

CALTAX COMMENTARY: CONDITION OF UI FUND IMPROVES, BUT REFORMS NEEDED FOR THE LONG TERM



By David Kline, Vice President of Communications and Research

It's a bad sign when it comes as good news that the deficit in the California Unemployment Insurance Fund is projected to drop to "only" \$1.3 billion next year. But considering that the fund had a deficit of \$8.6 billion at the end of 2014, and has been in the red since 2009, it is about as good as the news is going to get.

The UI Fund's improvement is partly due to an improving economy that has created more employment opportunities. Benefits paid to out-of-work Californians totaled \$6 billion in 2014, and are projected to fall to \$5.4 billion next year as more people find jobs.

Hold off on the celebrations, though, because another major factor is that employers have been contributing billions of dollars more to the system, in the form of a stealth tax increase. California's system was bailed out with a massive loan from the federal government in 2009, and every year the loan remains outstanding, employers' Federal Unemployment Tax Act (FUTA) credit is reduced – a situation that cost employers \$1.3 billion in additional federal employment taxes in 2015, and is expected to cost an additional \$3.8 billion cumulatively in 2016 and 2017.

All totaled, employers are projected to contribute \$5.8 billion to the UI Fund this year, and again next year, up approximately \$1.6 billion per year from the amount paid just seven years ago.

Even the relatively positive news about the UI Fund, reported in the California Employment Development Department's May 2016 Unemployment Insurance Fund Forecast, was coupled with a dire warning: "The current financing structure leaves the UI Fund unable to self-correct and achieve a positive fund balance sufficient to withstand an economic downturn."

Making matters worse, the state's zeal for increasing the minimum wage is increasing the average benefit payment, making it even harder to get the UI Fund back in balance.

The recent changes in the fund occurred without elected officials having to risk angering employers by voting for employment tax increases (since the increases were triggered automatically), or angering labor unions by voting for benefit reductions. It remains to be seen whether state officials will decide to alter this politically comfortable situation by taking concrete steps to improve the fund's long-term health.

Before the next economic downturn, however, reforms are needed.

Cracking down on fraud would be a good place to start. While the state touts its success every time someone is caught collecting unemployment benefits while working, or setting up a sham

company and collecting benefits after pretending to be laid off, the fraud level remains much too high. The U.S. Department of Labor reports that nationwide last year, 10.7 percent of the unemployment insurance benefit payments were improper, with overpayments totaling \$3.38 billion, and underpayments adding up to \$150 million. The three-year improper payment rate in California is 6.39 percent, with improper payments totaling almost \$429 million in 2015 alone, according to the department.

Another positive reform would be for the EDD to fight harder to protect the system's integrity. After reviewing the process for appealing EDD decisions to the Unemployment Insurance Appeals Board (UIAB), the state auditor reported in August 2014: "Attendance at the appeal hearing by the claimant, employer, or EDD can significantly affect the outcome of the appeal. We found that EDD rarely attends hearings. By not attending the hearings, EDD does not provide any active counter-argument to appellants' testimonies, which may make the appeals process more favorable toward appellants than it otherwise would be."

The auditor reported that at the first level of appeal, individuals appealing the EDD's determinations and seeking benefits prevailed 45 percent to 51 percent of the time, while employers who appealed an EDD decision prevailed just 32 percent to 34 percent of the time.

In 2011, Governor Jerry Brown proposed a large change to the system: elimination of the UIAB. Some employers applauded this idea, contending that an appeals process using administrative law judges would be preferable to the current system in which appeals are heard by political appointees who often have no background in law or employment issues, and sometimes have strong ties to labor unions. Instead of scrapping the UIAB, the state reduced its size from seven members to five. Currently, the board has three members and two vacancies that Governor Brown has not filled.

The state also should take a look at benefit levels, and the length of time that a person can collect benefits.

Reforming the system and getting the UI Fund on solid ground would be good for employers and workers alike. If the state can reduce the UI system's cost to employers – and, indeed, reduce many other government-created costs that hinder California's business climate – employers will create more jobs, and UI recipients will have more opportunities to collect a steady paycheck rather than an unemployment benefit.