# FIXING **UNEMPLOYMENT INSURANCE**

Legislative Analyst's Office

## The Challenge at a Glance

The Unemployment Insurance (UI) system is chronically insolvent. We project $2 billion annual deficits over the next five years.

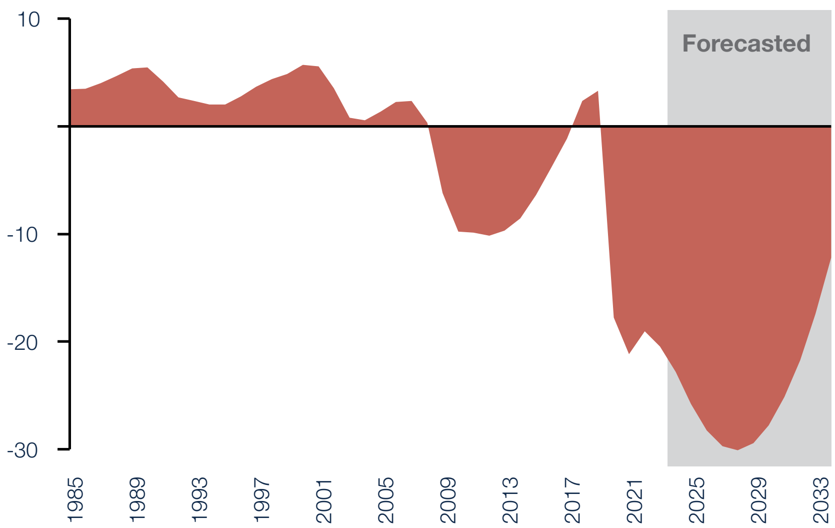
With deficits, the state has not yet made progress repaying the outstanding $20 billion federal loan used to cover benefits during the pandemic.

The federal loan will increase in the coming years, carrying annual General Fund costs of about $1 billion.

Unless changes are made, the state will have no reserves when the next recession begins.

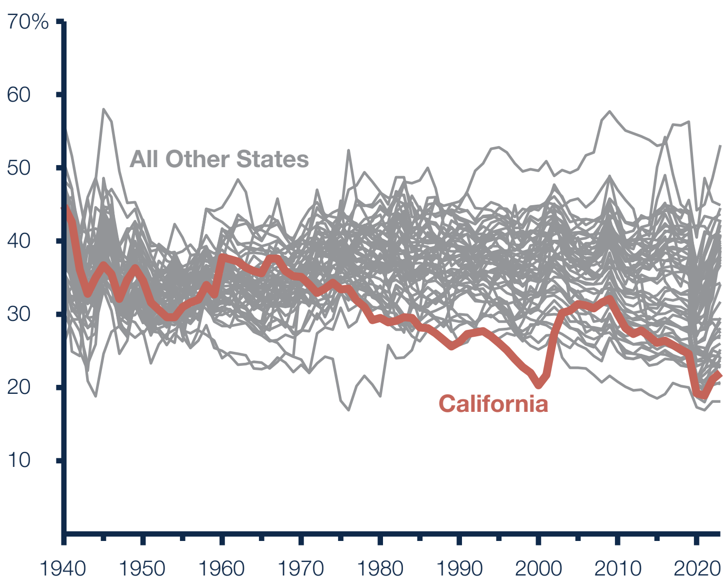
### State's UI Trust Fund to Remain Depleted for Foreseeable Future

UI Trust Fund Balance (In Billions)




### California UI Benefit Levels Now Among Lowest in U.S.

Average Weekly Benefit as a Share of Average Weekly Wage




## How Did We Get Here?

The UI tax system is supposed to automatically adjust based on the UI trust fund's condition. Tax rates should increase when a reserve cushion needs to be built and decrease once that's done.

In actuality, employer tax rates actually decrease when they should be increasing.

This broken system now fails to cover even normal UI costs, let alone the stress of a recession.

## Systematic Changes Are Needed

Changes to taxable wage base are not enough to restore solvency.

Substantial tax increases also are necessary and an honest reflection of the program's deep problems.

Absent course correction, these fiscal challenges could erode the program's two longstanding goals to: (1) provide a temporary cushion for unemployed workers and their families and (2) stabilize the state's economy by boosting consumer spending during downturns.

## Recommend Four Core Reforms

### 1 INCREASE TAXABLE WAGE BASE

Increase the wage base from $7,000 (the lowest in the nation) to $46,800.

This would align the taxable wage base with benefits workers are eligible to receive.

This higher wage base would put California in the top 10 of states.

### 2 REDESIGN TAX STRUCTURE

Replace the entire existing tax structure with a **standard rate** to cover typical UI costs, and a **reserve-building** rate that turns on when state needs to build a reserve cushion.

The new average tax rate would be 1.9 percent.

### 3 RETHINK EXPERIENCE RATING

Replace the current system with one based on whether businesses grow or shrink employment.

This would reduce existing administrative complexity, eliminate employers' incentive to dispute valid claims, and make it easier to balance the funding system.

### 4 REFINANCE THE FEDERAL LOAN

Even with these reforms, the state still needs to repay the federal loan before it can build reserves.

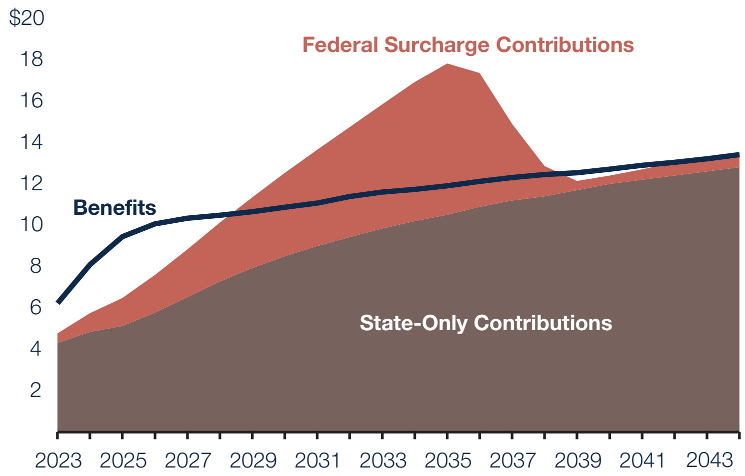
The loan stems from the pandemic, when the state limited in-person economic activity. As such, it is reasonable for the state to share the burden of repayments.

We recommend refinancing the federal loan with a revenue bond repaid by employers and new borrowing repaid by the General Fund.

## The Cost of Inaction

Whether or not the Legislature takes action, employers will soon pay more in UI taxes than they do today due to escalating charges under federal law. Making changes now lets the state set the terms and build a simpler, balanced UI financing system.

**State Not Expected to Achieve Solvency Without Federal Surcharge**
(In Billions)




## A Simpler, Balanced Outlook Under Reform

Under our recommendations, the state would be able to pay for UI benefits during typical years and would have more reserves on hand to deal with the fiscal stress of recessions. Federal loans might be required at some point in the future, but they would be smaller and repaid more quickly.

This reform would also allow the state to make changes to UI benefits without pushing the system further into insolvency—for instance, the Legislature could choose to increase benefits, expand benefits to additional workers, or index benefits benefit levels to the cost of living.

For more information, see our report: *Fixing Unemployment Insurance* at lao.ca.gov