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Overview of Unemployment Insurance and the Governor's Related Budget Proposals

LEGISLATIVE ANALYST'S OFFICE

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Hon. Joan Buchanan, Chair

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Unemployment in California

- ☑ ***State Unemployment Rate Remains High, but Is Falling.*** As of December 2011, California's unemployment rate is 11.1 percent. Currently, only one state (Nevada) has a higher unemployment rate than California. California's unemployment rate was about 4.8 percent at its most recent low point in late 2006. It peaked at 12.5 percent in late 2010 before falling to its current level of 11.1 percent.

- ☑ ***Wide Disparities in Labor Market Conditions Throughout the State.*** Some regional labor markets in California have done significantly better or worse than the state as a whole. The figure on the next page summarizes the impact of the recent economic downturn on various regional labor markets throughout the state.

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Unemployment in California *(Continued)*

Recession Affected State's Labor Markets to Different Degrees

Metropolitan Statistical Area	Labor Force at End of 2011 (*In Thousands*)	Previous Minimum Unemployment Rate[a]	Unemployment Rate at End of 2011	Percentage Point Change in Unemployment Rate
El Centro	77	14.6%	28.3%	13.7%
Yuba City	71	8.7	17.8	9.1
Merced	106	9.2	18.0	8.8
Stockton	298	7.3	15.8	8.5
Fresno	434	7.7	16.0	8.3
Modesto	235	7.8	16.0	8.2
Riverside/San Bernardino/Ontario	1,775	4.8	12.8	8.0
Madera/Chowchilla	66	6.8	14.5	7.7
Redding	85	6.4	13.9	7.5
Visalia/Porterville	211	8.4	15.7	7.3
Hanford/Corcoran	62	8.1	15.3	7.2
Bakersfield/Delano	372	7.4	14.3	6.9
Chico	104	6.0	12.7	6.7
Los Angeles/Long Beach/Santa Ana	6,459	4.3	10.9	6.6
Sacramento/Arden-Arcade/Roseville	1,031	4.6	11.2	6.6
Vallejo/Fairfield	213	4.8	10.8	6.0
Santa Cruz/Watsonville	152	5.5	11.3	5.8
Salinas	217	6.7	12.5	5.8
San Diego/Carlsbad/San Marcos	1,583	3.9	9.3	5.4
Santa Rosa/Petaluma	252	3.9	9.3	5.4
Oxnard/Thousand Oaks/Ventura	432	4.2	9.5	5.3
San Luis Obispo/Paso Robles	135	3.9	9.1	5.2
San Francisco/Oakland/Fremont	2,244	4.1	8.9	4.8
San Jose/Sunnyvale/Santa Clara	918	4.5	9.3	4.8
Napa	74	3.7	8.5	4.8
Santa Barbara/Santa Maria/Goleta	220	4.0	8.6	4.6
California	**18,219**	**4.8%**	**11.1%**	**6.3%**
United States	**153,887**	**4.4**	**8.5**	**4.1**

[a] Area's minimum unemployment rate between 2004 and 2008.
Seasonally adjusted estimates from the Bureau of Labor Statistics.

California's Unemployment Insurance Program

☑ ***Unemployment Insurance (UI) Program Provides Benefits to Workers Who Have Lost Their Jobs.*** The UI program, which provides weekly benefits to individuals who are unemployed through no fault of their own, was established under the federal Social Security Act of 1935. The program is funded by tax contributions paid by employers. Although the program is authorized by federal law, it is administered by the state which has significant discretion to set benefit and employer tax levels.

☑ ***UI Program Is Funded by Employer Tax Contributions.*** California employers pay both state and federal UI taxes. These taxes are paid by employers on the first $7,000 of wages paid to each of its covered workers. The federal tax rate (effectively 0.8 percent), which is used to fund program administration, is constant for all employers and across years—with the exception that it increases by 0.3 percent in years when the state must borrow from the federal government to cover UI benefit costs. State tax rates (varying from 0.1 percent to 6.2 percent), which are used solely to pay for UI benefits, vary across years (based on balance of reserve funding for UI benefits) and employers (based on the employer's previous layoff history).

☑ ***UI Program Provides Weekly Benefit Payments to Unemployed Workers.*** UI claimants receive weekly benefit payments which are intended to replace 50 percent of the individual's earnings lost due to unemployment. Weekly benefits are limited by a statutory maximum ($450) and minimum ($40). Current law limits claimants to no more than 26 weeks of benefits; however, other statutory provisions may effectively limit benefit duration to less than 26 weeks.

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California's Unemployment Insurance Program *(Continued)*

☑ ***Unemployed Workers Must Meet Eligibility Requirements to Receive Benefits.*** All UI claimants must meet both monetary and nonmonetary eligibility requirements. A monetary eligibility requirement is the minimum prior earnings threshold that an unemployed worker must meet to be eligible to claim benefits. Generally, nonmonetary eligibility requirements mandate that claimants must be actively seeking employment and able and willing to work.

California's UI Fund Is Insolvent

- ☑ ***California's UI Fund Has Been Insolvent Since January 2009.*** Primarily as a result of historically high demand for UI benefits during the recent recession, California's UI fund has been insolvent since January 2009 when fund resources became inadequate to pay benefits. As of February 2012, the UI fund deficit has grown to over $10 billion. The UI fund deficit is likely to continue to grow through 2014, when it is expected to reach around $13 billion. Absent corrective action, the UI fund is likely to remain in a deficit through 2020 or longer.

- ☑ ***Mismatch Between UI Fund Revenue and Costs Is Not Isolated to the Recent Recession.*** The inadequacy of UI fund revenues to cover the cost of UI benefits predates the recent recession and associated UI fund insolvency. In eight of the last ten years, California's UI benefit costs have exceeded revenues into the UI fund, suggesting that California's UI program has a structural mismatch between its revenues and benefit costs. This structural mismatch appears likely to persist in future years.

- ☑ ***Potential Federal Reforms Could Improve Solvency of the State's UI Fund.*** Three federal proposals, including one by the President, introduced in early 2011 would have positively affected California's UI fund solvency. Although it does not appear that these proposals have moved substantially closer to enactment since being introduced last year, we note that the President has indicated continued support for the concept in his 2013 proposed federal budget.

UI Fund Insolvency Required the State to Borrow From Federal Government

- ☑ ***To Continue Payment of UI Benefits, the State Borrowed From the Federal Government.*** The insolvency of the UI fund required the state to borrow from the federal government to continue paying UI benefits. The state's outstanding federal loan is currently about $10 billion. Carrying a federal loan balance results in significant ongoing state costs and increased federal taxes for California employers, as described in more detail below.

- ☑ ***State Must Make Interest Payments on Its Federal Loan.*** As a condition of carrying a federal loan balance, the state is required to make annual interest payments. The state's next interest payment is due September 2012 and is expected to be $417 million. As federal law does not permit these interest payments to be made from existing UI employer taxes, the cost of these payments falls on the General Fund.

- ☑ ***Loan From the Disability Insurance (DI) Fund Was Used to Cover Interest Payment in 2011.*** The state was required to make its first interest payment of $304 million in September 2011. The *2011-12 Budget Act* made this payment from the General Fund but covered the cost to the General Fund with a loan for a like amount from the state's DI fund (Unemployment Compensation Disability Fund).

- ☑ ***Federal Loan Results in Increased Federal Taxes for California Employers.*** For each year the state carries a federal loan balance, the federal UI tax rate on California employers increases (resulting in additional annual taxes of about $300 million that are on top of any such employer tax increases in prior years). In recent years, federal law has suspended these provisions. However, in January 2012 the first federal tax rate increase was implemented.

Governor's UI Proposals

- ***The Governor's Proposed 2012-13 Budget Includes Three UI-Related Proposals.*** As part of his 2012-13 budget, the Governor proposes to: (1) continue the current-year strategy of covering the cost of the state's interest payment on the federal loan to the UI fund with a loan from the DI fund, (2) establish a new revenue source for future interest payments on the federal loan, as well as for repayment of DI fund loans to the General Fund in 2011-12 and 2012-13, and (3) increase the minimum monetary eligibility requirement for receipt of UI benefits.

- ***Establishes a New Employer Surcharge to Cover Future State Interest Costs.*** The Governor proposes to establish a new employer surcharge which would be used to pay interest on the state's federal loan beginning in 2013-14 as well as covering the General Fund obligation to repay the DI fund loans made in 2011-12 and 2012-13. The surcharge would not be used to pay down the principal on the state's federal loan. All employers currently covered by the UI program would be subject to the new surcharge. Collection of the surcharge would begin in 2013 and is estimated to total $473 million.

- ***Increases the Minimum Monetary Eligibility Requirement.*** Presently, to qualify for UI benefits, an unemployed worker must have earned at least $900 in the highest quarter or $1,300 in any one quarter of his/her 12–month base period. These thresholds have not been adjusted for changes in wage levels since 1992. Under the Governor's proposal, these limits would be increased to $1,920 and $3,200 respectively. The Employment Development Department estimates that this change would reduce annual UI benefit payments by $30 million (less than 1 percent of total annual benefit payments).

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LAO Assessment of the Governor's Proposals

☑ ***Governor's Proposals Do Not Address UI Fund Insolvency.*** The Governor's proposal would not significantly address the structural imbalance of the UI fund. Correcting the mismatch between UI fund revenues and benefit costs will allow the state to repay its current federal loan in a more timely manner—as UI fund revenues in excess of benefit costs are dedicated to repayment of the federal loan—and build a healthy reserve to protect against the risk of insolvency (and the risk of increased borrowing from the federal government) during future economic downturns.

☑ ***Governor's Proposals Would Concentrate Impact of Repayment of the Federal Loan on Employer Costs.*** As the Governor's proposals do not accelerate repayment of the state's federal loan, repayment will occur almost exclusively from increases in federal UI employer taxes.

☑ ***If Part of a Comprehensive Long-Term Solvency Plan, Governor's Proposals Merit Consideration.*** Governor's proposal to dedicate a portion of future increased UI tax revenues to making the interest payment on the state's federal loan would avoid significant General Fund costs in future years. Also, we concur with the Governor's assessment that monetary eligibility thresholds should be updated to reflect changes in wage levels. However, as we note above, the Governor's proposals fall short of addressing the issue of long-term solvency of the UI fund.

☑ ***Recommend Adopting a Long-Term Solvency Plan, Potentially Including Aspects of the Governor's Proposals.*** In the absence of federal reforms, we recommend the Legislature adopt a balanced (including both employer tax increases and benefit decreases), comprehensive plan to ensure the long-term solvency of the UI fund. We recommend that the Legislature postpone considering the Governor's proposals until they can be considered as part of a long-term solvency plan.