Comments on Your Government

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RIPEC

Summary of Unemployment Insurance and Analysis of the Rhode Island Unemployment Insurance Trust Fund

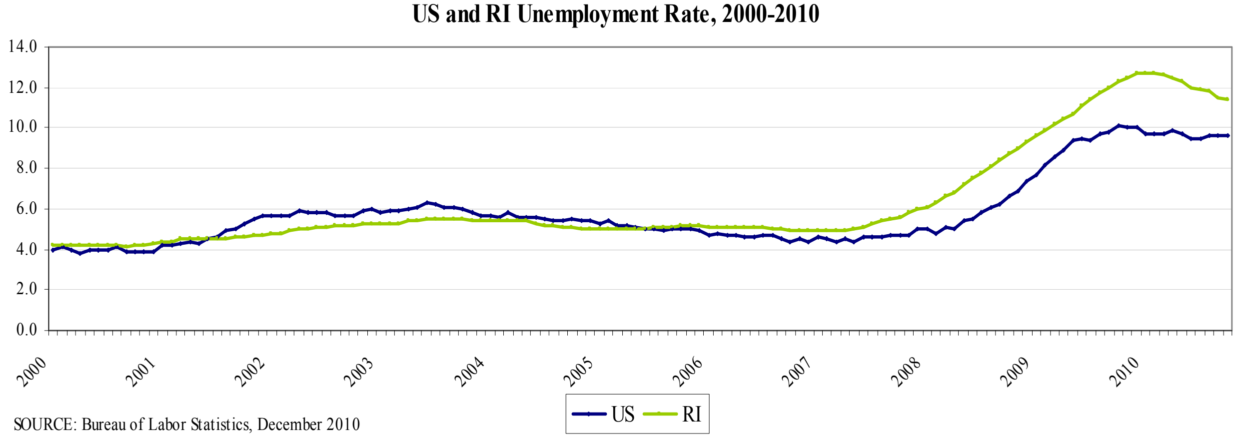
This RIPEC Comments provides an overview of unemployment insurance and examines the current status of Rhode Island's Unemployment Insurance Trust Fund. In addition, the report includes updated information on unemployment in the Ocean State and examines key aspects of how the State's unemployment insurance compares to other states in the country.

Introduction

Unemployment in the Ocean State and across the country has increased steadily since the middle of 2008, reaching its peak at the end of 2009. The United States saw a peak unemployment rate of 10.1 percent in October of 2009, while unemployment in Rhode Island reached 12.7 percent in December of 2009 and remained at that rate until March 2010. Persistently high unemployment at both the state and national level has put increased strain on state unemployment insurance (UI) trust funds. To date, 30 unemployment insurance trust funds – including Rhode Island's – are insolvent and have borrowed from the federal government.

The American Recovery and Reinvestment Act (ARRA) suspended interest payments on debt through the end of calendar year (CY) 2010, giving insolvent states two interest-free years; however, states are still responsible for repaying the principal, and the interest that accrues on any un-repaid principle after December 31, 2010. In most cases, solvency problems across the states have been growing over a number of years as the result of long-standing UI policies and practices that have eroded trust fund reserves. By most projections, it will likely take many years for state funds to return to a solvent position, particularly if the country experiences a jobless recovery.

Chart 1
US and RI Unemployment Rate, 2000-2010



SOURCE: Bureau of Labor Statistics, December 2010

Overview of Unemployment Insurance

The Federal-State Unemployment Insurance (UI) Program is designed to provide temporary financial relief to individuals who are unemployed through no fault of their own and meet other eligibility criteria as determined by each individual state. The program covers the 50 states, the District of Columbia, the Virgin Islands and Puerto Rico. While unemployment insurance is a joint federal and state program, each state or territory administers its own program and sets its own benefit provisions within guidelines established by federal law.*

Financing

Tax Base Components

In the majority of states, the program is funded entirely by a tax imposed on employers; however, three states (Alaska, New Jersey and Pennsylvania) require employee contributions. Unemployment taxes are levied at the state and federal level. The federal unemployment tax (FUTA) funds the administrative costs for UI and Job Services programs in all 50 states. The state tax is paid to state workforce agencies and is used solely for benefits paid to eligible unemployed workers.

The FUTA is currently levied on employers at a rate of 6.2 percent on wages up to $7,000 per year, with a credit against the liability of up to 5.4 percent. As a result, the FUTA has an effective net rate of 0.8 percent (up to a maximum of $56 per covered worker) in states that meet specified requirements. States that have an outstanding loan to the federal government on January 1 for two consecutive years, and have not repaid the loan before November 10 of the second year, will see a reduction in the credit against the FUTA.

At the state level, employer taxes are "experience rated", that is, employers with a higher percentage of former employees receiving benefits pay a larger amount of money into the fund. This rating is then either translated into a rate via a fixed schedule or by ranking employer rates against each other and then sorting employers into rate classes. All new employers pay a "new employer rate" until they meet requirements for the experience rating.

The tax rate as determined is then applied to the taxable wage base, which is also determined at the state level. A large number of states have a higher wage base than that applicable to FUTA. Some states have a flexible base that adjusts on an annual basis, usually in relation to wage changes in the state. Some states also require an additional contribution when fund levels drop below a specified point. Alternately, low balances may trigger a "least favorable" schedule with higher rates.

There are four methods of determining an employer's experience rating:

- Reserve ratio – contributions minus benefits charged (30 states);
- Benefit ratio – benefits charged divided by the employer's payroll (17 states);
- Benefit-wage ratio – the percentage relationship between total benefit payments and total benefit wages for an individual employer multiplied by the corresponding relationship at the state level (two states); and
- Payroll variation plan – quarter-to-quarter changes in employer payrolls, expressed as a percentage (one state).

* NOTE: All national figures include DC, the Virgin Islands and Puerto Rico unless otherwise noted. For simplicity, the term "state" is used generally, but is inclusive of DC, the Virgin Islands and Puerto Rico.

Table 1
Unemployment Insurance Tax Base Components

	Taxable Wage Base	Experience Rating Formula	Employer Ranking	Charging Method
Connecticut	$15,000	Benefit Ratio	Fixed	Proportionally
Maine	12,000	Reserve Ratio	Array	Most Recent
Massachusetts	14,000	Reserve Ratio	Fixed	Inverse Order
New Hampshire	10,000	Reserve Ratio	Fixed	Most Recent
Rhode Island	**19,000**	**Reserve Ratio**	**Fixed**	**Most Recent**
Vermont	10,000	Benefit Ratio	Array	Proportionally

SOURCE: US Department of Labor

Another factor that determines an employer's experience rating is the charging method, that is, which employer(s) are charged with the benefits when a worker becomes unemployed. In reserve- and benefit-ratio systems, the worker's benefit payments are charged, while the benefit wages are charged in benefit-wage-ratio states. There is no charging in payroll variation plans. There are three primary charging methods:

- Most recent/primary employer – all states that use this method relieve the employer if employment is casual or short-time (13 states);
- Inverse order – charges are limited to the base period and are charged in the inverse order of employment. A maximum limit is placed on each employer. When the limit is reached, the next employer is charged (six states); and
- Proportional – all employers within the base period are charged in proportion to the wages paid (31 states).

Like most states, Rhode Island applies a reserve ratio formula, using a three year average payroll, to determine an employer's experience rating. Rhode Island, along with 13 other states, charges the most recent employer. In calculating benefits, the State also excludes certain benefits from charging, which is a common practice across the country. The intent of "noncharging" is to relieve employers from charges for unemployment which results from circumstances beyond the employer's control. Benefits excluded from charging in Rhode Island include dependents' allowances, voluntary leaving and discharge for misconduct.

Tax Rates

Unemployment insurance tax rates vary significantly across the United States and depend on a number of factors. As noted above, states may set rates using a "fixed" schedule or an "array" schedule. The majority of states use the fixed schedule, including Rhode Island. An employer's rate on either schedule is dependent on their experience rating. Tax rates are also dependent on the state's unemployment insurance fund balance. Low balances will trigger a less favorable rate schedule. Regardless of which rate schedule is used, however, under federal law the maximum rate must be at least 5.4 percent.

In addition to the base rate, some states add additional taxes, which may include a solvency tax (based on the balance in a state's UI fund, 18 states), a social cost tax (based on unrecovered benefit costs such as noncharged benefits, 10 states), loan interest repayment taxes (and taxes assessed to repay bonds associated with benefit costs, 21 states,[†] including Rhode Island), reserve taxes (deposited in a reserve fund in which

[†] Note: some states may have multiple different loan and interest repayment taxes.

the principal is used for UI purposes, but the interest may be used for other purposes, five states), and taxes for UI administration or non-UI purposes such as job training or technology improvements (29 states including Rhode Island).

Table 2
2010 Employer Unemployment Insurance Contribution Levels

	Per Covered Employee	Per $1 of Wages Paid	Est. Contributions at Tax Base Minimum	Average	Maximum	Taxable Wage Base
United States	$360	$0.008	$103	$358	$1,129	-
Connecticut	$583	$0.010	$285	$564	$1,020	$15,000
Maine	331	0.010	94	322	863	12,000
Massachusetts	695	0.013	176	685	1,718	14,000
New Hampshire	119	0.003	5	124	700	10,000
Rhode Island	**576**	**0.014**	**321**	**711**	**1,860**	**19,000**
Vermont	334	0.009	110	352	770	10,000

SOURCE: US DOL Office of Workforce Security Division of Fiscal and Actuarial Services, "2010 Significant Measures of State UI Tax Systems", October 2010

Benefits

Determination of Monetary Entitlement

Eligibility and benefit levels vary across states. However, in all cases, claimants must have become unemployed through no fault of their own (with some exceptions) and must meet a minimum threshold for wages earned, length of employment, or a combination thereof during an established period of time called the "base period". The base period is typically the first four of the prior five calendar quarters, with some allowances. States vary in how eligibility is determined, but use one of four methods: multiple of high-quarter wages (a certain dollar amount in the highest-earning quarter plus a set amount of base period earnings); multiple of weekly benefit amount; flat qualifying amount; or weeks/hours of employment.

In most cases, benefits are set to replace half an eligible claimant's former wages up to a certain limit (often the average weekly wage in the state). While high-wage workers will see higher benefit levels, low-wage workers will typically see a greater share of wage replacement than high-wage workers because of this limit. Weekly benefits are computed in four ways:

- High-quarter: the base period quarter in which wages were the highest, divided by 13 (the number of weeks in a calendar quarter), multiplied by the percentage of the wages replaced;
- Multi-quarter: a multiple of the total or average quarterly wages paid in more than one quarter;
- Annual-wage: a percentage of annual wages in the base period; or
- Average weekly wage: a percentage of the claimant's average weekly wages in the base period.

To qualify for benefits in Rhode Island an individual must:

- Meet earnings requirements of at least $8,880 in either base period (the first four of the last five completed calendar quarters) or an alternate base period (the last four completed calendar quarters before the start of the claim)

  \- OR –

  Be paid at least $1,480 in one of the base period quarters AND be paid total base period wages of at least one and one-half times highest single quarter earnings AND be paid total base period wages of at least $2,960;
- Be able, available and actively searching for work; and
- Be willing to accept a suitable job while claiming benefits.

An individual can be denied benefits for the following reasons:

- Leaving suitable employment without good cause‡;
- Being fired for proven misconduct connected with their job; or
- Refusing a suitable job offer.

In addition to the above, the following criteria apply to individuals receiving or seeking unemployment assistance in Rhode Island:

- An individual's UI compensation may be lowered, but not eliminated, by an amount equal to 50 percent of the amount of a pension, retirement pay or annuity received in any week in which an individual is eligible for unemployment benefits. Social Security benefits are NOT disqualifying under this provision.
- Unemployment compensation is subject to federal and State income tax; amounts deducted from an individual's tax payments will be held in the employment security fund until transferred to the State or federal government for payment of the tax.
- An individual may retain eligibility for unemployment benefits while attending adult basic education or vocational training, full or part-time as long as the education or training will enhance the individual's employability, the education or training can be completed successfully, and that the individual did not leave suitable employment.

Under current law, Rhode Island's maximum weekly benefit amount (WBA) is equal to 67.0 percent of the statewide average weekly rate. In 2010, the maximum WBA was $551, the second-highest rate in New England and in the country (Massachusetts has the highest WBA). The current benefit formula is designed to replace 60 percent of an individual's average weekly wage (4.62 percent of high-quarter wages). This is the highest wage-replacement ratio in New England and the 6th highest nationally.

Duration of Benefits and Emergency Unemployment Compensation

States also determine the number of weeks an individual is eligible to collect benefits. In the vast majority of states, the maximum number of benefit weeks is 26 although Massachusetts allows workers to collect for up to 30 weeks and beneficiaries in Montana can collect for up to 28 weeks. A few states have uniform durations of 26 weeks while other states have variable durations. In general, states with uniform durations have high minimum wage thresholds for all but the lowest benefit levels. In

Table 3
Weekly Benefits, 2010

	Method of Ben.	Weekly Benefit*			Min. Wages for Max WBA	
	Computation	Min.	Ave.**	Max.	High Quarter	Base Period
Connecticut*	MQ/HQ	$15	$330	$537	$13,962 in 2Q	$21,480
Maine*	MQ	62	275	359	NA	$15,664 in 2Q
Massachusetts*	MQ	33	395	629	NA	$32,708 in 2Q
New Hampshire	AW	32	275	427	NA	$41,500
Rhode Island*	HQ	**68**	**381**	**551**	**$11,927**	**NA**
Vermont	MQ	64	294	425	NA	$19,125 in 2Q

HQ = High Quarter, MQ = Multi-Quarter, AW = Annual Wage; WW = Average Weekly Wage

* In states where a range was presented, the lowest and highest figures were used; indicates states with a range for min and max benefits.

** Average benefit is based on US Department of Labor statistics from 2010 Q2t: http://workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum10/DataSum_2010_2.pdf

SOURCE: US Department of Labor; RI Department of Labor and Training

‡ Note: there are some exceptions to this rule. For example, an individual may voluntarily leave work due to a domestic abuse situation.

Table 4
Emergency Unemployment Compensation Legislation

The Emergency Unemployment Compensation Act	June 20, 2008	Provided 13 weeks of additional benefits to all states for individuals who exhausted previous UI programs (through July 4, 2009)
Unemployment Compensation Act	November 22, 2008	Added 7 additional weeks to the 13 weeks (20 total) through the EUCA) for states with high unemployment rates (through Aug 27, 2009)
American Recovery and Reinvestment Act	February 17, 2009	Amended the Unemployment Compensation Extension Act to include an additional 33 weeks through December 31, 2009 and increased UI benefits by $25 per week in all states.
Worker, Homeownership and Business Assistance Act	November 6, 2009	Provided an additional 14 weeks for Emergency Unemployment Compensation for all states and an additional 6 weeks for states in which unemployment was over 8.5 percent. Benefits were available to those whose eligibility for UI benefits expired before December 31, 2009.
Department of Defense Appropriations, 2010	December 19, 2009	Amended the effective dates of the EUC program, including additional benefits, through February 28, 2010.
Temporary Extension Act of 2010	March 2, 2010	Extended Federal unemployment programs, including the EUC, through April 5, 2010 and postponed termination of the program until September 4, 2010.
Continuing Extension Act of 2010	April 15, 2010	Further extended Federal unemployment programs, including the EUC, through June 2, 2010 and postponed termination of the program until November 6, 2011.
Unemployment Compensation Extension Act of 2010	July 22, 2010	Provided for a third extension of the EUC, through November 30, 2010 and postponed termination of the program until April 30, 2011.
Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010	December 17, 2010	Continues the federal benefit programs through 2011 and restored benefits for eligible long-term jobless workers retroactive to December 1, 2010.

general, qualifying unemployed individuals in Rhode Island are eligible for between 8 and 26 weeks of unemployment benefits.

During periods of high unemployment in a state Federal law provides for extended benefits (EB) which are triggered when the insured unemployed rate for the previous 13 weeks is at least five percent and is at least 120 percent of the average of the rates for the corresponding 13-week period in each of the two preceding years.

The majority of states have optional triggers for EB. Some states allow for 13 weeks of EB if the insured unemployed rate for the previous 13 weeks is at least six percent, regardless of prior year experience. Other states will pay the 13 additional weeks when the average total seasonally adjusted unemployment rate (TUR) for the most recent three months is at least 6.5 percent and is 110 percent of the rate for the corresponding three-month period in either or both of the two previous years. In some states, the duration of EB increases to 20 weeks if the TUR is at least 8.0 percent

Table 5
Extended Benefits

UI Claims	Maximum Weeks of Benefits Provided	Deadline for Starting Claim
Regular UI Claim	Up to 26 weeks of benefits	Date of unemployment
1st Tier of Federal Extension	Up to 20 weeks of benefits	December 25, 2011
2nd Tier of Federal Extension	Up to 14 weeks of benefits	January 1, 2012
3rd Tier of Federal Extension	Up to 13 weeks of benefits	January 1, 2012
4th Tier of Federal Extension	Up to 6 weeks of benefits	January 1, 2012
State Extended Benefits	Up to 20 weeks of benefits	January 8, 2012
Potential Maximum Weeks	Up to 99 weeks of benefits	

during the same time period. In Rhode Island, EB is triggered using the 6.5 percent TUR option.

Under permanent federal law, 50 percent of EB are financed through the federal government and the remainder is financed by states. However, current federal law temporarily amended this provision. Through 2011, 100 percent of EB are financed through the federal government.

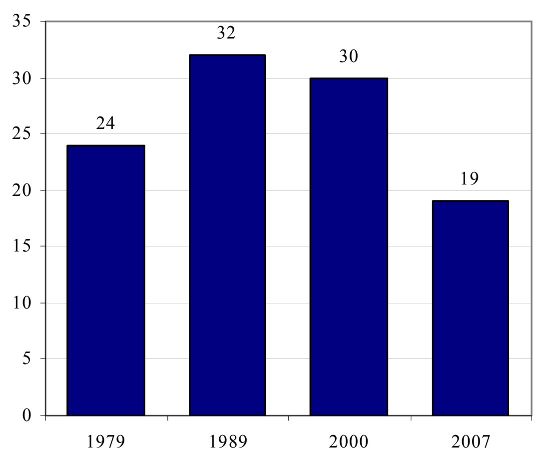
In addition to state EB programs, the federal government enacts temporary programs extending UI benefits. The most recent program is Emergency Unemployment Compensation 2008 (EUC08). This program provides up to 53 additional weeks of federal unemployment benefits. As shown in table 5, an individual may collect federal EUC benefits once their regular UI claim has expired.[§] If a claimant exhausts all four tiers of federal EUC benefits they may be eligible for state extended benefits for up to 20 additional weeks. Together, these programs may provide up to 99 total weeks of benefits.

Unemployment Insurance Trust Funds

The UI program relies on state trust funds to "forward fund" benefits. Revenues collected during periods of economic stability or growth are used to help fund benefits during an economic downturn. This forward-funding mechanism relies on states having built up sufficient reserves before a recession, drawing on those reserves during a recession, and rebuilding during recovery. This structure underscores the intent of the program to help counter economic fluctuations, preventing states from raising taxes during periods of economic hardship while providing a cushion, while at the same time injecting funds back into the economy.

Extended periods of high unemployment, coupled with long-standing UI policies have weakened trust fund reserves. As a result, states entered into this recession less prepared than in previous economic downturns and many have borrowed from the federal government. Based on data from January 11, 2011, 30 states currently have outstanding loans totaling $41.5 billion. The Department of Labor estimates that up to 40 states may need to borrow approximately $90 million from the federal government to continue funding their UI programs by 2013.

Chart 2
Number of States Holding Recommended Trust Fund Savings at the Start of Recent Recessions



SOURCE: National Employment Law Project "Understanding the Unemployment Trust Fund Crisis of 2010", April, 2010

Unemployment Insurance Financing

Unemployment insurance trust funds are entirely self-financed through taxes levied on the employer. The amount of revenues generated is determined both by the wages subject to taxation, and by the tax rate. Adjusting either the taxable wage base or

[§] NOTE: to be eligible for federal EUC benefits, an individual's benefit year must have ended after May 5, 2007 and they must meet certain wage and employment requirements.

the rate will result in increases or decreases in revenues.

The Unemployment Insurance Trust Fund (UTF) is a part of the US Treasury and consists of 53 state accounts (50 states, the District of Columbia, the Virgin Islands and Puerto Rico) into which state-levied taxes are deposited. In addition, there are six federal accounts:

- Employment Security Administration Account (ESEA): finances the administration costs of state UI programs;
- Extended Unemployment Compensation Account (EUCA): reimburses states for the federal share of EB;
- Federal Unemployment Account (FUA): provides loans to insolvent state funds;
- Federal Employees Compensation Account (FECA): finances benefits to former federal and military employees; and
- Two accounts related to the Railroad Retirement Board that pay UI benefits to railroad workers.

Under the Reed Act, when the ESEA, EUCA and FUA accounts reach statutory limits, excess funds are transferred to state accounts in proportion to their share of FUTA taxable wages. States may only use these funds to cover the cost of state benefits and administration of state programs; there must be a specific appropriation by a state legislature for a state to use these funds for administrative purposes. The most recent Reed Act distribution was in 2002.

The majority of states adjust tax rates on an annual basis. Rates are adjusted based on trust fund balances; in most states, low balances will trigger a schedule with higher rates while high balances will result in schedules with lower rates. The particular trigger varies across states. Some states have a set dollar amount while others use a percent of payroll or base the trigger on benefit or other ratios. In Rhode Island, the "least favorable" rate schedule is triggered when the trust fund balance is less than 2.75 percent of payrolls, resulting in a minimum rate of 1.9 percent and a maximum rate of 10.0 percent.

Trust Fund Solvency

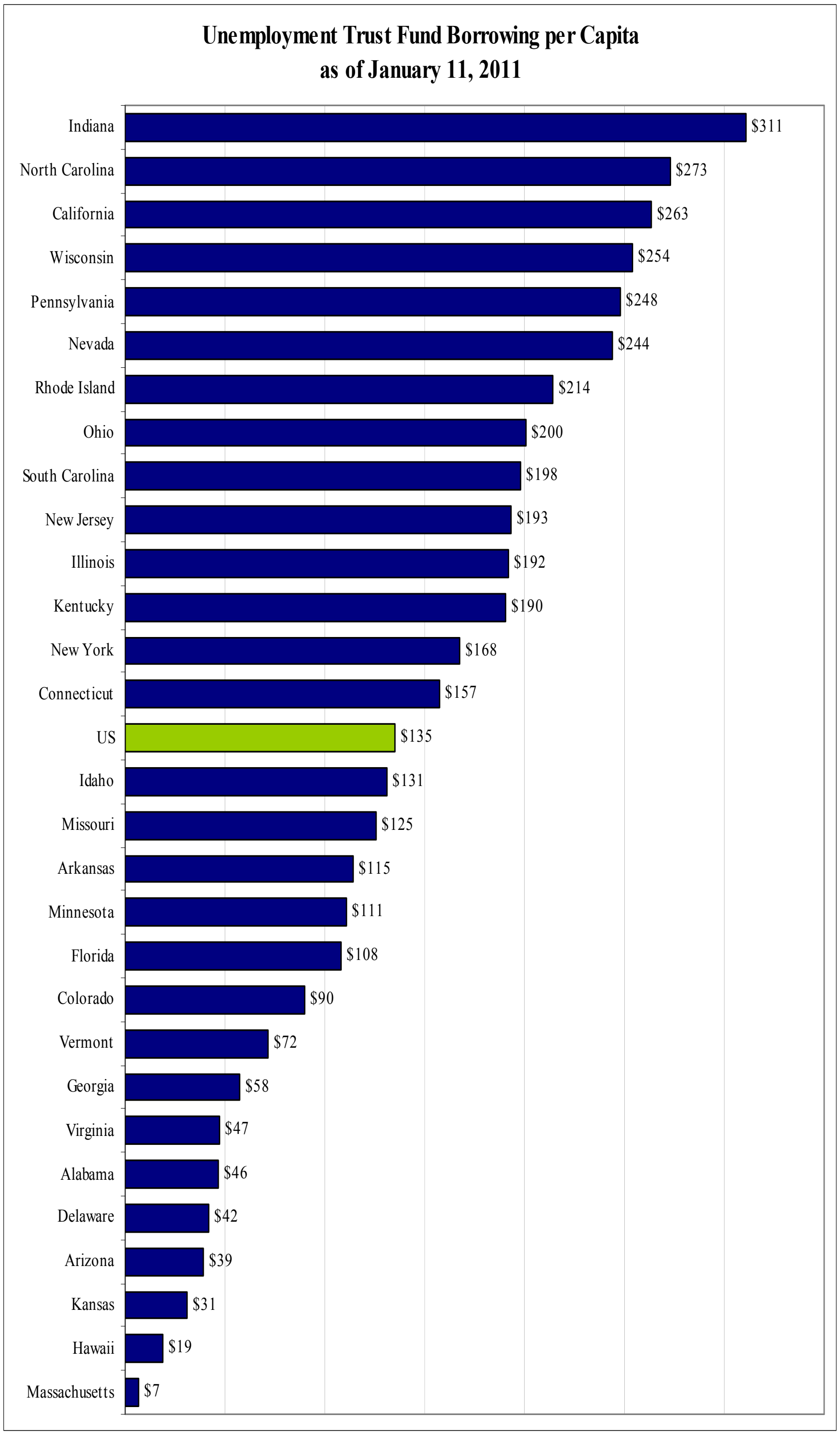
In the event that a state becomes insolvent – that is, they have exhausted their trust fund reserves – they may take interest-free loans from the federal government ("cash flow loans"). In order to qualify for an interest-free loan, states must:

- Repay these loans by September 30 of the year of the loan;
- Not have taken a loan in the last quarter of the calendar year of an interest free loan. If loans are made during this time period, interest-free loans from the prior fiscal year will retroactively accrue interest charges; and
- Meet funding goals established under DOL regulations (to be phased in starting in 2014 and fully implemented by 2019).

If the state has an outstanding balance on January 1 for two consecutive years the full amount of the loan must be repaid by November 10 of the second year or employers will lose 0.3 percent of the FUTA tax credit for each year in which the state has an unpaid balance.[**] Currently, Michigan, Indiana and South Carolina are subject to the credit reduction. Employers in

[**] If a state has unemployment levels above 13.5 percent, they may be eligible for a grace period of up to nine months.

these states will see a 0.3 increase in their FUTA (0.6 percent in Michigan), retroactive to January 1, 2010. Of note, the American Recovery and Reinvestment Act (ARRA), temporarily waived interest payments and interest accrual until December 31, 2010.



Nationally, UI trust funds are in historically weak fiscal condition. The Government Accountability Office (GAO) noted that just 24 states borrowed from the federal government during the recession in the 1980s when national unemployment was almost 11 percent. Currently, there are 30 states with insolvent trust funds that are borrowing from the federal government. In addition, aggregate net reserves nationally are negative, the first deficit since 1983 and the largest in the program's history. As of January 11, 2011, total national borrowing was $41.5 billion ($135 per capita). Rhode Island began borrowing in March of 2009 and, to date, has taken $225.5 million in loans. The State's borrowing to date equates to $214 per capita, or 58.5 percent higher than the US average. The Rhode Island Department of Labor and Training (RIDLT) estimates that trust fund borrowing will peak at $291.0 million in May 2011. Among the New England states, Maine and New Hampshire are the only two that have not borrowed from the federal government.

The RIDLT estimates that the State Employment Security (ES) fund will remain insolvent through CY 2017. In the event that the fund continues to be insolvent through that time, the Department estimates that employers in the state would face an increase in federal and state UI taxes of $294.5 million between CY 2012 and CY 2017. Of this amount, $105.5 million would be through the 0.3 percent interest assessment, $61.7 million of which would be for interest payments, and the $189.0 million balance would be to pay back the loans through a reduction in employers' FUTA credit. Even with the additional taxes, the Rhode Island ES fund is expected to face ongoing challenges due to a continued low balance unless changes are made.

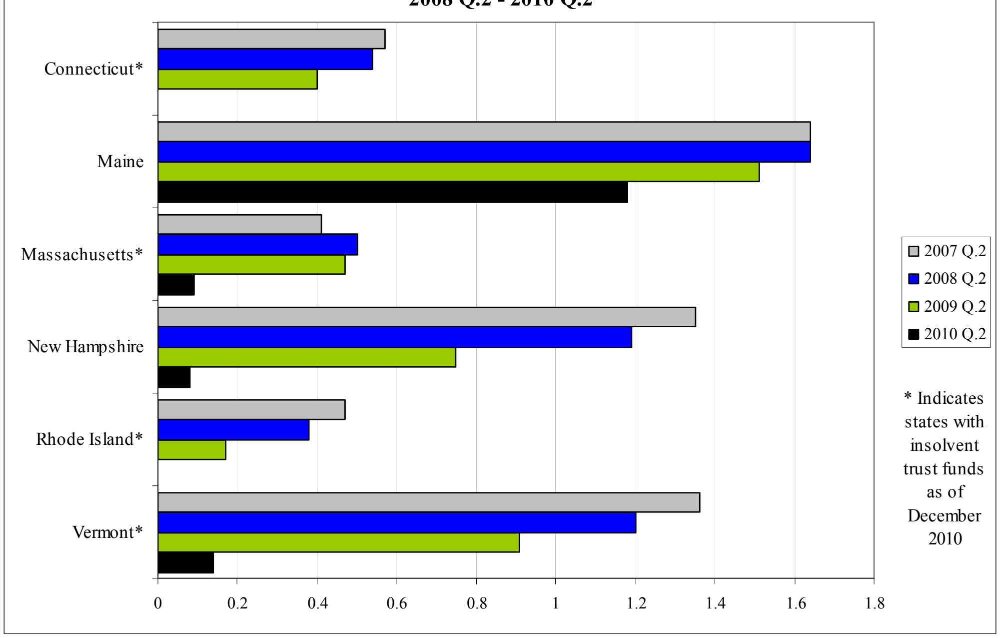
Adequate Trust Fund Balances

There is no federal statutory requirement regarding adequate trust fund balances; however, the US Department of Labor (DOL) has set forth guidelines for trust fund solvency. In order to be minimally solvent, the DOL suggests trust fund balances be able to provide benefits for one year, using the average three highest levels of benefit payments over the past 20 years. This ratio, the average high-cost multiple (AHCM), should be greater than one. States with an AHCM below one are at risk of becoming insolvent in the event of a recession.

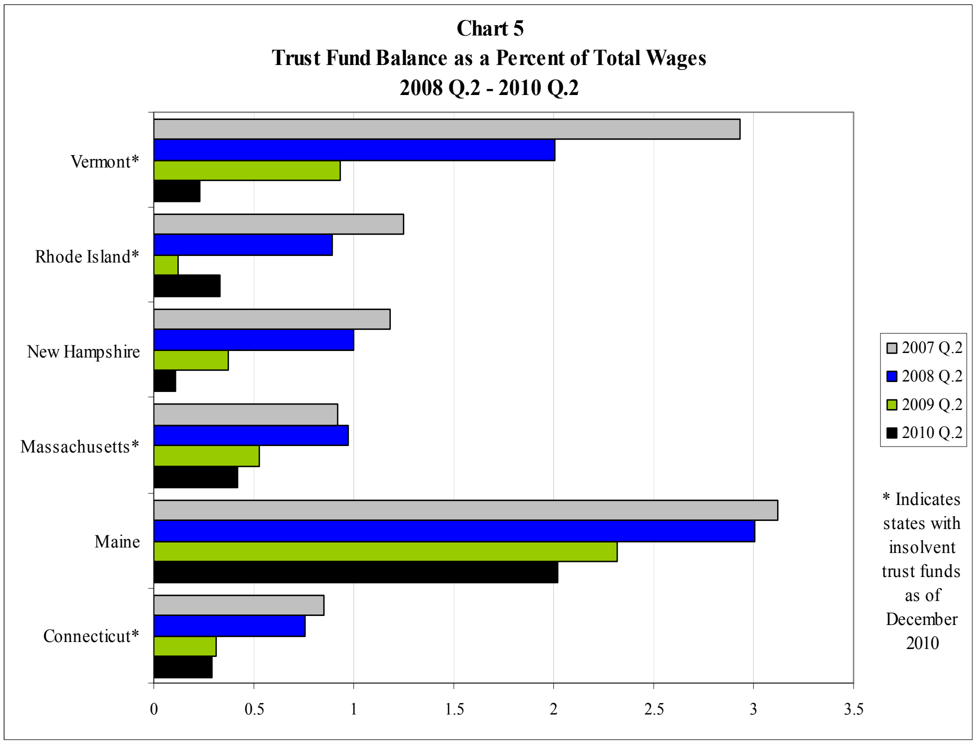
Chart 4 shows the AHCM for the six New England states between the second quarter of 2008 and the second quarter of 2010. As shown on the chart, Maine is the only New England state to have an AHCM of over one in all three years. Both Connecticut and Rhode Island had an AHCM of zero in the second quarter of 2010 and have been borrowing from the federal government since October and March 2009, respectively. In each of the three quarters, Rhode Island's AHCM has been the lowest of the New England states. Over the past three years, Rhode Island's AHCM has also been among the lowest in the country, ranking in the bottom 15 states or lower each year. Maine's 2010 Q.2 AHCM of 1.18 was the highest in the country.

Another way to measure the health of a trust fund is the trust fund balance as a percent of total wages. The DOL measures the balance as a percent of estimated wages for the most recent 12 months. This measure is also commonly referred to as the "reserve ratio". Effectively, the reserve ratio is a measure of the insured risk as lost wages are essentially the risk that is insured through UI. Reserve ratios also reflect the size of a state's economy. As with AHCM, there is no

Chart 4
Average High Cost Multiple
2008 Q.2 - 2010 Q.2



official guidance regarding trust fund solvency; however, a number of organizations recommend a pre-recession reserve ratio of at least 2.0 percent, indicating that the reserve would be able to replace two years of covered wages.



Data from the DOL indicate that the only New England state to meet the 2.0 percent threshold is Maine, which had a reserve ratio of 2.02 percent in the second quarter of 2010. Among the six states, New Hampshire had the lowest reserve ratio in 2010 Q.2 (0.11 percent). Rhode Island's 2010 Q.2 reserve ratio of 0.33 percent was the third highest across the region (behind Maine and Massachusetts) and represented an increase from the 2009 Q.2 reserve ratio of 0.12 percentage points.

Steps to Restore the Fund to Solvency

By any measure, the State's UI trust fund has been nearing insolvency for a number of years, and is likely to remain insolvent for the foreseeable future unless changes are made. As a result, businesses are likely to see sharp increases in the amount of taxes paid into the UI system including the 0.3 percent per year FUTA credit reduction, an additional 0.3 percent interest tax, and continued higher tax rates under the "least favorable" rate schedule. Clearly, Rhode Island is not the only state facing significant challenges to UI trust fund solvency; however, the prolonged recession, high rate of unemployment, and historically weak trust fund reserves have put additional pressure on the State to implement reforms.

Given the need for the State to reform the current system in order to restore the system to solvency, ameliorate the negative consequences of significant tax increases, and ensure the effectiveness of UI as an economic stabilizer, the RIDLT proposed a number of changes to both the financing and benefit systems in Rhode Island. This section of the report provides an overview of these proposals, along with RIPEC comments on the proposals. One should note that, as a condition of federal EB support, states may not make changes to their benefits until July 1, 2012.

Tax Changes

Proposal 1
The RIDLT proposes elimination of the current taxable wage base and replacing it with a flexible wage base. In 2012, the taxable wage base would be set to $19,000

(the current base), or 47 percent of the statewide average annual wage rounded to the next highest multiple of $200. The percentage would increase each year through 2015 when the wage base would be set at 50 percent of the average annual wage. The Department estimates that this would generate an additional $4.0 million in UI contributions in 2013.

Based on RIDLT calculations, this would result in a wage base of $19,800 in 2012. In 2010, Rhode Island had the 16th highest wage base in the country. If this proposal were in effect in 2010, Rhode Island's wage base would have been the 15th highest in the country. Currently, 20 states have flexible wage bases, 13 of which are based on a percent of state average annual wages. If the formula were in effect in 2010, all states would have used a higher percent of annual wages than the Rhode Island proposal. Of note, no state in New England uses a flexible wage base.

Prior to 1999, the State had a flexible taxable wage base that was equal to 70.0 percent of the State's average annual wage. The base was subsequently moved to a fixed base that ranged from $12,000 to $29,000, dependent on the state of the UI trust fund.

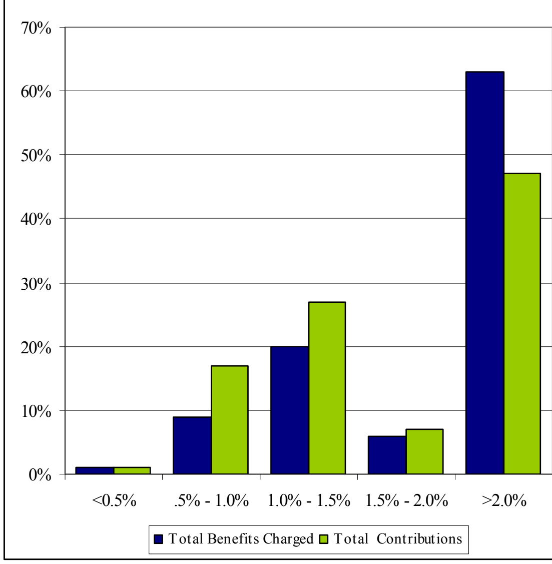
Data indicate that fixed wages result in a decline in the ratio of taxable wages to total wages. As a result, the proportion of wages subject to the UI tax nationally has declined from approximately 50 percent in 1970 to 27.2 percent in 2008. The GAO notes that, in 2008, states without an indexed wage base had a ratio of taxable wages to total wages of 25 percent, compared to a ratio of 53 percent in states with an indexed taxable wage base.

Many UI systems, including Rhode Island's set benefits to replace a certain share of wages, which are revised annually. If the taxable wage base is not increased, states run the risk of moving toward insolvency as benefits paid out may grow at a faster rate than contributions paid in. The majority of employment security literature recommends indexing the taxable wage base to wages. At the same time, however, in considering this proposal, the State should be mindful of the fact that Rhode Island currently has the highest taxable wage base in the region, and ranks toward the top nationally.

Proposal 2

The second RIDLT proposal is to raise the taxable wage base for employers subject to the highest tax rated group (employers with a current tax rate of 10 percent) to $3,000 above the taxable wage base for employers in the eight other groups. The Department estimates that this proposal would generate an additional $3.1 million per year in UI tax revenues.

Chart 6
Distribution of Benefits and Contributions by Effective UI Tax Rates, 2010



The intent of this proposal is to increase contributions by employers who have had the greatest impact on the trust fund. All states will have a higher level of benefits charged when compared to their contribution levels, as is inherent in any insurance program. As a result, employers with less liability pay disproportionate taxes in order to adequately fund the program. For example, as shown on chart 6, Rhode Island employers who paid taxes with an effective rate of 2.0 percent or more (that is, taxes were 2.0 percent or higher as a percentage of payrolls) accounted for 47 percent of total UI contributions in 2010. At the same time, however, this group of employers also accounted for 63 percent of total benefits charged. The DLT notes that employers who would be affected by the proposal (that is, those who are paying the current 10.0 percent tax rate), account for 15 percent of total contributions and 28 percent of all benefits charged.

As noted above, this proposal would ensure that those that place the largest stress on the UI system pay more to support the system. However, companies with the highest experience rating also tend to be the most financially stressed. The State should consider whether this proposal would place an undue burden on already struggling companies and whether this would have a further negative economic impact in a time of economic distress.

Benefit Changes

Proposal 1

Beginning July 1, 2012, the department proposes to freeze the maximum weekly benefit (MWBA) at its current amount ($551, currently 67.0 percent of the statewide average weekly wage) and reduce the percentage used in calculating the benefit to 57.5 percent of the statewide average weekly wage (SAWW). The change would be phased in when the current maximum equals 57.5 percent of the SAWW. Once 57.5 percent of the SAWW is greater than $551, the maximum benefit would begin increasing. The MWBA was increased to the current 67.0 percent of the SAWW from 60.0 percent of the SAWW in 1987. Prior to that, the MWBA was increased from 50.0 percent to 60.0 percent of the SAWW in 1970.

The change would not have any immediate impact on benefit levels and would only affect future claimants. Based on department estimates, roughly 25 percent of current beneficiaries are eligible to collect the MWBA. The department estimates that this proposal would save, on average, $12.3 million per year (6.1 percent) when fully implemented.

In general, most organizations recommend against reductions in benefits in order to restore trust funds to solvency. However, within New England, only Massachusetts has a higher MWBA and the state's current MWBA is the 6th highest in the country. If this change were implemented this year, Rhode Island's MWBA would be the third highest in the region (behind Massachusetts and Connecticut), and would be the 10th highest in the country. This change would bring the State's benefits more in line with the region and with the rest of the country; however, any changes to benefits should not undermine the economic stabilization principles that undergird UI programs.

Proposal 2

The department also proposes reducing the weekly benefit calculation to replace 50.0 percent (3.85 percent of high quarter wages) of lost wages compared to the current 60.0 percent (4.62 percent of the highest quarter wages), effective July 1, 2012. This change is estimated to save 12.3 percent ($24.9 million) per year, on average, when fully implemented. The current wage replacement level was set in 1987 when it was increased from 55.0 percent. Prior to 1965, the wage replacement level was set at 50.0 percent.

As with the prior proposal, benefit changes are generally not recommended. However, Rhode Island's current wage replacement rate is among the highest in the country (tied with three other states to rank sixth highest). A large number of states (17) use a 50.0 percent wage replacement calculation in determining benefits. This change would rank the Ocean State 32nd and would be in line with the wage replacement rates in both Massachusetts and Connecticut.

Table 6
Maximum Weekly Benefit Amount & Wage Replacement

	MWBA	Rank	% Wages Replaced	Rank**
Alabama	$265	47	50.0%	32
Alaska*	370	34	50.0% - 60.0%	29
Arizona	240	49	52.0%	21
Arkansas	441	13	50.0%	32
California	450	12	50.0% - 56.5%	30
Colorado*	489	10	60.0%	6
Connecticut*	537	7	50.0%	32
Delaware	330	39	56.5%	15
Florida	275	45	50.0%	32
Georgia	330	39	61.5%	5
Hawaii	559	5	61.9%	4
Idaho	334	38	50.0%	32
Illinois*	385	28	47.0%	50
Indiana	390	27	55.0% - 65.0%	12
Iowa*	376	32	56.5% - 68.0%	13
Kansas	436	14	55.3%	18
Kentucky	415	23	68.0%	2
Louisiana	247	48	72.0%	1
Maine*	359	37	59.1%	10
Maryland*	430	16	54.2%	19
Massachusetts*	629	1	50.0%	32
Michigan*	362	36	53.3%	20
Minnesota*	377	31	50.0%	32
Mississippi	235	50	50.0%	32
Missouri	320	42	52.0%	21
Montana	422	22	49.4% - 52.0%	31
Nebraska	318	43	50.0%	32
Nevada	400	26	52.0%	21
New Hampshire	427	19	52.0% - 57.0%	14
New Jersey	600	2	60.0%	6
New Mexico*	380	29	60.0%	6
New York	405	25	50.0% - 52.0%	32
North Carolina	505	8	50.0%	32
North Dakota	431	15	50.0%	32
Ohio*	375	33	50.0%	32
Oklahoma	430	16	56.5%	15
Oregon	493	9	65.0%	3
Pennsylvania*	564	3	52.0% - 56.5%	17
Rhode Island*	**551**	**6**	**60.0%**	**6**
South Carolina	326	41	50.0%	32
South Dakota	309	44	50.0%	32
Tennessee*	275	45	50.0%	32
Texas	406	24	52.0%	21
Utah	451	11	50.0%	32
Vermont	425	20	57.5%	11
Virginia	378	30	52.0%	21
Washington	560	4	50.0%	32
West Virginia	424	21	52.0%	21
Wisconsin	363	35	52.0%	21
Wyoming	430	16	52.0%	21

* Indicates states that allow for dependent's allowances which are not relfected in these figures.
** Rank is calculated by the RI Dept of Labor & Training
SOURCE: US Dept of Labor; RI Dept of Labor & Training

Proposal 3

The department proposes changing the method of benefit computation from the claimant's highest quarter wages in the base period to the average of the two highest quarters. Individuals who work consistent work weeks with consistent wages would not be affected by this change; however, individuals with significant overtime in one quarter of the base period would see a reduction in benefits. Based on data from 2004-2008, the RIDLT estimates that this change would save approximately $4.1 million per year.

The majority of states (27) currently use the high quarter method to compute benefits. Thirteen states, including Connecticut,†† Maine, Massachusetts and Vermont use the multi-quarter method, which, in general, averages the two highest quarters. Of the remaining states, six use the claimant's annual wage and four, including New Hampshire, calculate benefits using the average weekly wage.

Because actual UI benefits vary across states based on a number of factors, there is no clear link between the benefit calculation method itself and total benefits. Further, the literature does not appear to give preference to any of the four computation methods. However, as noted above, claimants would not be affected by this change unless they earned a significant amount of overtime

†† Excepting construction workers whose benefits are computed using the high-quarter method.

during the high quarter. A review of changes in state unemployment legislation for the past few years indicates that no state has changed their method of computation.

Proposals 4-7

The remaining four proposals are projected to reduce benefit costs by roughly $7 million per year. The changes would affect maximum benefits, the treatment of severance pay, dependent's allowances and qualification criteria as follows:

- Reducing the maximum benefit calculation from 36.0 percent of total base period wages to 33.0 percent of base period wages ($2.4 million per year). Only those claimants who work less than 47 weeks per year and exhaust their benefits would be affected by this change. Currently, Rhode Island has one of the highest maximum benefit limits in the country ($17,732).

- Allocating severance pay over a number of weeks based on the claimant's weekly benefit amount, delaying the payment of UI benefits up to 26 weeks ($2.0 million per year). Rhode Island is the only New England state that does not use severance pay to reduce or delay the payment of UI

Table 7
Overview Trust Fund Solvency Proposals

Proposal	Description	Est. Savings/Revenue
Taxes		
1	Replace current tax base with a flexible formula tax base	$4.0 million/year
2	Increase the taxable wage base for the highest-rated employer group to $3,000 of the base for all other employers	$3.1 million/year
Total		*$7.1 million/year*
Benefits		
1	Freeze the MWBA at current level and reduce the percentage calculation to 57.5% of the SAWW	$12.3 million/year when fully implemented
2	Change the weekly benefit calculation to replace 50% of lost wages	$24.9 million/year when fully implemented
3	Use the average of the 2 highest-quarter wages instead of the highest quarter in the base period when calculating benefits	$4.1 million/year on average
4	Reduce the maximum benefit collection to 33% of base period wages from the current 36%	$2.4 million/year
5	Allocate severance pay over a number of weeks based on the claimant's weekly benefit amount to delay payment of UI benefits*	$2.0 million /year
6	Reduce the maximum dependent's allowance percentage from 5% to 3% per dependent	$2.7 million/year
7	Raise the qualification for voluntary quits, misconduct and discharges, and refusals of suitable work to 8 weeks of work with earnings equal to the claimant's weekly benefit amount	No estimate
Total		*up to $48.4 million/year*
Total Savings		**up to $55.5 million/year**

* Up to 26 weeks

SOURCE: RI Department of Labor and Training "Proposal to Restore Unemployment Insurance Trust Fund Solvency", revised November 26, 2010 benefits. The RIDLT indicates that 19 states (out of 32 responding) deduct severance pay and two states deduct severance pay in special circumstances.

- Reducing the maximum dependent's allowance percentage from 5.0 percent per dependent to 3.0 percent per dependent ($2.7 million per year). Nationally, only 13 states provide additional benefits for dependents. Connecticut, Maine and Massachusetts all provide allowances for dependents; however, Rhode Island's current 5.0 percent allowance is the highest in the region ($27 per dependent per week). This change would reduce the allowance to $16 per dependent per week, the second-highest in the region (behind Massachusetts at $25 per dependent per week).

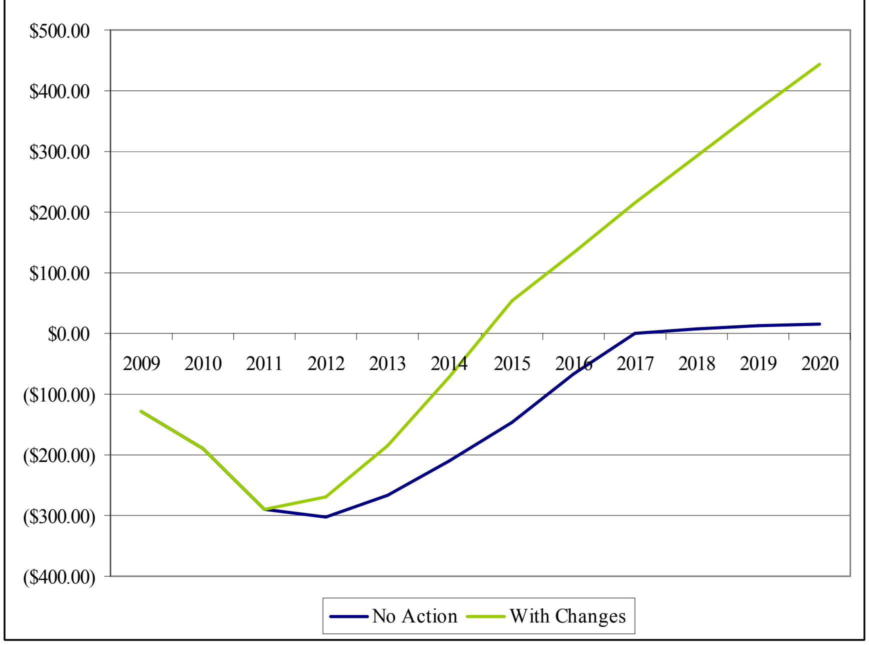
- Raising the requalification criteria for voluntary quits, misconduct and discharges and refusals of suitable work to eight weeks of work with earnings equal to the claimant's weekly benefit amount. While the Department is unable to estimate the savings from this proposal, it would ensure that high-wage earners would need to earn more money than low-wage earners to overcome their disqualification. The majority of states use the weekly benefit amount in determining disqualifications.

As noted earlier, in general, analysts recommend against changing benefits; however, as with the other benefit changes proposed by the Department, these changes, in general, bring Rhode Island benefits more in line with the rest of the country and the region. In particular, tightening the requalification criteria appears to be a common action across states looking to restore solvency.

RIPEC Comments

Trust fund insolvency in Rhode Island is not unique, nor are the factors that led to insolvency. Around the country, states are struggling to repay significant loans to the federal government or face significant increases in taxes during a time of economic and fiscal hardship. There is no question that the current system must be reformed in order to restore the State to a solvent position, reduce employer taxes, and to ensure that Rhode Island's trust fund is in a

Chart 6
UI Trust Fund Balance 2009 - 2020



stronger position to weather the next economic downturn.

The proposals presented by the RIDLT reflect similar proposals across the country and reflect the reality that the fund will likely not be restored to solvency without a combination of modernization of the financing structure, and modifications to the benefit structure. Chart 6 shows the estimated trust fund balance with no action by the State, and if all the Department's proposals were enacted. With no action, the fund would be restored to solvency in 2017 although the balance would remain low and would still be below $20 million in 2020. If there were another economic downturn, the State would again be forced to borrow from the federal government. According to the DOL "State Trust Fund Solvency Calculator" (using 2009 Q4 data), the projected 2020 trust fund balance would result in an AHCM of 0.04 and a reserve ratio of 0.12 percent.

If all of the Department's proposals were enacted, solvency would be restored in 2015, two years earlier than without action. However, the fund balance is projected to increase at a faster rate, and the State's UI trust fund would be in a significantly stronger position in the event of another recession. Using the DOL "State Trust Fund Solvency Calculator", the State would achieve an AHCM of 1.07 in 2020 with a fund balance of $443.5 million and a reserve ratio of 3.27 percent (using 2009 Q4 data).

RIPEC recommends that the State evaluate these proposals using the following criteria:

- Do the changes support the economic theory behind unemployment insurance?
- Will the adjustments present undue hardship to businesses or employees through increased costs?
- Is it possible to achieve a more equitable financing structure through these modifications?
- How does the State's financing structure and benefits compare within the region and nationally? Would these changes bring the State more in line with the rest of the region and the country?
- Are these changes in line with what other states are proposing?
- What are additional or other changes that should be considered (e.g., exploring the possibility of bonding to repay the federal loan in order to avoid the FUTA penalty)?
- Should the State look into ways of providing unemployment insurance tax relief for companies that are re-hiring?
- What are the implications for businesses if action is not taken or if there is a delay in action?