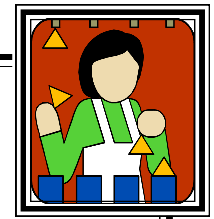

Making the Unemployment Insurance System Work For California's Low Wage Workers

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CALIFORNIA BUDGET PROJECT

The **California Budget Project** (CBP) was founded in 1994 to provide Californians with a source of timely, objective and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low and middle income Californians. Support for the CBP comes from foundation grants, publications, and individual contributions. Grants from the Rosenberg, Ford, Friedman Family, and Charles Stewart Mott Foundations supported the preparation of this report. This report was updated by Jean Ross, based on a report originally written by Diana Meredith.

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Executive Summary

California's Unemployment Insurance (UI) system fails to meet the needs of many of the state's low wage workers. While the UI system is often viewed as a universal safety net, fewer than half of the state's workers collect benefits if they become unemployed. Elements of the program's design, such as high earnings requirements and delays in counting earnings toward eligibility, force many Californians to turn to public assistance or face substantial hardship when they lose a job through no fault of their own. Ironically, employers of low wage workers confront a higher tax burden than employers of higher waged persons, yet low wage workers are least able to obtain assistance if they become jobless.

Making The Unemployment Insurance System Work For California's Low Wage Workers outlines a policy agenda for restoring the unemployment insurance system as a resource for all California workers. Before the recent changes in state and federal welfare law, individuals suffered no penalty for relying on public assistance rather than UI during periods of joblessness. New laws limiting the lifetime receipt of welfare benefits to sixty months increase the importance of identifying the appropriate safety net for individuals who lose their jobs. For an individual who loses her or his job, UI benefits may avert the need to claim time limited welfare. For states, the shift from an open-ended match of state and federal welfare dollars to a system where states receive a fixed allotment of federal assistance creates a financial incentive to shift costs out of public assistance programs to programs funded from other revenues.

Recommendations

- ***Implement a movable base period.*** California should join eight other states in adopting a base period that reflects modern technology. The existing base period structure is especially hard on low wage workers, since they have to work longer in order to qualify for benefits and are more likely to suffer if their recent earnings are not considered when determining eligibility.

- ***Establish adequate wage replacement levels.*** California's wage replacement rate, measured by the average weekly benefit divided by the average weekly wage, is the lowest in the nation. For many jobless workers, low UI benefit levels constitute a particular hardship. California should, at a minimum, meet the federal target of replacing 50 percent of lost earnings. Higher replacement levels for those with relatively low earnings can help ensure that UI benefits are sufficient to cover basic living expenses for those who lose their job.

- ***Raise the taxable wage base to at least the national average.*** Equity considerations argue in favor of increasing the taxable wage base, even in the absence of expanded benefits. Thirty-eight states currently have taxable wage bases higher than California. In 2000, the average taxable wage base was $11,914, in comparison to California's base of $7,000.

- ***Adopt a $300 quarterly earnings requirement.*** Unemployment insurance taxes apply to the first dollar of employees' earnings, yet workers are not eligible for benefits until they earn at least $900 and, under most circumstances, $1,300. Reducing minimum earnings requirements will extend coverage to many low wage and part-time workers who are currently denied access to unemployment insurance.

Introduction

For more than 60 years, the Unemployment Insurance (UI) system has provided income support to workers who lose their jobs. For nearly as long, people have debated the purpose of the program. UI provides income security to individuals, stabilizes the economy during recessions, and provides an incentive to firms to minimize layoffs. Differing views of the program's primary objective lead to varying interpretations of a well-documented nationwide trend: the proportion of unemployed workers claiming UI benefits has declined over the past half century, from nearly 50 percent to approximately 35 percent.[1] While, on average, California workers are somewhat more likely to receive UI benefits than those in the nation as a whole, the state's recipiency rate (43.0 percent) remains below historic rates.[2] The large share of the unemployed who do not receive UI raises important policy questions with respect to who among the unemployed are not receiving benefits, why, and whether state action is needed to change this situation.

Who Pays for Unemployment Insurance?

State and federal taxes levied on employers fund the UI system. A 0.8 percent federal tax on the first $7,000 of each covered employee's wages pays for program administration, a portion of extended benefits, and other federal costs.[3] The state tax, which primarily funds regular UI benefits, is a variable, "experience rated" tax. Under experience rating, tax rates vary based on the system's costs attributable to a particular employer. Just as automobile drivers who cause the most accidents pay the highest insurance premiums, firms that "cause" unemployment through layoffs pay higher taxes.

Federal policy encourages states to set maximum tax rates of at least 5.4 percent and to use a taxable wage base of at least $7,000.[4] Thirty-three states and the District of Columbia had higher maximum tax rates and forty states and the District of Columbia had higher taxable wage bases in 2000.[5] California, however, caps UI tax rates at 5.4 percent and uses a taxable wage base of $7,000 (Table 1).

Federal law requires coverage of virtually all wage and salary employees within the UI system. California wage and salary employees excluded from the regular UI system include ministers and other individuals employed for religious purposes, certain household workers, elected officials, and family members employed by partnerships or sole proprietorships. Employers who pay less than $100 in wages during a calendar quarter are also exempt from paying UI taxes.[6]

In a perfectly experience-rated system, each firm's state tax payments would equal the UI benefits paid to its former workers. In reality, some costs are spread evenly among all employers.

GLOSSARY OF TERMS

Base period: A yearlong span of work history used to determine whether a UI applicant has sufficient earnings to qualify for benefits.

Experience rating: The practice of tying the tax rate imposed on an employer directly to the amount of benefits paid to that employer's former employees.

Ineffectively charged benefits: UI payments that are not charged directly to the claimant's employer because that employer already pays the maximum tax rate.

Monetary criteria: The minimum level of recent earnings (or hours or weeks worked, in some states) a claimant must demonstrate in order to be eligible for UI benefits.

Non-charged benefits: UI payments that are not charged directly to a claimant's employer because the employer was not responsible for the loss of employment.

Non-monetary criteria: Guidelines set by the state to limit benefits to claimants who can demonstrate they are out of work through no fault of their own, are able and available to work, and are actively seeking work.

Taxable wage base: The maximum amount of a worker's wages on which an employer must pay taxes.

Table 1: California's Taxable Wage Base is the Lowest in the Nation as A Percentage of Average Pay				
State	Maximum 2000 Tax Rate	2000 Taxable Wage Base	1999 Average Annual Pay	Taxable Wage/Average Pay
Hawaii	5.40%	$27,500	$29,771	92%
Alaska	5.94%	$24,800	$34,034	73%
Idaho	5.40%	$24,500	$26,042	94%
Washington	5.40%	$24,300	$35,736	68%
Oregon	5.40%	$23,000	$30,867	75%
New Jersey*	5.40%	$21,200	$39,516	54%
Utah	8.00%	$20,200	$27,884	72%
Nevada	5.40%	$19,600	$31,213	63%
Minnesota	9.10%	$19,000	$33,487	57%
Montana	9.55%	$17,700	$23,253	76%
Iowa	7.50%	$17,300	$26,939	64%
North Dakota	6.49%	$16,100	$23,753	68%
Connecticut	5.40%	$15,000	$42,653	35%
New Mexico	5.40%	$14,800	$26,270	56%
North Carolina	5.70%	$13,900	$29,453	47%
Wyoming	8.78%	$13,600	$25,639	53%
Rhode Island	9.81%	$12,000	$31,177	38%
Maine	5.81%	$12,000	$26,887	45%
Massachusetts	7.23%	$10,800	$40,331	27%
Wisconsin	8.50%	$10,500	$29,597	35%
Colorado	5.62%	$10,000	$34,192	29%
Oklahoma	5.40%	$9,800	$25,748	38%
Michigan	8.10%	$9,500	$35,734	27%
Ohio	8.00%	$9,000	$31,396	29%
D. of Columbia	7.00%	$9,000	$50,742	18%
Illinois	6.80%	$9,000	$36,279	25%
Arkansas	6.40%	$9,000	$25,371	35%
Texas	6.27%	$9,000	$32,895	27%
Delaware	8.30%	$8,500	$35,102	24%
New York	8.30%	$8,500	$42,133	20%
Maryland	7.50%	$8,500	$34,472	25%
Georgia	5.40%	$8,500	$32,339	26%
Pennsylvania	9.07%	$8,000	$32,694	24%
West Virginia	8.50%	$8,000	$26,008	31%
Kentucky	8.25%	$8,000	$27,748	29%
Kansas	7.40%	$8,000	$28,029	29%
New Hampshire	6.50%	$8,000	$32,139	25%
Vermont	5.90%	$8,000	$27,595	29%
Alabama	5.50%	$8,000	$28,069	29%
Virginia	5.40%	$8,000	$33,015	24%
Missouri	6.00%	$7,500	$29,958	25%
Tennessee	10.00%	$7,000	$29,518	24%
South Dakota	7.00%	$7,000	$23,765	29%
Louisiana	6.20%	$7,000	$27,221	26%
Indiana	5.50%	$7,000	$30,027	23%
Mississippi	5.40%	$7,000	$24,392	29%
Nebraska	5.40%	$7,000	$26,633	26%
South Carolina	5.40%	$7,000	$27,124	26%
Florida	5.40%	$7,000	$28,911	24%
Arizona	5.40%	$7,000	$30,523	23%
California	5.40%	$7,000	$37,564	19%
Average of states	**6.71%**	**$11,914**	**$33,313**	**36%**

*New Jersey average annual pay for 1998.
Source: Department of Labor, Employment and Training Administration, SESA Tax Statistics 2000
Department of Labor, Bureau of Labor Statistics, Average Annual Pay for 1998 and 1999

One source of these costs is “ineffective charges,” which are UI payments attributable to a specific employer but not charged directly to him or her because he or she already pays the maximum tax rate. All employers pay for excess charges to these employers’ accounts.

Other costs that are not subject to experience rating include “non-charged benefits,” which reflect UI payments made to unemployed workers that are not attributable to a particular employer. An example of non-charged benefits is a payment to an employee who leaves a job to accompany a spouse to a new location. Individuals who relocate under these circumstances are eligible for UI, but any benefits paid are not charged to an employer since that firm was not responsible for the employee’s loss of work. California has a very low percentage of non-charged benefits. In 1997, California’s rate of non-charged benefits, 7.1 percent, ranked thirty-seventh among the 44 reporting states.[7]

Employers Do Not Always Bear the Full Cost of Their Employment Decisions

Like most states, California limits the amount it charges a specific employer for UI benefits paid to that firm’s former workers. If a business incurs UI costs that exceed the contributions generated by the maximum tax rate, the system spreads excess costs among the state’s remaining employers. These costs are called ineffectively charged benefits. California has a relatively high rate of ineffectively charged benefits. In 1997, 21.7 percent of total UI benefits paid in California were ineffectively charged benefits, the thirteenth highest rate among the 44 reporting states.[8] This reflects the sizeable number of employers that pay the maximum tax rate due to the frequency with which they cause unemployment.

The Experience Rating Index is a measure of the overall degree to which the costs of a state’s UI system are passed on to employers based on the costs specific employers impose on the system. California’s score was 59 percent in 1997, meaning that 59 percent of the benefits paid in California in 1997 were charged to specific former employers, down from 68 percent in 1990.[9] California’s Experience Rating Index ranked twentieth among the 44 reporting states in 1997.

When experience rating is weak, industries with relatively stable employment patterns subsidize the UI costs of more cyclical industries.[10] A low degree of experience rating undermines the UI system’s ability to encourage stable employment by allowing employers that cause unemployment to pass on a portion of the cost of higher UI premiums to employers with stable employment. Research suggests that experience rating influences employer behavior: the higher the degree of experience rating, the lower the rate of temporary layoffs. This benefit, however, carries a potential cost: employers may be reluctant to hire new workers.[11]

California’s Unemployment Insurance System

Number of initial claims filed, 2000:	2,490,632
Total benefits paid, 2000:	$2,522,557,632
Average duration of claims, 2000:	16.1 weeks
Minimum benefit amount:	$40 per week
Maximum benefit amount:	$230 per week
Tax rate charged new employers	3.4 percent

Non-monetary qualifications for benefits include:

- Claimants must be unemployed through no fault of their own
- Claimants must be able and available to work
- Claimants must be actively seeking work

Employees Bear Part of the UI Tax Burden

Although employers formally pay UI taxes, economists argue that firms are able to pass along at least part of the burden of the tax to workers in the form of lower wages. Employers are most able to pass along the parts of the tax that apply to every firm and the parts that do not vary based on employers' experience (the "flat" parts of the tax).[12] The federal tax is a flat tax, as is the portion of an employer's tax bill that reflects the firm's cost share of non-charged and ineffectively charged benefits. Employers are much less able to shift the portion of the tax that reflects a firm's own experience rating. Policy changes or other factors that increase the proportion of non-charged and ineffectively charged benefits result in employees bearing a large share of the UI tax burden. Consequently, policy changes that affect all employers equally do not place employers at a competitive disadvantage with respect to other firms in the state.

California's Tax is Highest on Low Wage Workers

California's low taxable wage base makes the UI tax a regressive tax. Employers pay the tax on the full amount paid to workers making $7,000 or less per year, but not on amounts paid in excess of $7,000 per year. As a result, employers of workers with higher earnings are taxed on a fraction of their total wages. Low wage workers and their employers therefore pay a higher real UI tax rate. Take, for example, two workers at different firms both taxed at the rate of 3.4 percent, the rate currently imposed on new employers.[13] One of the workers – a part-time receptionist – earns $7,000 a year. The other, an accountant, makes $50,000 a year. The employers pay $238 in UI tax on behalf of each employee. However, the $238 paid on the wages of the receptionist equates to a tax rate of 3.4 percent. The same dollar figure amounts to a 0.5 percent tax rate on the earnings of the accountant.

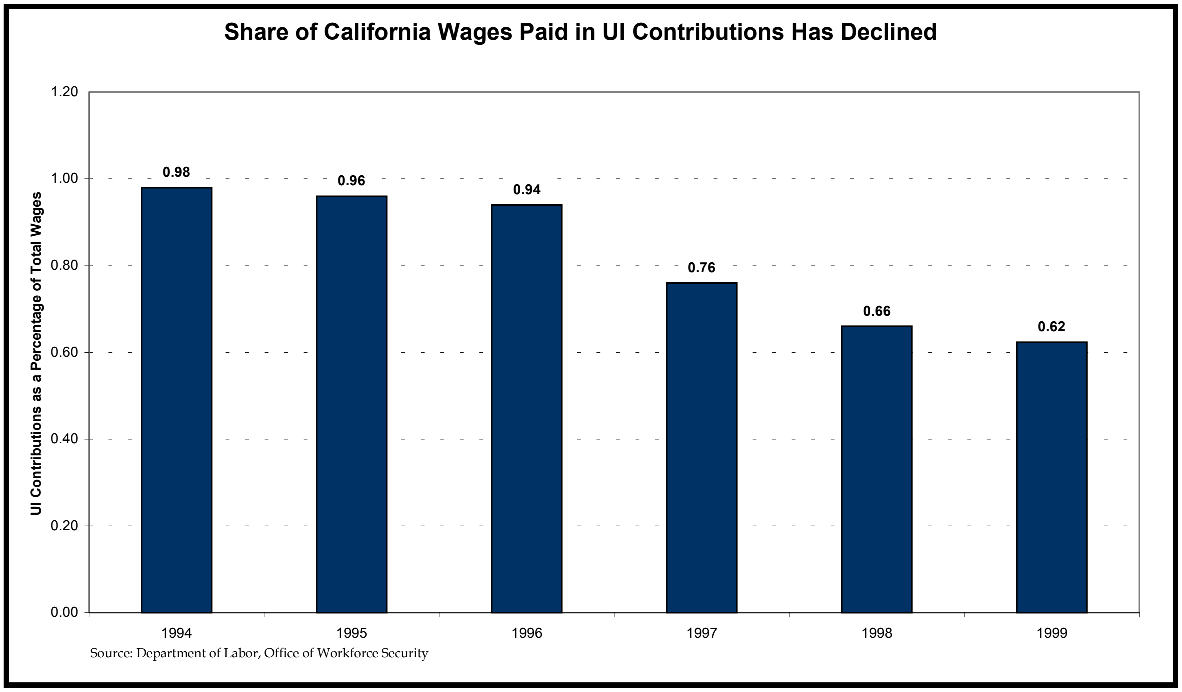
Most states' taxable wage bases are above $7,000. Seventeen states index their taxable wage bases to some percentage of their average annual state wages.[14] The taxable wage base in these states ranges from 100 percent of the average wage in Hawaii and Idaho to 50 percent of the average wage in Oklahoma and North Carolina. California's 2000 taxable wage equals 19 percent of 1999 average annual pay, the lowest in the nation, except for the District of Columbia (Table 1). California's current system imposes a greater burden on employers of low wage workers, while levying a lower tax on those who hire higher paid employees. Yet, as will be described below, lower wage workers are least able to access the system when they lose their jobs.

The Cost of the Unemployment Insurance System Has Declined

California employers' contributions to the UI system have declined as a share of total wages. The share of total wages paid in UI contributions fell from 0.98 percent in 1994 to 0.62 percent in 1999, a drop of 36 percent.[15] Put another way, employer contributions would have been $1.5 billion higher in 1999 had the contribution rate continued at 1994 levels. Actual contributions declined by $715 million between 1996 and 1999 despite an increase in employment of over a million persons, reflecting lower demands on the system as unemployment rates dropped during the last half of the 1990s.

Program Design Excludes Many Low Wage Workers

Over the past fifty years, the share of jobless American workers receiving unemployment benefits fell from nearly half during the 1950s to 35 percent in the late 1990s.[16] Researchers attribute the national decline to several factors.[17] First, the shares of both manufacturing and unionized jobs, which are traditionally associated with higher rates of UI recipiency, have declined as a share of the total workforce. Second, the proportion of the workforce made up of women and young workers has increased. These groups are statistically less likely to receive UI due to their lower earnings. The impact



of this demographic change declined after 1980. Finally, states have tightened eligibility requirements for benefits.

Low wage workers are significantly less likely to receive UI benefits than their higher paid counterparts. A recent study by the General Accounting Office, a research agency that reports to Congress, found that approximately 18 percent of unemployed low wage workers received benefits in 1995 as compared to 40 percent of the higher waged unemployed.[18] UI receipt was significantly lower among unemployed low wage workers even when compared to higher wage workers who had worked for similar periods before losing their jobs.[19] Only 34.7 percent of low wage workers who had worked 35 weeks or more before losing their jobs received UI as compared to 61.9 percent of their higher paid counterparts. Women and part-time workers are also less likely to receive UI benefits when they lose their jobs.[20]

The lower rate of UI recipiency among low wage workers is particularly noteworthy in several respects. First, unemployment rates are higher among this group as compared to the workforce as a whole.[21] Second, the share of the California workforce employed at low-wages is large and has expanded over the past decade. In 1999, 28.7 percent of the California workforce earned less than $8.19 per hour as compared to 24.0 percent earning the inflation adjusted equivalent a decade before.[22]

Factors that contribute to the low levels of UI recipiency among low wage workers include the period of time used to established eligibility for benefits and the fact that low wage workers are disproportionately represented in industries with low rates of UI recipiency, low rates of unionization, and minimum earnings requirements.

Definition of the Base Period

One factor contributing to declining coverage is the structure of the base period used to determine eligibility. California law bases eligibility for benefits on an individual's earnings during the first four of the past five completed calendar quarters. This definition ignores any amounts earned during the quarter in progress and the most recently completed quarter (Table 2). A person with substantial recent work history may be denied UI benefits — or experience a delay in receiving benefits — due to insufficient work history within the base period. Take, for example, a person attempting to establish a claim

Table 2: Base Period Definition Ignores Recent Work History	
For Claims Beginning In:	**The Base period Ends the Previous:**
February, March, April	September 30
May, June, July	December 31
August, September, October	March 31
November, December, January	June 30

Source: Employment Development Department, *For Your Benefit*, DE 2320 Rev. 43 (6-95)

during June of 2001. That person's eligibility is based on the amount earned between January 1 and December 31 of 2000.

The rationale for a lag between the base period and the point a person loses his or her job dates to the time before electronic payrolling and data transmission when employers mailed information to state employment departments and workers then manually keyed information into the department's database.[23] Delays in data availability can be shortened if employers report wage information electronically, rather than on paper. In 2000, 64 percent of California payroll taxes were remitted electronically, a figure that has increased substantially in recent years.[24]

Twelve states use alternative or movable base periods to calculate eligibility for workers who do not meet regular base period monetary requirements.[25] A 1995 study sponsored by the US Department of Labor estimates that adoption of a movable base period increases the number of eligible applicants by 6 to 8 percent.[26] The study also found that low wage, part-time, and intermittent workers benefit disproportionately from adoption of a movable base period. Implementation of a movable base period affects a state's UI trust fund balance in the first year as benefit payments increase, but the effect declines over time.[27] Other states' experiences suggest that movable base periods result in some additional administrative costs, although states with movable base periods could not estimate the magnitude of these cost increases.

Minimum Earnings Requirements

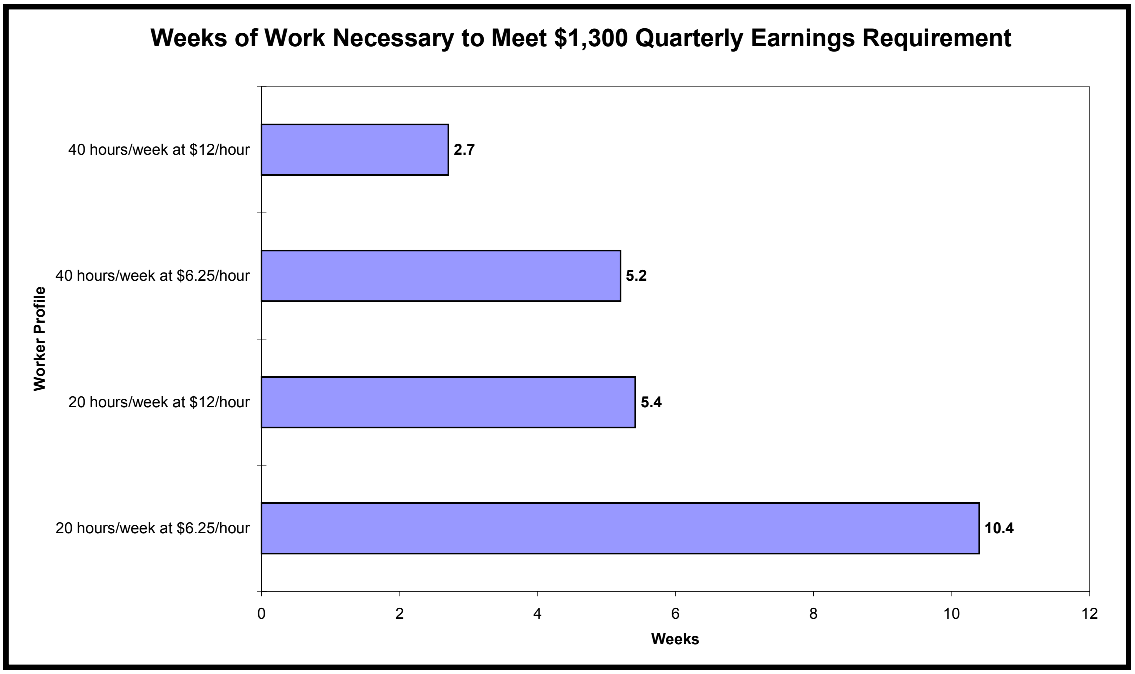
During the 1980s, federal policy changes and financial distress affecting a number of state UI trust funds led many states to reduce benefit costs by tightening monetary eligibility requirements and reducing benefit levels.[28] These actions resulted in a sharp decline in the share of unemployed qualifying for benefits.

California diverged from the national trend, with recipiency rates remaining steady as the state maintained relatively low minimum earnings requirements for most of the decade.[29] The state tightened eligibility in 1990 as part of a compromise that also increased maximum benefit levels. Prior to 1990, California required applicants to have total earnings of at least $900 during the base period and at least some earnings from work in at least eight calendar weeks of the base year in order to qualify for UI. Applicants now must earn at least $900 in one calendar quarter of the base year and have total base-year earnings of at least 1.25 times the highest quarter wages in order to qualify for benefits.[30] Alternately, applicants can qualify with earnings of at least $1,300 in their highest quarter. Lack of sufficient base period earnings resulted in denial of approximately 18 percent of California's 1.5 million new claims for UI benefits filed in 2000.[31]

Who is Most Affected by Earnings Requirements and Lagged Base Periods?

Part-time workers are less likely to meet the earnings requirements for UI compensation. Thirty-six percent of unemployed part-time workers fail to meet monetary eligibility requirements, compared to 8 percent of unemployed full-time workers.[32] Part-time workers are also much more affected by lagged base periods.[33]

The structure of California's system makes it difficult for part-time workers to qualify for UI benefits. Part-time workers need more months on the job than full-time workers earning the same wage to accumulate sufficient earnings to qualify for assistance. A worker employed for 20 hours a week at $6.25 per hour must work 10.4 weeks to earn sufficient wages to meet the $1,300 earnings test. However, none of those earnings would appear in the employee's base period immediately, due to the four to seven-month lag between the time wages are earned and the date they enter base period calculations. Therefore, a half-time minimum wage worker must work at least seven months in order to qualify for UI benefits at the time of separation. Full-time and higher paid employees qualify after a significantly shorter period of employment). A full-time worker earning $12 per hour, for example, earns sufficient wages to meet the earnings test in 2.7 weeks, or just over five months taking the lagged base period into account.

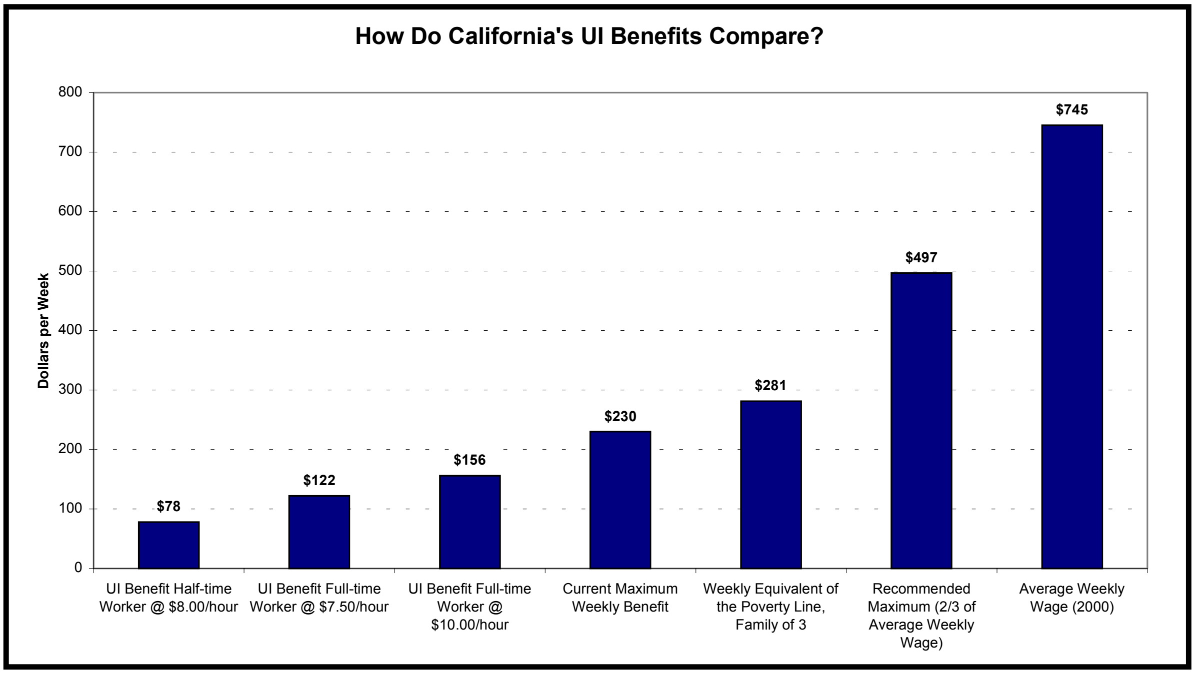


Benefits for All Workers Fail to Meet Recommended Standards

What constitutes an adequate benefit level is the subject of ongoing controversy. All states link benefit levels to prior earnings by calculating the amount received as a percentage of past earnings. In addition, all states cap maximum benefit levels. Finally, the UI system functions as a social insurance system providing benefits based on a presumption of need.[34] While the federal government has set a goal of replacing 50 percent of lost wages through UI benefits since 1935, it has never required states to meet this threshold. More recently, President Richard Nixon proclaimed that UI should replace at least 50 percent of lost wages for at least four-fifths of those who lose their jobs. This standard has become known as "one-half for four-fifths."[35] Other researchers define the optimal benefit level as one that provides sufficient income to cover essential living expenses while preventing undue hardship.[36]

Ideally, benefit levels should provide a balance between providing sufficient income for covering necessary expenses and creating an incentive for the jobless to return to work. The federal Advisory Council on Unemployment Compensation estimates that states can achieve 50 percent replacement for most workers by setting the maximum weekly benefit equal to two-thirds of a state's average weekly wage.[37]

California's maximum weekly benefit ($230) is the fifth lowest in the nation and the state's average weekly benefit ($160.71), as a percentage of average weekly wages, is the lowest in the nation (21.6 percent).[38] California's benefits levels are low, in large part, due to their failure to keep pace with inflation. The state's benefit levels have not been increased since January 1, 1992, the last installment of a series of increases signed into law in 1989.[39] A maximum benefit of $284 per week would be needed in 2001 to simply maintain the same purchasing power as in 1992. In order to comply with the federal Advisory Committee's recommendation that the maximum benefit should equal two-thirds of the state's average weekly wage, California would have needed a weekly maximum benefit of $497 in 2000.[40]

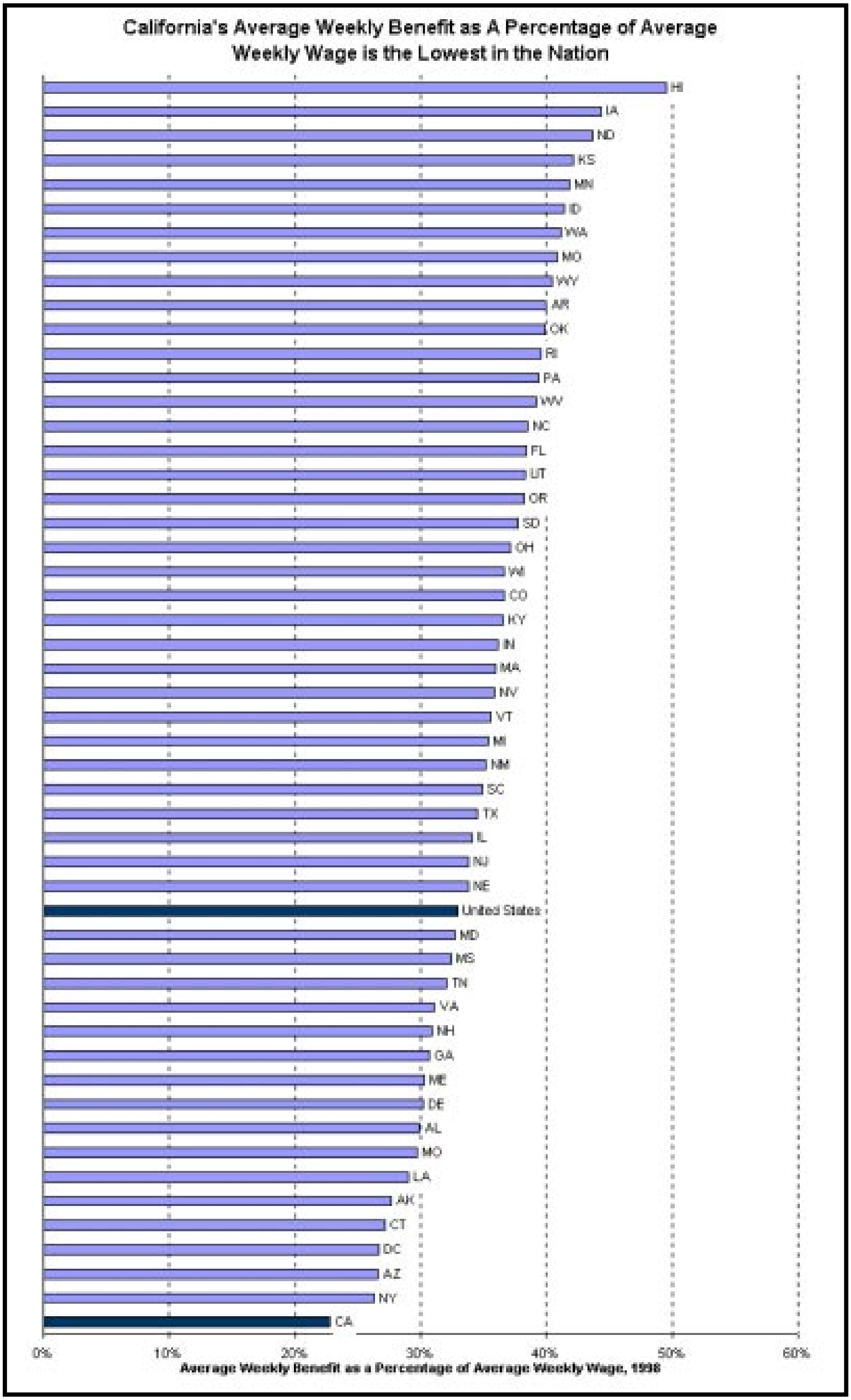


Thirty-one states and the District of Columbia index maximum benefit payments to average wage levels to ensure that benefit levels keep pace with inflation.[41] Indexing helps maintain the purchasing power of UI benefits as prices increase due to inflation. The fifteen states with the highest average weekly benefit as a percentage of average weekly wage all index benefit levels. In contrast, only two of the ten states with the lowest average weekly benefit as a percentage of average weekly wage index benefit levels for inflation.

For low wage workers, low replacement rates create a double hardship, since benefits replace only a fraction of already low earnings. California's UI system does replace a greater share of the earnings of low wage workers than it does for those at higher income levels. However, few individuals receiving minimum or near minimum benefit payments can subsist on UI alone: $40 per week for claimants meeting the minimum earnings requirement.

The Intersection of Welfare and the Unemployment Insurance System

Low earnings, part-time work, and frequent cycling between employment and assistance frequently characterize the transition from welfare to work.[42] While little is known about the prospects of those who have left the welfare rolls for employment since the enactment of welfare reform, historically a


California's Average Weekly Benefit as A Percentage of Average Weekly Wage is the Lowest in the Nation
HI
IA
ND
KS
MN
ID
WA
MO
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OK
RI
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WV
NC
FL
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OR
SD
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SC
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IL
NJ
NE
United States
MD
MS
TN
VA
NH
GA
ME
DE
AL
MO
LA
AK
CT
DC
AZ
NY
CA
0%
10%
20%
30%
40%
50%
60%
Average Weekly Benefit as a Percentage of Average Weekly Wage, 1998

significant percentage of individuals, about 35 percent, who left welfare returned to the rolls after losing a job or suffering another financial setback.[43] Recent changes to state and federal welfare laws impose a five-year lifetime limit on welfare benefits and require individuals to quickly transition into work or work-related activities. Enabling former welfare recipients to obtain assistance through UI, rather than welfare, when they lose a job prevents individuals that have found work and lost it due to no fault of their own to avoid using time limited welfare benefits.

Historically, individuals who have left welfare for work have experienced difficulty accessing the unemployment system when they lose their jobs. One national study of single mothers on welfare between 1984 and 1990 found that 43 percent of single mothers who received Aid to Families with Dependent Children (AFDC) for at least two out of 24 months also worked at some point during those two years. Those with employment worked an average of 910 hours per year, the equivalent of slightly less than a half-time job. However, only 11 percent of those who worked received UI benefits at any time in the two-year period.[44] The same study found that single mothers who received UI worked more hours and spent fewer months on AFDC than those who did not receive UI. However they received, on average, only $100 less per year in AFDC payments than AFDC mothers who did not receive UI. In California, the Employment Development Department (EDD) estimated that more than half of the applicants who would have been eligible for UI under a movable base period in 1995 were receiving welfare. Supporting these households with UI, rather than welfare, would have reduced welfare costs by as much as $41 million, depending on the structure of the base period adopted.[45] Similarly, EDD estimated that lowering the minimum earnings requirement to $300 per quarter together with instituting a movable base period would reduce welfare spending in California by an estimated $150 million per year.[46]

Options for Expanding Eligibility

California's Unemployment Insurance system fails to meet the needs of many of the state's neediest jobless. Relatively strict monetary requirements hinder the ability of many low wage and part-time workers to obtain benefits when they lose a job through no fault of their own. California lags far behind much of the nation in adapting its UI system to meet the needs of the modern workforce it has helped pioneer. As a result, just over one out of every three Californians now receives UI when they lose their job. It is important to note that changes in the monetary criteria used to establish eligibility do not change the fundamental requirement that, in order to receive benefits, individuals must have lost their job through no fault of their own.

- ***Implement a movable base period.*** The UI system cannot fulfill its mission to provide income security for unemployed workers if it excludes or delays benefits to tens of thousands of workers simply because of the timing of their earnings. California should join the twelve other states that have adopted a base period that reflects modern technology. The existing base period structure is especially hard on low wage workers, since they have to work longer in order to qualify for benefits and are more likely to suffer if their recent earnings are not considered when determining eligibility.

  While a movable base period involves some additional administrative burden, research indicates that administrative issues have not created overwhelming obstacles in states that have adopted movable base periods.[47] An alternative or moveable base would also enable individuals who lose their jobs to receive UI benefits rather than be forced to turn to the welfare system. The state's Department of Finance (DoF) has estimated that approximately a quarter of the cost of implementing an alternative base period would be returned to the state in the form of lower welfare costs.[48] Previous estimates by the EDD suggest that implementation of an alternative base period would increase eligibility for UI by approximately four percent without changing the basic requirement that an individual become unemployed through no fault of their own.[49]

- ***Adopt a $300 quarterly earnings requirement.*** Unemployment insurance taxes apply to the first dollar of employees' earnings, yet workers are not eligible for benefits until they earn at least $900, and under most circumstances, $1,300. While critics note that a $300 quarterly earnings requirement extends eligibility to minimum-wage workers employed for less than two weeks, the current earnings requirement of $1,300 allows many higher wage workers to qualify with only two or three weeks' worth of earnings. Lowering the minimum earnings requirement will establish parity for lower wage workers and help remedy the current situation whereby benefits are denied to those most in need, solely on the basis of the amount they are paid.

Options for Ensuring Adequate Benefit Levels

While California currently replaces a higher share of the lost income for lower paid workers than it does for those with higher earnings, benefit levels are insufficient to cover basic living expenses for many of the unemployed, particularly for households with a single earner. California should:

- ***Establish adequate wage replacement levels.*** For many jobless workers, low UI benefit levels constitute a particular hardship. California should, at a minimum, meet the federal target of replacing 50 percent of lost earnings. Higher replacement levels for those with relatively low earnings can help ensure that UI provides a minimal safety net for those who lose their job. California's wage replacement rate – measured as the average weekly benefit divided by the average weekly wage – is the lowest in the nation. While costly – increasing the replacement level to a minimum of 50 percent of average weekly wages would cost nearly $1 billion per year at full implementation – the annual cost of increasing benefits is less than the annual savings to employers due to reduced contributions over the past five years.

Financing an Expanded Unemployment Insurance System

When the UI program started in the 1930s, the federal and state tax rates applied to all wages paid to workers covered by the system. In 1939, the federal government set the taxable wage base for UI at $3,000. Today, California taxes the first $7,000 of employees' earnings. Despite periodic adjustments, the taxable wage base has not kept pace with inflation. Had the wage base been indexed to match wage growth since 1940, it would now exceed $50,000.[50] In contrast, the wage base for Social Security taxes, which is indexed, climbed to $80,400 in 2001.

By imposing the UI tax on a relatively low base, the system effectively imposes a higher tax on employers of lower wage workers. Increasing the state's taxable wage base would equalize the tax burden between low wage and high wage firms. To the extent workers bear the UI tax burden, raising the taxable wage base would also improve equity between low wage and high wage workers. A higher taxable wage base could also provide revenues to pay for expanded eligibility for low wage workers or increased benefits.

Research suggests that raising the taxable wage base will have a minimal impact on employment levels and labor costs. According to a 1995 Department of Labor study, the impact of doubling the federal taxable wage base to $14,000 on employment levels would be negligible.[51] The study used a conservative set of assumptions with regard to potential offsetting factors. For example, increasing the taxable wage base would improve the state's UI trust fund balance, which would trigger tax rate reductions after a couple of years. Incorporating the impact of tax rate reductions would further reduce any negative employment impact. Similarly, increasing the taxable wage base will have a minimal impact on total labor costs due to the relatively low levels of UI taxes. In 2000, for example, state and federal UI taxes equaled 0.5 percent of total wages paid to workers covered by the system.[52]

- ***Raise the taxable wage base to at least the national average.*** Equity considerations argue in favor of increasing the taxable wage base, even in the absence of expanded benefits. California's current taxable wage base is tied for the lowest in the country. Raising California's taxable wage base to the national average would reduce the regressive nature of the UI tax and spread the cost of the system more equitably among employers with minimal competitive impact. Reductions in UI tax rates can offset all or part of the impact of increasing the taxable wage base. Alternately, a portion of the increased revenues could provide the funding necessary to pay for changes to eligibility criteria and benefit payments, with the remainder used to reduce tax rates for all employers.

  An increase in California's taxable wage base to $11,000, just under the national average of $11,914, would increase UI trust fund revenues by more than the amount needed to fund the expansions in eligibility and dependent benefits discussed in the report. Excess revenues could be used to provide across-the-board rate reductions for employers, thereby offsetting a significant fraction of the cost of increasing benefits.

- ***Index the wage base to the state's average wage.*** Linking the taxable wage base to average wage levels can prevent the tax structure from becoming obsolete due to inflation. Increased revenues resulting from taxing a larger base can be used to help benefit levels to keep pace with inflation. Eighteen states have solved this problem by indexing their UI taxable wage base to some percentage of their average state wage. Maintaining an adequate benefit structure requires adequate funding. Indexing the taxable wage base to the average wage will help ensure adequate long-term funding for the system.

Conclusion

Hundreds of thousands of California UI applicants with recent work history are denied benefits every year for failing to meet monetary criteria. Some of them turn to public assistance as a result of their failure to qualify for assistance. Ironically, the former employers of these individuals pay a higher effective tax for benefits that low wage workers are often unable to receive. California can follow the lead of a number of other states to make the unemployment insurance system work for low wage workers. Doing so will reduce welfare costs and keep these individuals part of a system historically focused on assisting individuals as they attempt to return to work.

The state's wage replacement rate is the lowest in the nation and even the maximum benefit is far below the amount needed for bare bones subsistence during just brief periods of unemployment. California's benefit levels have not increased for nine years. Inflation has eroded the purchasing power of California benefit levels by a substantial 20 percent since the last increase was enacted. The state's lowest paid workers are most likely to suffer from the failure of benefits to keep pace with inflation, increasing the likelihood that families will be forced to turn to time-limited welfare to make ends meet if they lose their jobs through no fault of their own.

Achieving these savings will, however, impose some additional costs. There are several reasons why the balance tips in favor of expanding UI to better serve the low wage unemployed. First, due to declining unemployment and the current strength of the California economy, the UI trust fund is in a strong position. At the end of the third quarter of 2000, the balance of the fund, $5.786 billion, equaled 235 percent of the benefits paid during the preceding 12 months.[53] Because of the fund's strong position, modest benefit increases could be absorbed in the near term with minimal or no increased revenues. Contributions to the state's UI fund as a percentage of total wages have fallen by more than a third over the past five years, translating into employer savings of more than a $1.5 billion in 1999. These savings far exceed the cost of implementing the recommendations proposed in this report. Finally, equity concerns argue for expanding the taxable wage base. The additional revenues generated by doing so could help finance the reforms proposed above as well as a reduction in tax rates.

The UI system remains a vital resource for workers who become unemployed through no fault of their own. Ensuring that all members of the work force have adequate access to this resource, and financing it in a way that makes sense, will ensure that the unemployed have the breathing space necessary to undertake a productive search for new employment.

Prior to the recent changes in state and federal welfare law, individuals suffered no penalty for relying on public assistance rather than UI during periods of joblessness. New laws limiting the lifetime receipt of welfare benefits to sixty months increase the importance of identifying the appropriate safety net for individuals who lose their jobs. For an individual who loses her or his job, the ability to receive UI benefits may avert the need to claim time-limited welfare benefits. For states, the shift from an open-ended match of state and federal welfare dollars to a system where states receive a fixed allotment of federal assistance creates a financial incentive to shift costs out of public assistance programs to programs funded from other revenues. Making the UI system more responsive to low wage workers will help ensure that California's unemployed receive the benefits they need and deserve.

Endnotes

[1] Stephen A. Wandner and Andrew Stettner, "Why are Many Jobless Workers Not Applying for Benefits?," *Monthly Labor Review*, Vol. 123, No. 6 (June 2000), p. 21.
[2] US Department of Labor, Employment and Training Administration, unpublished data.
[3] US Department of Labor, Employment and Training Administration, *Unemployment Insurance Taxes* downloaded from http://www.worforcesecurity.doleta.gov/unemploy/taxinfo.asp on February 13, 2001. The federal tax rate is actually 6.2 percent, but employers receive a 5.4 percent tax credit if their state's UI programs meet federal guidelines. The federal taxable wage base includes the first $7,000 of covered employees' wages.
[4] Advisory Council on Unemployment Compensation (1996), p. 66.
[5] US Department of Labor, Employment and Training Administration, Office of Workforce Security, *SESA Tax Statistics – Alphabetically by State 2000 All-State Tax Rates* downloaded from www.workforcesecurity.doleta.gov/unemploy/statetax.asp on February 13, 2001. All of the remaining states, including California, have maximum tax rates of 5.4 percent and taxable wage bases of $7,000.
[6] US Department of Labor, Employment Training Administration, Office of Workforce Security, *Significant Provisions of State Unemployment Laws* (January 16, 2001), downloaded from www.workforcesecurity.doleta.gov/unemploy/sigprojan2001.asp on February 13, 2001, and Employment Development Department, *2001 California Payroll Guide* (no date).
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[14] US Department of Labor, Employment and Training Administration, *Comparison of State Unemployment Laws Table 201* downloaded from http://www.workforcesecurity.doleta.gov/unemploy/pdf/2001ch201.pdf on February 13, 2001.
[15] US Department of Labor, Office of Workforce Security (unpublished data).
[16] Stephen A. Wandner and Andrew Stettner, "Why Are Many Jobless Workers Not Applying for Benefits?," *Monthly Labor Review*, Vol. 123, No. 6 (June 2000), p. 22.
[17] US General Accounting Office, *Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), p. 9, and Walter Corson and Walter Nicholson, *An Examination of Declining UI Claims During the 1980s: Draft Final Report* (Washington, DC: US Department of Labor, 1988), p. 3.
[18] US General Accounting Office, *Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), p. 15. Low wage workers are defined as those who earned $8.00 per hour or less in 1999 dollars.
[19] Ibid, p. 15.
[20] Young-Hee Yoon and Roberta Spalter-Roth, *Unemployment Insurance: Barriers to Access for Women and Part-time Workers* (Washington, DC: National Commission for Employment Policy, 1995), and US General Accounting Office, *Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), p. 16.
[21] US General Accounting Office, *Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited* (December 2000), p. 21.
[22] California Budget Project, *Falling Behind: California Workers and the New Economy* (September 2000), p. 8.
[23] Walter Vroman, *The Alternative Base Period in Unemployment Insurance: Final Report* (Washington, DC: US Department of Labor, 1995), pp. 25-28.
[24] California Employment Development Department, personal communication (March 9, 2001).
[25] National Employment Law Project, *What is an "Alternative Base Period" and Why Does My State Need One? Expanding UI for Low-Wage and Part-Time Workers* (August 2000), downloaded from http://www.nelp.org/pub23.pdf. Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Rhode Island, Vermont, Washington, and Wisconsin have alternative base periods. This report uses the terms alternative, flexible, and movable base interchangeably to refer to policies that take into account most recent earnings or earnings in a nonstandard time period in order to establish eligibility for benefits.
[26] Vroman, p. 6.
[27] Vroman, p. 21.
[28] Daniel P. McMurrer and Amy B. Chasanov, "Trends in Unemployment Insurance Benefits," *Monthly Labor Review*, Vol. 4, No. 9 (September 1995), p. 35.
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[30] US Department of Labor, Employment Training Administration, Office of Workforce Security, *Significant Provisions of State Unemployment Laws* (January 16, 2001), downloaded from www.workforcesecurity.doleta.gov/unemploy/sigprojan2001.asp

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[33] Young-Hee Yoon and Roberta Spalter-Roth, *Unemployment Insurance: Barriers to Access for Women and Part-time Workers* (Washington, DC: National Commission for Employment Policy, 1995), p. 36.
[34] Advisory Council on Unemployment Compensation (1995), p. 125.
[35] Advisory Council on Unemployment Compensation (1995), p. 127.
[36] Advisory Council on Unemployment Compensation (1995), p. 131.
[37] Advisory Council on Unemployment Compensation (1995), p. 242.
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[44] Roberta Spalter-Roth et al., *Income Insecurity: The Failure of Unemployment Insurance to Reach Working AFDC Mothers* (Washington, DC: Institute for Women's Policy Research, 1994), pp. 2-3.
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[46] David Maxwell-Jolly, *Senate Appropriations Committee Fiscal Summary: SB 202 (Solis)* (Sacramento, CA: California Senate Appropriations Committee, May 1996).
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[52] US Department of Labor, Employment and Training Administration, *UI Data Summary: State Financial Data Third Quarter* 2000 (Washington, DC), downloaded from www.workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum00/3rdqtr/finance.htm on February 13, 2001. Insured unemployment as a percentage of total unemployment.
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