CALIFORNIA
▪ BUDGET PROJECT ▪

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BUILDING A SOUND FOUNDATION FOR CALIFORNIA'S UNEMPLOYMENT INSURANCE SYSTEM
KEY FINDINGS AND RECOMMENDATIONS

California's Unemployment Insurance Trust Fund Faces Insolvency

- California' Unemployment Insurance (UI) trust fund lacks sufficient resources to pay benefits owed to jobless workers. The state expects to begin borrowing from the Department of Labor to meet its obligations in April 2004.

- The financial crisis in California's unemployment insurance system stems from the fact that the system is structurally incapable of generating sufficient revenues to pay the benefits owed to unemployed workers during an economic downturn. In 2004, the Employment Development Department predicts that, even on the highest F+ tax rate schedule, the gap between employer contributions of just under $5.0 billion and benefits payments of over $6.8 billion will equal $1.9 billion. In 2005, if no changes are made to the system, the gap between employer contributions of $5.1 billion and benefit payments of $6.5 billion will equal $1.4 billion.

- Among the roots of the problem is the state's low "taxable wage base" – the maximum amount of a workers' wages on which an employer must pay UI taxes. California's taxable wage base has remained fixed at $7,000, the minimum allowed by federal law, since 1983. In the second quarter of 2003, California was one of ten states with a taxable wage base of $7,000. In contrast, 24 states had a taxable wage base between $7,001 and $12,000; seven states had a taxable wage base between $12,001 and $20,000; and nine states – including Oregon, Washington, and Nevada – had a taxable wage base of $20,001 or higher. As a percentage of average annual wages, California's taxable wage base is the lowest among the 50 states.

- In 1983, taxes paid into the UI trust fund equaled $1.6 billion, while benefits paid out of the trust fund totaled $2.2 billion. By 2002, payments into the trust fund had increased to $2.6 billion (65.4 percent), while benefits had increased to $5.6 billion (161.7 percent). By keeping the taxable wage base constant, increases in trust fund revenues were driven almost entirely by a rise in the number of covered employees. Benefit payments, on the other hand, rose due to an increase in the number of persons drawing benefits as the labor force expanded, wage increases (thereby boosting benefit payments owed to jobless workers), and benefit increases enacted in 1989 and 2001.

California's Unemployment Insurance System in Context

- California's UI benefits are moderate in comparison to those of other states. In the fourth quarter of 2003, California ranked 28th among the states with respect to average weekly UI benefits. California's average weekly benefit was $250.69 as compared to the US average of $261.44. In mid-2003, California's average weekly UI benefit replaced only 31.4 percent of the average weekly wage of UI recipients. On this wage replacement measure, California ranked 45th among 50 states.

- California ranks modestly higher than other states with respect to the share of jobless workers who receive UI benefits. In 2003, 15 states had a higher UI "recipiency rate" than did California. The recipiency rate reflects the number of insured unemployed in the regular UI program as a percentage of the total unemployed workforce.

- Employer contributions to California's UI system have declined as a share of total wages. In 1967, during Governor Reagan's first year in office, UI taxes stood at 1.58 percent of total wages. In 2002, the last year for which a full year's worth of data is available, the UI taxes paid by California employers were 0.53 percent of total wages, just one third of the 1967 level.

Unemployment Insurance Eligibility Requirements Disadvantage Low-Wage Workers

- California's UI eligibility requirements do not take into account workers' earnings during the current and most recently completed calendar quarters. Evidence suggests that this practice disadvantages low-wage workers. Today, 18 states and the District of Columbia use "alternate base periods" to include workers' more recent earnings. Three of these states (Hawaii, New Mexico, and Virginia) adopted an alternate base period during 2003.

Restoring the Foundation of California's Unemployment Insurance System

- Policymakers should raise California's UI taxable wage to at least the average of the 50 states. This will allow the trust fund to bring in sufficient revenues to pay benefits owed to jobless workers. In the second quarter of 2003, the average of the 50 states was $12,768, as compared with California's $7,000.

- California's policymakers should also index the taxable wage base – that is, adjust it annually to reflect changes in average weekly wages. Without indexing, a capped taxable wage base will prevent the UI trust fund from meeting the demands of a changing labor force.

- Policymakers should consider modifications to the state's tax rate schedule that move the UI system toward greater solvency. For example, the solvency of the UI trust fund could be improved by requiring a larger reserve in order to trigger a movement to a lower UI tax rate schedule.

- California should adopt a system-wide solvency goal to inform future UI policy debates. For example, if policymakers were set an "average high cost multiple" of 1.0 to 1.5 as a goal, this would mean that the trust fund would have a reserve sufficient to cover 12 to 18 months of benefit payments at any time, sufficient to meet the challenge of a serious economic downturn.

- California should follow the lead of 18 other states by adopting an alternate base period. This action would make the state's unemployment insurance eligibility rules more fair to low-wage workers.