Fixing Unemployment Insurance Financing

Testimony before the Joint Legislative Budget Hearing on Workforce Development

March 1st, 2023

James A. Parrott, PhD
Director of Economic and Fiscal Policies
Center for New York City Affairs at The New School

Summary

New York's state unemployment insurance (UI) financing is severely flawed. It is the reason we're facing an $8 billion trust fund federal debt that will take another four to five years to pay down. It is the reason our benefit structure is mediocre at best, and inferior to benefits paid in all of our neighboring states. And it is the reason our employers are paying much higher UI taxes than they were before the pandemic.

New York's UI tax structure causes small employers with fewer than 100 employees to pay effective tax rates (relative to total wages) that are three to four times the rates paid by large companies with 500 or more employees. Industries with low average wages pay much higher effective UI tax rates than very high-wage industries like finance, information (media and tech), professional services, and management of enterprises (i.e., corporate headquarters).

The root of the problem is New York's unusually low taxable wage base of $12,300, lower than in 35 of the 50 states despite the fact that New York has the highest average weekly wage of all 50 states. Because of New York's chronic UI trust fund insolvency, the state's maximum weekly benefit has been frozen at $504 since 2019; it would be $200 more per week if our fund were solvent.

Some commentators have mistakenly attributed New York's UI trust fund debt to fraud. This tendency was compounded by an unfortunate press release accompanying a State Comptroller audit that exaggerated the extent of fraud related to the State's UI trust fund by a factor of 25.

New York's UI trust fund debt burden can only be addressed by overhauling the financing system. By following the lead of other states that assess unemployment taxes on a higher portion of payroll, and also on gig companies, New York can make sure big corporations pay their share, expand the state's inadequate benefits, and actually reduce taxes on small businesses. New York has the latitude under federal law to lessen the weight of experience rating in setting our UI tax rates to assist small businesses. Also, the State has the resources and should make permanent New York's successful Unemployment Bridge program in order to provide crucial support to workers who are shut out of the regular unemployment system.

Fixing Unemployment Insurance Financing

Good afternoon, distinguished chairpersons and members of these committees. My name is James Parrott, Director of Economic and Fiscal Policies at the Center for New York City Affairs at The New School. Thank you for the opportunity to testify on workforce issues in the FY 2024 New York State Budget.

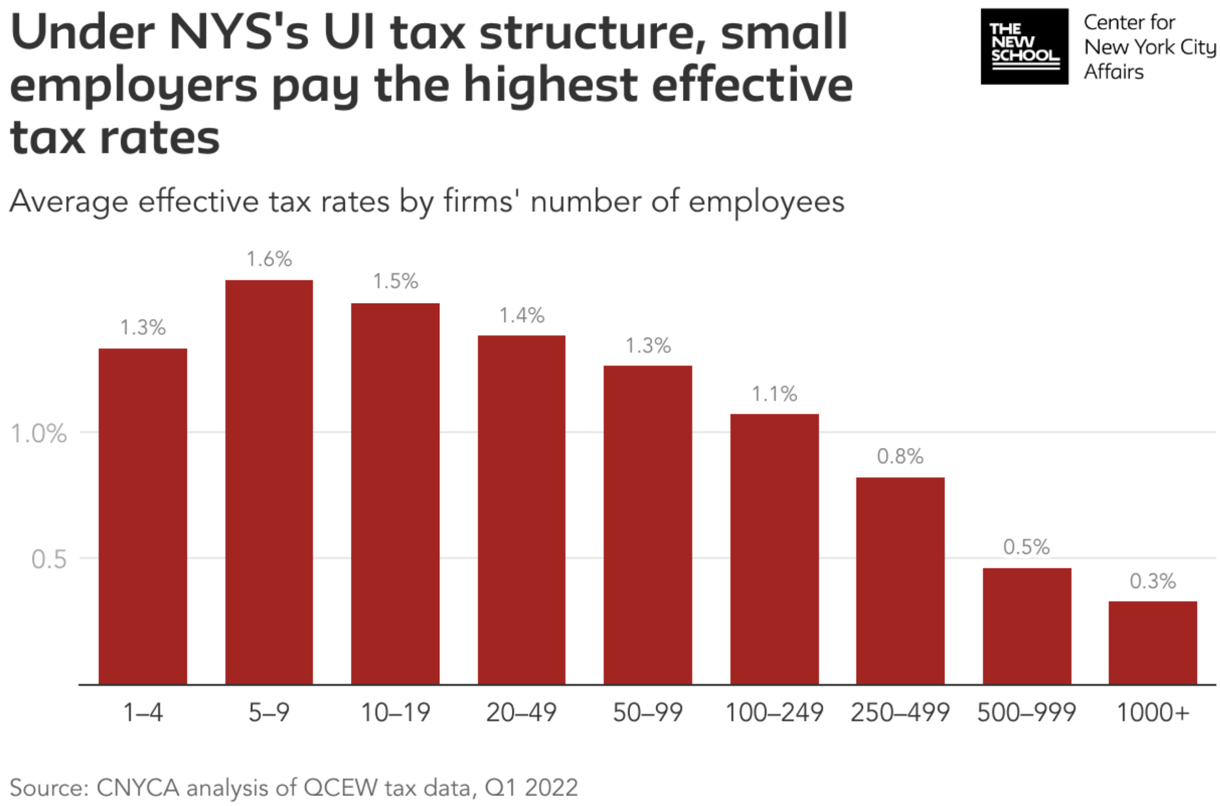
I have studied extensively the New York State and New York City economies and labor policies for the past 30 years. I would like to focus on Unemployment Insurance today.

The way New York finances state unemployment insurance is severely flawed. It is the reason we're facing a UI trust fund federal debt that will take another four to five years to pay down. It is the reason our unemployment benefit structure is mediocre at best, and inferior to benefits paid in all of our neighboring states. And it is the reason our employers are paying much higher UI taxes than they were before the pandemic.

New York's chronically inadequate financing meant that the State had to borrow nearly $4 billion to get through the Great Recession of 2008-09. This led to an effort in 2013 to overhaul UI financing. However, many of us thought at the time that the solution didn't go nearly far enough. And it didn't. New York finally paid off the Great Recession trust fund debt in 2014 (it took six years) and had built up a trust fund balance of a little over $2 billion going into 2020.

The pandemic triggered unprecedented job losses, particularly in New York State, and forced the State to begin borrowing again from the federal government to pay benefits. At its peak in March 2021, New York had borrowed $10.4 billion. As of February 15, 2023, the State's UI debt was $8.04 billion. With our current financing structure, and assuming no significant increase in unemployment claims and a moderate degree of employment growth, it will take until 2026 or 2027 to retire the federal debt. Given the structure of the State's UI tax rate schedules and federal law, New York's employers will continue to pay elevated UI tax rates over this period, and that is a tax structure that weighs more heavily on small employers than large employers.

The first chart shows that in 2022, small employers, e.g., those with fewer than 100 employees, generally paid UI effective tax rates (relative to total wages) that were three to four times the rates paid by large companies with 500 or more employees.

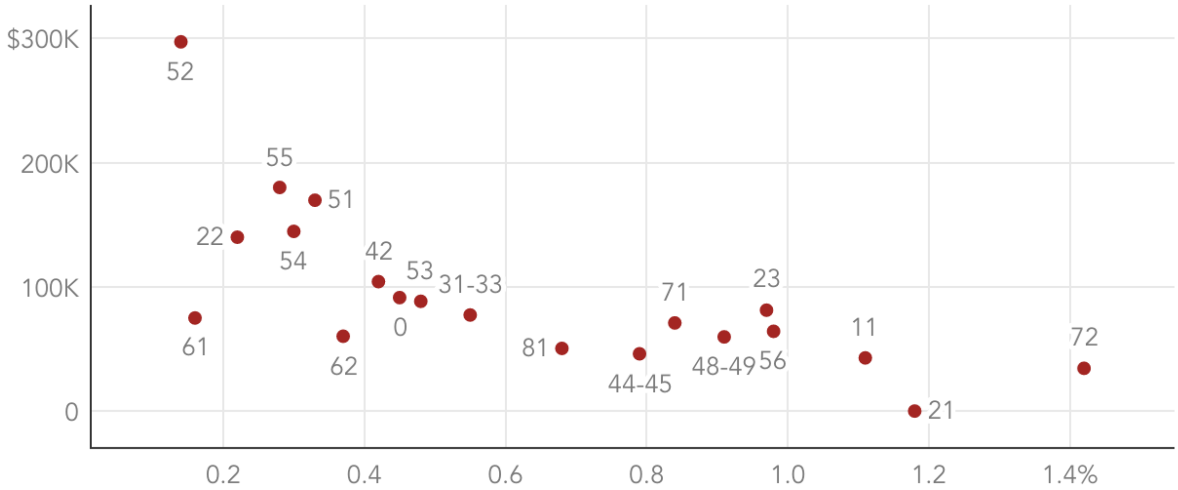


There is also a strong inverse relationship between average industry wages and effective UI tax rates. That is, industries with low average wages pay much higher UI tax rates than industries including finance, information (media and tech), professional services, and management of enterprises (i.e., corporate headquarters) that have average annual wages of $150,000 or more. Not surprisingly, these high-paying industries also have fairly high concentrations of total industry employment in large companies.

Under NYS's UI tax structure, lower wage industries pay the highest effective tax rates

Center for New York City Affairs

Average annual wage by average UI tax rate on total wages, New York State data by private industry, Q3 2021-Q2 2022



Note: Numbers nearest to a point indicate corresponding NAICS industry codes, as seen in the below table.

Source: CNYCA Analysis of QCEW tax data, Q3 2021-Q2 2022

NAICS	Industry
0	Total, All Private Ind's
11	Agriculture
21	Mining
22	Utilities
23	Construction
31–33	Manufacturing
42	Wholesale Trade
44–45	Retail Trade
48–49	Transportation & Warehousing
51	Information
52	Finance & Insurance
53	Real Estate and Rental & Leasing
54	Professional
55	Management of Companies and Enterprises
56	Administrative and Support and Waste Mgmt. & Remediation Serv.
61	Educational Serv.
62	Health Care & Social Assistance
71	Arts
72	Accommodation and Food Serv.
81	Other Services (except public admin.)

Three factors combine to determine the UI tax an employer pays: the State tax portion, the Federal tax portion, and the taxable wage base.

State UI tax

Generally, there are three components to an employer's state UI tax rate, with the first two below varying depending on an employer's account balance (reflecting their "experience" with UI claims) and the solvency of the State's general trust fund account. The ranges cited in the description of the components are based on a negative trust fund balance (which has been the case since mid-2020 and is likely to continue for another four to five years).

- "Normal" component: ranges from 1.5 percent to 8.9 percent, increasing as the employer's account (contributions minus benefits charged, divided by payroll) diminishes, but would be less if the trust fund balance were positive. This is the only part of the UI tax that goes into the individual employer's account.
- "Subsidiary" component: ranges from 0.525 percent to 0.925 percent, increasing as the employer's account diminishes, but would be less if the trust fund balance were positive. This portion of the tax goes to the trust fund.
- "Re-employment service fund" component: 0.075 percent for all employers, used to fund job search by claimants.

Thus, combined tax rates with a negative trust fund balance range from 2.1 percent to 9.9 percent. With the highest level of trust fund solvency, the combined rates range from 1.575 percent to 5.975 percent. (There are nine to ten intermediate gradations of solvency between a deficit and the highest level of solvency. There are 63 half-percentage gradations for the experience-based "normal" component ranging from an employer's account balance of 10.5 percent or more to a negative balance of more than 21 percent.)

Federal UI tax

Under the Federal Unemployment Tax Act, employers make federal tax payments of six percent on only the first $7,000 of employee wages. And for states with solvent trust funds and no federal debt, 5.4 percent of the federal tax is credited back to the employer for a net federal tax of 0.6 percent ($42 per employee per year). Employers in states that have net UI trust fund debt outstanding for more than two years (like New York) have their net federal tax increased by 0.3 percent in the third year, and by 0.6

percent in the fourth year, and so on in increments of 0.3 percent more per year until the federal debt is retired. Beginning January 1, 2023, New York employers are paying a net federal tax of 1.2 percent (or $84 per employee per year, twice the usual level).

While interest on the federal funds New York borrowed to pay benefits was waived during the pandemic, the waiver ended on September 6, 2021. New York employers owed the federal government $162 million in interest for 2022. This translates into an Interest Assessment Surcharge of 0.23 percent, or $27.60 per employee. An interest charge will be payable annually until the trust fund deficit is paid off.

Taxable Wage Base (TWB)

Federal UI law permits states to determine their own taxable wage bases – the portion of an employee's earnings on which UI tax is assessed. For a very high-wage state, New York has an unusually low taxable wage base of $12,300 (it was $12,000 in 2022), lower than in 35 of the 50 states. The table below shows that several states have much higher taxable wage bases than New York.

Selected States with Higher UI Taxable Wage Bases Than New York

Center for New York City Affairs

Data as of Q3 2022

State	UI Taxable Wage Base
Washington	$62,500
Hawaii	$51,600
Oregon	$47,700
Idaho	$46,500
Alaska	$45,200
Utah	$41,600
New Jersey	$39,800
North Dakota	$38,400
Montana	$38,100
Minnesota	$38,000
Nevada	$36,600
Iowa	$34,800
New Mexico	$28,700
North Carolina	$28,000
Wyoming	$27,700
New York State	**$12,000**

Source: U.S. Department of Labor, Employment and Training Administration

Under the 2013 UI changes, New York has been very gradually phasing in increases in the taxable wage base. But that will make the UI taxable wage base $13,000 in 2026. After 2026, it will be adjusted each January 1 to equal one-sixth of the state's average annual wage. Given moderate increases in the state's average annual wage, the taxable wage base in 2027 will be in the $17,000-$18,000 range, still well below several other states.

The 2013 UI changes also called for gradually increasing the maximum weekly UI benefit amount so that it would equal 50 percent of the state's average weekly wage in 2026. However, that phase-in schedule has been frozen since 2019 at a weekly maximum of $504, an amount that is now about 30 percent of the average weekly wage. Had the maximum not been frozen as a result of the systems' flawed financing structure, it would now be $200 more per week.[1]

The employer cost of inadequate New York UI financing

It is clear from an examination of New York's UI tax structure that employers, particularly small employers and others who are taxed on a higher share of their total wages, are severely disadvantaged by New York's flawed UI financing. For example, an employer at a given experience rating (say a five percent positive employer account balance to start the year), is paying $253 more (56 percent) in UI taxes this year, because the State's trust fund is in the red, compared to the amount such an employer would pay if there were a moderate positive balance in the State's trust fund. Most of this differential is due to the state tax, with about two-fifths of the extra payment required by the federal tax and the interest surcharge.

And of course, this poor state financing penalty is highly regressive, with small firms paying a higher penalty relative to their payroll than large employers who tend to be in industries with very high average wages.

The solution is to raise the taxable wage base and restructure the UI tax schedule

It is clear that New York needs to significantly raise its taxable wage base to lessen the regressive impact of the current UI tax structure and to serve other important priorities. If we raised the taxable wage base, we could reduce the rate structure with the result that we could:

1—pay back the state's federal trust fund debt sooner;

2—improve New York's mediocre unemployment benefits; and

3—reduce the tax burden on small employers.

Preliminary modeling with a significantly higher taxable wage base demonstrates how these three results can be achieved.

In addition, if we lessened the weight of experience rating in determining UI tax rates, we could go further in shifting the tax burden to large employers who generally have

[1] New York's maximum weekly benefit had been set at 50 percent of the average weekly wage for the year 2000, but through inaction there was no increase in the dollar amount until 2014, and the maximum benefit plummeted in relation to the state average weekly wage.

higher employer account balances. This is particularly important at this time, given the continuing very adverse and extremely lop-sided impact of the pandemic on "face-to-face" industries like those in leisure, hospitality, and retailing that bore the brunt of the public health-related business restrictions.

It is widely understood that, while face-to-face service industries bore the brunt of the economic dislocation, other industries that were able to continue operations on a remote-working basis, including finance, media, technology and professional services, prospered during the pandemic, with few layoffs and with many achieving record profits. We should revamp our UI tax structure to shift some of the tax burden from those who paid the highest price during the pandemic to those who prospered the most. We can retain an experience rating component, but lessen the weight that it has in determining UI tax rates.

Some commentators have mistakenly attributed New York's UI trust fund debt to fraud. Unfortunately, federal pandemic relief programs like the Paycheck Protection Program and Pandemic Unemployment Assistance attracted costly abuse by foreign-based crime rings. An unfortunate press release accompanying a State Comptroller audit dramatically exaggerated the extent of fraud related to the State's UI trust fund (the press release made up a number not found in the audit). Because the Cuomo Administration also failed to modernize the New York State Labor Department's UI computer system, failures in that system early on in the pandemic not only delayed getting benefits to New Yorkers thrown out of work by the pandemic, but also led to a makeshift processing system that fraud rings exploited. The State Labor Commissioner reports that fraud and inadvertent overpayments due to the makeshift processing system in the State's UI program totaled $388 million; the Comptroller's press release erroneously cited a figure more than 25 times greater.[2]

Effective fraud prevention is needed and identity theft is a real problem, not just in the UI system. Beyond what NYS DOL is already doing to verify claimants' identities, additional reforms that would address the fraud problem include fixing the overpayment waiver system and increasing the penalties for employers who don't report their workers' wages (including "gig" companies). We should also clarify the concept of "willful misrepresentation" in UI law, do more to support claimants with limited English proficiency, and address the understaffing and lack of resources at NYS DOL.

[2] Roberta Reardon, "Commentary" New York is working on fraud, but can't solve it alone," Times Union, December 23, 2022.

There is also an urgent need for New York to take effective action to ensure that giant "gig economy" corporations like Uber and Doordash start paying their unemployment taxes. Scores of UI Appeals Board decisions and multiple court rulings have determined that workers for these gig companies are entitled to regular UI benefits; during the pandemic well over 50,000 gig workers received benefits from the UI trust fund. To allow these gig companies to remain off the hook just shifts their UI tax liability onto other businesses.

Conclusion

New York's UI trust fund debt burden can only be addressed by overhauling the financing system. By following the lead of other states that assess unemployment taxes on a higher portion of payroll and on gig companies, New York can make sure big corporations pay their share, expand the state's inadequate benefits, and actually reduce taxes on small businesses. New York has the latitude under federal law to lessen the weight of experience rating in setting our UI tax rates to assist small businesses. Also, the State has the resources and should make permanent New York's successful Unemployment Bridge program in order to provide crucial support to workers who are shut out of the regular unemployment system.

Thank you for the opportunity to testify today.