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## Unemployment Insurance



### UI Benefit Increase Will Raise Employer Taxes and Threaten the Program

*By Carol Evans*

While all parties agree that it is time to increase California's unemployment insurance benefits, it is unfortunate that Governor Gray Davis signed a bill that is a short-sighted solution courting long-term damage.

On October 1, over objections of Cal-Tax and the business community, the governor signed SB 40 (Alarcon), which will dramatically increase UI benefits by 95 percent, starting with a \$100-a-week increase in the maximum benefit on January 1.

The employer community is concerned that these extraordinary benefit increases will bankrupt the UI Trust Fund, even though taxes are raised substantially. The Employment Development Department (EDD) projection for SB 40 is based on an April 2001 Department of Finance economic forecast. Despite obvious changes in California's economy, the Legislature and governor relied on old, pre-September 11 information when considering the impact of SB 40.

Cal-Tax had urged the governor to hold off action on the bill to allow time for EDD to update its forecast on the impact of the increases on the UI Trust Fund, especially in light of the worsening economy.

The governor said the benefit increase is justified even more because of the impact on the economy and jobless rate caused by the September 11 terrorist attacks. He

said tens of thousands of Americans have lost jobs and “I want to make sure we have unemployment benefits that allow these workers to survive until the economy recovers.”

The historical tradeoff for California's UI program has been lower benefits in exchange for easier eligibility compared to other states, in order to protect the integrity of the UI Fund and to keep the cost to California employers in check. Past benefit increases have been accompanied by improvements in eligibility standards to maintain that balance. Governor Davis' signature on SB 40 broke with historical tradition and could very well break the UI Trust Fund as benefits increase by an astounding 95 percent over the next four years with no offsetting reforms.

This state already has the broadest coverage and loosest eligibility standards of any state, and will now also be among those states paying the highest benefits. The math is easy. Without major program reforms, UI taxes for California employers will rise dramatically. Even with one of the lowest benefit schedules of all states, California's UI taxes are already at the national average as a percentage of total payroll. With Governor Davis' action, we can expect California employers' UI tax obligations to rise well above the national average over time.

A Davis administration official, briefing reporters on September 30, said the Department of Finance believes the UI Trust Fund has a balance sufficient to absorb benefit increases for two years (it was \$6.37 billion last June 30). Benefits are paid by taxes on employers based on the first \$7,000 in wages for each employee.

Critics of SB 40, including the state Chamber of Commerce and the California Manufacturers and Technology Association, have said the higher benefits would require a business UI insurance tax increase of 32 percent, reaching \$782 million more a year in 2005.

The threat of insolvency also looms on the horizon. The state's UI funding mechanism is designed to restore the UI Fund through statutory formula-driven tax rate schedules, based on claim activity and fund balance. As reserves are drawn down, the tax rates employers pay bump up to maintain fund solvency. Given the level of Governor Davis' new unemployment benefits, if the state were to experience an economic downturn similar to the early 1990s, even with the highest employer tax rates in effect ever in the history of the state, it would likely still not be enough to prevent the fund from bankruptcy.

The maximum weekly benefit will rise to \$330 on January 1, 2002 (from \$230), to \$370 in 2003, \$410 in 2004, and \$450 in 2005. Based on an April 2001 economic forecast, the Employment Development Department projects that the UI rate schedule will remain at "C" (the current schedule in effect) for 2002 and 2003. The rate will climb to "D" in 2004 and "E" in 2005.

Besides the maximum weekly benefit increase as described above, these are SB 40 provisions as the measure was signed by Governor Davis:

- Substitutes 50 percent wage replacement formula for current 39 percent in 2003 (45 percent in 2002).
- Allows simultaneous collection of UI and federal Workers Adjustment Renotification and Training (WARN) Act payments (meaning eligible claimants would receive their regular salary and UI payments at the same time).
- Allows payment of UI benefits to claimants seeking part-time employment (an amendment added at the 11th hour, receiving no analysis or review).
- Requires alternative base-period study by December of 2002.

A number of other anti-business provisions were deleted prior to legislative approval, which may have been included as a labor “wish list” that could be peeled off when needed to attract certain votes in the Legislature. They included permanent indexing of the maximum weekly benefit to 50 percent of the state average weekly wage, UI eligibility during trade disputes, an alternative base period making eligibility even easier, and a corresponding \$250 employer fine for failing to report wage information.

Even as amended, this bill is bad for business in California, lays a tax trap that will hammer employers in just a couple of years, and threatens to disrupt the entire UI funding system.