employers can depend on, so you can depend on, if you are getting something from the employment services, that it is going to be valid.

One of the queer things that has happened, whether you like it or whether you don't—and I think with all due respect, Ms. Owens, your testimony doesn't necessarily take into account what we have learned through the job placement programs we developed under welfare. We have under that program developed a much more responsive relationship between the job placers and the employers, and the old unemployment system employers don't even participate in. They don't trust them so they don't look at their rosters, they use temporaries instead of. The growth of temporary employment services is a terrible condemnation of our old system.

So there are very big issues in how America helps people who are unemployed and helps people who need to get reemployed and small business has to be at the table, but I can't believe that through this bill there isn't some way we couldn't encourage States to integrate their unemployment services for the unemployed and

for people coming off of unemployment lifestyles, like welfare or out of prison.

I mean, there is just so much to be done that we cannot lose this opportunity to fix what we know is a problem, we know is causing big trouble. And maybe to at least put in place some demos or whatever we can do to move toward a system that legitimately recognizes people who need to work part-time because of their other responsibilities they carry or disabilities they carry—we tried to do this in the Ticket to Work bill. We tried to do that. It didn't work. We haven't got that far. We need to look at the big issues and try not to get ourselves snarled down and prevent a step forward.

Now, solvency is a big issue, and I agree with that, but I do ask you to all work with us to be sure we accomplish something this year, because every year matters, and I don't care who is the President or who is the majority. They are going to be closely balanced for a number of years to come and we are going to have take one step at a time to make real progress in America for working people. So I just hope we will all work together to get something done together this year on this.

Thanks.

Chairman HERGER. I thank the gentlelady. Now the gentleman from Michigan, Mr. Levin, to inquire.

Mr. LEVIN. You know, in a sense I will pick up from where Mrs. Johnson left off. I guess you noticed some impatience in my questions, and I do have that. I was going to, Mr. Herger, pull out $4, since you pulled out $1. I think is what Michigan got back in 1999 for—let me do this first. This is what we got back in 1992 for every dollar we put in, and I am very skeptical that under this proposal we would have the funds to do that. I just don't believe it, especially if we have an extended benefit change and these other changes.

But let me just say something else, indicating my impatience. I don't see a ghost of a chance that this proposal can be adopted, the Administration proposal. If the decision is to try to put it through the House, maybe you can do that. We will have a huge debate, but there is no chance I would think it can pass the Senate. And essentially what we are going to say to you, especially those of you who support this or anybody else, it is the status quo all over again. It is where we are going to be, and it is sad. We have these trust fund monies. There is agreement there has to be more put forth for administrative expenses. Everybody agrees on that, and we are going to be stuck right where we are. Nothing is going to happen. And some of those who support this proposal, whatever you want to call it, have been—that is not true of everybody on this Committee—the major opponents of more appropriations. It is not true of everybody on this Committee.

So the institution that would be considering this is the institution that has helped to create this problem and that could solve it by moving nonadministrative expenses. And I kind of smile, Mr. Brock, when you say about the small State supplement, could Congress and the Administration accept it as mandatory spending? I mean, we haven't been willing to appropriate moneys, and to talk about mandatory expending for a piece of this I think is a dead end. So if we want another dead end, we will follow this path. I

think it is a terrible mistake, and to Mr. Blankenburg, I don't know how much you have lobbied this Congress to get moving on administrative expenses. My guess is not much. I won't put you on the spot. I don't want to put anybody on the spot.

Mr. BLANKENBURG. I will be happy to tell you. Two years. I worked on the Hill for 6 years.

Mr. LEVIN. You worked on the Hill for 6 years? So—but I don't want to put any organization on the spot. I don't know how much NFIB has used its efforts to try to get this Congress to use moneys that were set aside for a certain purpose. We know that these trust fund moneys, like other trust fund monies, were used for many years to hide a larger deficit, and we need to face up to it.

And let me just say in terms of trusting the States, we are going to get into a huge argument, because I think the record of many States in terms of preserving moneys for unemployment comp these last few years in many States has been miserable. And now with a recession, they are coming here and saying extend unemployment benefits when they have diminished the funds available in some cases way below what is recommended by the Labor Department, way, way below.

So we are going to end up having this deep argument about this proposal, and administrative funding is going to stay just where it is, and so I thought last year, Mr. McCrery, you and others—I was less a participant—tried to move this ball along. And now we are essentially changing the goal post dramatically, and if anybody thinks this will lead to legislation, I think they are wrong. So we need to decide, is there another course, and I hope there is.

Chairman HERGER. I thank the gentleman from Michigan. Now the gentleman from Kentucky, Mr. Lewis, to inquire.

Mr. LEWIS. Thanks, Mr. Chairman. Excuse me. Mr. Brock.

Mr. BROCK. Yes, sir.

Mr. LEWIS. What do job seekers lose today by there not being adequate funding for the administration of UI benefits and employment service programs, and how will this proposal improve services for those laid off employees who are looking for work?

Mr. BROCK. Yes, sir. Job seekers—obviously I don't mean to be trite or flippant—they are looking for a job. They are wanting someplace where they can come, where employers have listed their jobs, where there are individuals in fact working with the employers in overall job development to be sure that they get the qualified workers that they need.

Job seekers, right now I—this is very closely akin to it, and I will refer to my own State here in this regard, but in years past we talked about the long unemployment lines. Many of our States, Oklahoma being one of them, have gone to telephone call centers today so you don't see those lines, but what you would see if you were looking closely, you would see people—telephone lines that are clogged in many cases. Now, this isn't true in every State, but by and large it is true in a lot of them. You would see people that are out of work through no fault of their own simply wanting to get benefits to get them by as a bridge until they can get their next job, holding for 40, 50 minutes, whatever. And I realize—when we put ourselves in their position, that is a very difficult position to be.

But overall with adequate funding of the administration of this whole program, we would see the program working as it was originally intended to work, that people would be off work for far less time than they are today, we would be able to help them get back quicker, we would be able to help employers get the workers that they need much quicker. It would just be a system that is operating the way that it was originally intended.

Mr. LEWIS. If the program was fully funded, would you be satisfied with the system, how it works?

Mr. BROCK. Well, generally speaking, I—and here again in this case, I am speaking for the membership of the national organization that I am the President of. I believe, yes, basically we would be. I mean, obviously nothing is perfect, but in general that is our greatest concern right now, is just being able to keep up with the demand.

Again referring to Oklahoma, if you don't mind—I mean, I am more familiar with these statistics—our initial claims for unemployment were up 50 percent prior to September the 11th. September the 11th has just dumped that additional load on us, and we are trying to keep up. We are getting calls from our local legislators and others asking "how come I can't get through to file my unemployment claim," and we try to get the word out and let people know to be patient. No one has missed a check yet, but it is just the inability to be able to keep up with the demand, and I only see it getting worse.

Mr. LEWIS. Thank you.

Chairman HERGER. I thank the gentleman from Kentucky. Now the gentleman from Michigan, Mr. Camp, to inquire.

Mr. CAMP. Thank you, Mr. Chairman. Mr. Yarbrough, you mentioned in your testimony that employers are overtaxed because of some of the shortcomings in the unemployment compensation system, and you mentioned the concept of quadruple taxation. Can you tell me what you mean by that and what might be an example of that?

Mr. YARBROUGH. Well, I guess the first tax is obviously the two-tenths. That is $14 that we are having to pay, which is not being returned to the State for UI administrative funding. The second tax is the fact that our State unemployment taxes are increased because we do not receive enough UI administrative funding from the government. The third tax is that we are now paying temporary agencies to refer workers to us, because we are not receiving enough referrals from our UI offices. The fourth tax is that we have had to open up our own continued employment centers to try and find enough workers.

So what has happened is we are having to go out and search four different times, where in the late eighties, early nineties, when the system was up and viable and fully funded, I had liaison officers walking to me from the employment service saying, these are the people that we have available, these are the tax credits that you could take advantage of, and these are the folks that we have ready to come to work for you.

And so since now the funding has been flat-lined out of here, all those things and all those services have gone away. The State UI offices are also no longer even certifying that our workers are eligi-

ble to work. But, I just want to say that there are four different levels of taxation.

Mr. CAMP. Ms. Owens, you mentioned the lack of benefits for workers who were formerly employed. And the States have the option of providing people part-time workers' UI benefits at this point, don't they?

Ms. OWENS. Yes.

Mr. CAMP. And I think several States do, as many as 15; is that your understanding?

Ms. OWENS. That is about right. If I might interrupt just a second. One of the things that I think was surprising to worker advocates was that during the boom time of the nineties, especially the last few years of the nineties when, as I said, we had almost full employment and many of the State trust funds were flush, States did very little to expand coverage or increase benefits and, in fact, they cut taxes. And one of our concerns is that once States have the obligation of covering administrative financing costs as well as benefits, there will be even less incentive to expand coverage. So this proposal makes it that much less likely that States will on their own initiatives make these changes.

Mr. CAMP. About 15 States have elected to offer part-time benefits; is that correct?

Ms. OWENS. That is correct.

Mr. CAMP. And no State withdrew that offer in the nineties.

Ms. OWENS. No. Not that I am aware of.

Mr. CAMP. That has been in the States' prerogatives since the inception of the program, has it not, since the thirties?

Ms. OWENS. I would assume that is the case.

Mr. CAMP. And I am just asking, you are not suggesting in your testimony that the Federal Government take over and tell the States whom to cover, are you?

Ms. OWENS. Not entirely. We probably disagree as to what might be appropriate Federal standards versus State standards, and we do think that while there are matters that certainly are appropriately left to the States, that this is a national economy and there are some more decisions the Federal Government should make. Unlike most European nations that run national unemployment systems, many decisions most important to workers here are left solely to the States.

Mr. CAMP. And I would like to hear from some of the other representatives on that point. Mr. Yarbrough.

Mr. YARBROUGH. I did want to add that several States have enacted additional UI taxes to help compensate for the lack of administrative funding they are receiving from the Federal Government.

Mr. CAMP. For the Federal Government to do that in some sense, there would be a mandating of tax hikes on States to provide benefits that aren't provided.

Mr. YARBROUGH. Working on the Governor's advisory board at home, labor and management sit down with the public and work out these issues before we go to the legislatures with what we need to be seeking and what we need to be doing. That way we get good local support on what takes place. That is the problem, we continue to come to this group and we have seen no reform, no dollars come back. We brought several proposals. Everybody says we have got

to do something but everybody wants to wring their hands, and we need the dollars back. People are needing the service.

Mr. CAMP. Thank you. Mr. Blankenburg, do you have any comments?

Mr. BLANKENBURG. Following up on what Chuck said, these are situations that are worked on at the State levels whether to cover part-timers or not. And just to emphasize your point, by having the Congress mandate it, you are throwing the whole balance of the system out of whack.

Mr. CAMP. Thank you. Thank you, Mr. Chairman. I see my time has expired.

Chairman HERGER. Thank you, Mr. Camp. Now the gentleman from Oklahoma, Mr. Watkins, to inquire.

Mr. WATKINS. Just kind of an editorial comment. I notice my colleague, Mr. Levin, has left. But I would agree with him about legislation going to a dead end because that other body has become kind of a graveyard over there. We passed very progressive steps to try to stimulate the economy three times, and we moved out front on several other issues. All have fallen by the wayside when it got over to the Senate. I want to acknowledge that being an obstructionist, though, does not provide much leadership. It is easy to do. You can always board up the barn and head to the house and say—but that doesn't solve the problem. And we have got to solve problems. And it becomes a very discouraging situation sometimes when we try to work through things and they are not resolved.

Let me just ask, in Oklahoma, I know—we all are kind of short-changing the refunds to the States, so to speak, on administrative costs, and I noticed that we have only been getting about 41 percent back, and there are problems that can come about, but some people say there are going to be certain program purposes dropped. But let me ask you in the way of a question, what is in jeopardy in Oklahoma if we don't—and what can you do or what would you do if you got 100 percent? That is a hypothetical question there.

Mr. BROCK. Congressman, I am not aware of programs particularly being dropped per se, at least nothing comes to my mind at the moment. But the problem is that it just continues to choke more and more the delivery of these services. For us, for example, in Oklahoma, it would mean that we would have more local offices that we are having to close and consolidate offices just simply because it is a matter of the funding that we receive.

One thing that Chuck mentioned earlier just brought to my mind, our legislature, and rightfully so, for several years has given pay increases to our State employees. These are State employees but they are coming from a federally funded source. We just have to eat that. Every time they give a 3, 4, 5 percent salary increase, that is just that many fewer people out there.

Mr. WATKINS. Is 100 percent of that increase picked up by Federal?

Mr. BROCK. We are 100 percent Federally funded except we are one of those States, and the report that I gave to you a few moments ago, that about $1.2 million or so from our penalty and interest, we use that to pay about 20 salaries also. That money is over and above what employers are already paying for.

Mr. WATKINS. That is kind of a reverse mandate.

Mr. BROCK. In essence, it is.

Mr. WATKINS. The State says we are going to require the feds to pay more money.

Mr. BROCK. That is correct. And I suspect that the same thing is true in all of the States that I represent and that they have to make it up somewhere.

Mr. WATKINS. We have 77 counties in Oklahoma. How many offices do we have?

Mr. BROCK. We have 40.

Mr. WATKINS. Some people have to drive 50 miles or more if they know——

Mr. BROCK. And this is where we are trying to economize through technology, for example. Taking unemployment insurance claims by telephone as opposed to maybe 40 or 50 minutes waiting on the telephone. That is better than having to drive 50 miles to file an unemployment claim. So there are some economies as a result of technology and so forth. This is the people business and we need to be able to lend people the personal care and assistance that they need, not only in times of crisis and job loss and what-have-you, but for those who have a job but want a better job. We need to be able to help them, too. And as a result, we just end up bottom fishing, if you please. We just end up doing the bare minimum just to get by from day to day.

Mr. WATKINS. In Oklahoma, our per capita income is 20 percent of the national average, and unemployment benefits, I guess, are likewise.

Mr. BROCK. Well, I am not looking at it exactly that way. We pay our unemployment benefits based on a percentage of our average income in Oklahoma. So it is comparable. It fits our specific situation. Now how that relates to the national average as far as benefits are concerned, I would have to do a little research on that.

Mr. WATKINS. Well, I share a concern and look forward to trying to find some solutions and look forward to working with you and other States in trying to find some solutions. And I thank you very much. I know it is a long trip up; I don't know when you got to town but——

Mr. BROCK. I got a better night's sleep than you did.

Mr. WATKINS. Thank you so much for coming.

Chairman HERGER. Thank you very much, Mr. Watkins. I want to thank each of our panelists for very interesting and helpful testimony. We seem to be unanimous in recognizing that we have a very serious problem and I believe our constituents throughout the Nation expect us to correct this. Certainly part of the problem, and it was just brought out, I believe, by you, Mr. Brock, is that the employer—going back to something we had stated before, but with a visual of that—is paying a dollar. The Federal Government is taking that dollar and putting on average 54 cents into a trust fund that is not being used. On average 46 cents—in your case, Mr. Brock, only 41 cents—is actually getting back to the States. Some 14 States here actually have had to inflict an additional tax to help meet State costs. We can and should and must do better than this, and hopefully we are going to do that.

Mr. WATKINS. Jon, I am leaving after this year, and I am going to become unemployed.

Mr. BROCK. That is not through no fault of your own.

Chairman HERGER. I want to thank everyone involved, and thank you, Mr. Cardin, for a very informative hearing. Thank you very much. This hearing stands adjourned.

[Whereupon, at 2:10 p.m., the hearing was adjourned.]

[A submission for the record follows:]

Statement of the American Federation of State, County and Municipal Employees, AFL-CIO

The American Federation of State, County and Municipal Employees (AFSCME) submits the following statement on President Bush's Unemployment Administrative Financing Reform Initiative for the March 5, 2002 hearing record of the Human Resources Subcommittee of the House Ways and Means Committee.

As a participant in the multi-year unemployment insurance (UI) "stakeholder dialogue," AFSCME is deeply disappointed that the current Administration has abandoned the fundamental premise of that process: that unemployment insurance reform can best be achieved when consensus is sought among the key stakeholders in the system. The consensus reform plan reached in June 2000 represented a remarkable achievement at the federal level. Although stakeholder negotiations occur at the state level, never before had such a process occurred in Washington, much less produced a consensus.

The stakeholder package was a fair and balanced compromise among competing interests. It contained something of importance for each party, but not every change sought by the participants. For workers, it required that states implement an alternative base period and cover part-time employees and provided federal funds to pay these benefits. For states, workers and employers, it provided increased and dependable funding for state unemployment insurance and employment service (ES) operations. For employers, it repealed the federal unemployment insurance (FUTA) surtax.

Unfortunately, opposition by some business groups at the end of the 106th Congress stopped consideration of this package. Now the Administration has sent to Congress a one-sided plan that abandons the progress made during the stakeholder process.

The Administration plan would phase down the federal FUTA tax by 75 percent in five years. It would shift the responsibility for UI and ES administrative financing to the states over the five-year period, leaving the federal government with responsibility only for the federal-state extended benefits program and the loan account and transferring to the states a new annual financial responsibility of over $3.5 billion.

This devolution plan can in no way be regarded as a comprehensive employment security reform. It gives employers a $36.5 billion tax cut over 10 years, but it does nothing to address the need to expand the percent of unemployed workers receiving unemployment benefits. In calendar year 2000, this "recipiency rate" was only 38 percent nationally and ranged from a high of 73 percent in Connecticut to a low of 16 percent in New Hampshire.

The absence of any reforms to address recipiency rates is not just disappointing. It also is alarming. The low percent of the unemployed who receive benefits compromises the program's countercyclical effectiveness and has rendered the federal extended benefits (EB) program increasingly less relevant. Because the EB program is triggered by the insured unemployment rate (IUR), which measures the number of individuals who receive basic benefits, increasingly it fails to reflect the nation's overall pattern of unemployment. Thus, reducing the IUR from five percent to four percent, as proposed by the Administration, is not a satisfactory solution to improving the extended benefits program. State benefit policies also must be modernized to reflect the changing composition of the workforce, including the growth of low-wage, temporary and part-time employment.

Worse yet, we believe that the Administration's devolution plan will harm workers and further weaken this important safety net program in several ways.

First, it will create new downward pressure on state benefit policies. This is because the proposal eliminates the current "firewall" between administrative financing, which is a federal responsibility, and benefit financing, which is a state responsibility.

Currently, state policymakers balance two competing pressures, those from employers to minimize taxes and those from worker advocates to improve state benefit policy. The devolution plan will add a third claim on state taxes and resources—the need for administrative funding. Inevitably, employer pressure to keep taxes

down, combined with state needs to maintain an adequate administrative structure, will lead to cuts in benefits or rejection of much needed worker improvements.

There is very good reason to believe that state benefit policy will be caught in this vise. Despite the 1990s economic expansion, states failed to strengthen their benefit policies while employers reaped substantial benefits. Between 1994 and 2000, for example, tax decreases took over $47 billion out of the UI system while recipiency rates hovered at an all-time low of about one-third of the unemployed.

The Bush devolution plan also undercuts the primary enforcement mechanism for federal protections for workers. Currently, as a condition of receiving federal administrative grants, states must maintain proper and efficient administration, pay benefits accurately and promptly "when due", and provide a fair and impartial hearing process. Without any federal funding of state operations, the appropriateness of federal standards for the use of state funds will certainly be challenged. Furthermore, it is highly doubtful that the federal government would raise employer taxes by eliminating the tax-offset credit in nonconforming states as the Administration has proposed.

AFSCME strongly believes that there is an administrative underfunding crisis. Severe underfunding means workers do not get benefits paid in a timely fashion and do not get the reemployment services they want and need. Furthermore, underfunding has led states increasingly to rely heavily, if not exclusively, on telephone claims systems or other electronic methods, which do not adapt easily to sudden surges in volume or to the complexity of disputed claims. In addition, because states are not fully reimbursed for their workload, it is possible that federal underfunding may constitute another rationale for not improving state benefit policies to cover more unemployed workers.

However, even as a solution to this problem, the devolution plan falls short in our view.

In the first place, although the Administration intends to transfer $14 billion from the federal trust fund into state trust funds during the five-year transition period, there will be no federal administrative funding after that. This means that states will have to rise over $3.5 billion annually in new state revenue simply to make up for the loss in federal funding.

The Administration maintains that, because federal FUTA taxes will be reduced by six-tenths of a percent, states should be able to finance their administrative costs without employers experiencing a tax increase. There are several fallacies to this analysis.

Employers do not regard two-tenths of the six-tenths as a source of revenue for the system at all because they consider it an outdated and unnecessary surtax that should have expired long ago. As a result, states could only be able to reclaim four-tenths without raising employer taxes beyond what employers might be willing to accept.

In the aggregate, the four-tenths tax would have raised $3.5 billion in FY 2001. That is only about $300 million more than the FY 2001 federal appropriation, a level which the states have said is inadequate. The amount is actually less than states have been receiving during the current recession.

For individual states with high recipiency rates, the picture is worse. For example, Connecticut's federal administrative grant was $57 million in FY 2001, while a four-tenths tax on its employers would have raised only $44 million. Other states, such as Pennsylvania, California, and Michigan, would be in the same situation.

The current administrative financing system more accurately reflects state workload needs and is countercyclical in nature. It also pools risk nationally. First, administrative funds are allocated among the states according to their share of UI claimants and employer taxes collected. Second, there is a federal mechanism that automatically releases additional administrative funding if national unemployment rises above expected levels and the number of claimants rise. Both of these features would be eliminated if the federal administrative financing responsibility ends. Individual states could not easily replicate these features.

The fact that a four-tenths unemployment tax would not have yielded as much as the current system has sent to the states during the current recession graphically demonstrates the bind states in which may find themselves. Unless the states build adequate reserves during economic expansions, they will not be able to increase their administrative resources easily when claims surge during recessions. That means they may have to borrow from the federal loan fund at six percent interest (or whatever the rate at the time might be), thus unnecessarily increasing the cost of their operations.

The track record of the states does not inspire confidence that they will handle this new financial responsibility prudently in all cases. As noted earlier, states were much more eager to cut taxes than strengthen their benefit systems even when a

robust economy would have made doing so much easier. Furthermore, some states have mismanaged their benefit trust funds by failing to build up adequate reserves and choosing instead to give their employers tax cuts. Most notable are New York and Texas, which will be borrowing $1.5 billion from the federal government because their benefit trust funds are running out of money.

The essence of the Administration's plan is to cut employer taxes and to pass the responsibility for administrative funding off to the states. While it may be a "new balance," it is no meaningful solution to the problem. A far better solution would be simply to request additional appropriations for FY 2003. Even better would be a return to the stakeholder framework, with its administrative funding mechanism that would release adequate funds based on workload as a mandatory expenditure. For FY 2003, it would guarantee states an additional $1 billion in federal appropriations, instead of giving them the "opportunity" to levy a four-tenths increase in state employer taxes that would raise only $300 million more.

The release of $8 billion in Reed Act funds as part of the economic stimulus bill has given states a unique opportunity to address the administrative underfunding problem and weaknesses in state benefit policies. The Reed Act money should give the states ample resources for many years to come if they use it wisely. In our view, it obviates the need for the Administration's misguided devolution plan. AFSCME strongly urges the Committee to monitor closely how states use their Reed Act funds and to refrain from considering the Administration's proposed administrative financing proposal.