

Connecticut's Unemployment Compensation System

Why Is the UC System in Trouble?

Connecticut's unemployment compensation system has been under severe strain as a result of the recession.

A rapid rise in jobs lost, a record number of business closings, and a high volume of benefits paid out of the system caused the state's Unemployment Compensation Fund (the Fund) to become insolvent in October 2009. To make matters worse, economists forecast joblessness resulting from the recession to continue well into the next decade.

Since the Fund became insolvent, the Connecticut Department of Labor (CTDOL) has borrowed nearly \$670 million from the federal government and is anticipated to continue borrowing in excess of \$1 billion in order to meet unemployment benefit obligations.¹ To date, 36 other states also have borrowed from the federal government for the same purpose.²

Who Pays for UC Benefits?

Connecticut's unemployment compensation system is funded entirely by employers who pay taxes into the Fund. Nonprofit and government employers generally do not pay taxes, but reimburse the Fund for benefits paid out on their behalf.

How Are UC Taxes Assessed?

The amount a Connecticut employer pays in UC taxes depends on the following factors:

1. Taxable wage base

In Connecticut, employers pay quarterly UC taxes on the first \$15,000 in wages paid per employee each year. Wages earned above the \$15,000 wage base are not subject to the UC tax.

Connecticut's \$15,000 wage base has been in effect since 1999 and is currently the 18th highest in the nation.³

2. Experience rate

This rate is established on a yearly basis and is based on the amount of UC benefits actually paid to an employer's workers for the last three years. This

rate ranges from a statutory minimum of 0.5% to a maximum of 5.4%. Since the recession, many employers have seen their rates increase due to layoffs, furloughs, and use of shared work programs.

3. Solvency tax

Also known as the fund balance tax, the solvency tax is assessed on every employer as a percentage of their taxable wage base when the Fund drops below the fund reserve goal. The solvency tax can be as high as 1.4% and is added onto an employer's experience rate. This tax is currently applied at the maximum level allowed by law.

The amount an employer pays into the Fund is calculated by multiplying total taxable wages by the employer's experience rate plus the solvency tax rate.

4. Special assessment

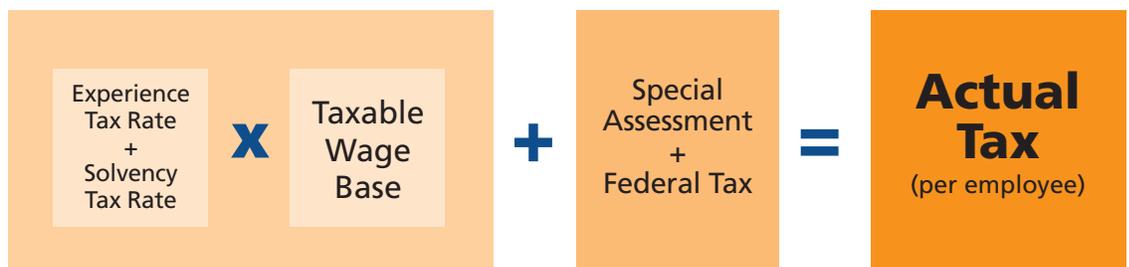
A special tax may be imposed to repay interest on loans taken to pay benefits during times of Fund insolvency.⁴ Connecticut employers will pay a special assessment due in Aug. 2011 to cover \$40 million in interest accrued so far.

5. Federal tax

Employers also pay federal UC taxes under the Federal Unemployment Compensation Tax Act (FUTA). The rate is 6.2% of the first \$7,000 paid in wages to each employee per year.

Employers who pay their state UC tax in full and on time, however, receive a 5.4% credit toward their FUTA tax, so the FUTA tax rate is typically 0.8% (6.2% minus 5.4%).

When states owe principal on federal loans, federal law requires a reduction of the FUTA tax credit (effectively a tax increase) over the next few years, as long as principal is outstanding. FUTA tax will be increased 0.3% each year.



By the Numbers

- ▶ **141,181**—Approximate number of Connecticut workers receiving unemployment benefits as of the week ending March 12, 2011.⁵
- ▶ **98,000**—Approximate number of employers contributing to Connecticut's UC system.⁶
- ▶ **\$670 million**—The amount Connecticut has borrowed from the federal government to cover UC benefit payments as of March 15, 2011.⁷ Borrowing is expected to exceed \$1 billion. The federal government began charging interest on UC loans on Jan. 1, 2011.
- ▶ **\$70 per employee (approximate):**
 - **\$40**—The average cost of a special assessment Connecticut employers will begin paying on Aug. 1, 2011, to pay the interest on federal UC loans. The assessment totals approximately \$40 million.⁸
 - **\$30**—The approximate amount employers' FUTA tax increases every year starting in 2012 until the principal on federal UC loans is paid off.⁹ The increase represents a 0.3% decrease in the FUTA tax credit (roughly \$30 in 2012, \$60 in 2013, and \$90 in 2014).

Will There Be Help from Washington?

President Obama's 2012 federal budget proposal includes a plan to help states deal with UC debt in the short term.¹⁰ **(The plan has met with opposition in Congress, however, making its passage unlikely.)** The key recommendations include:

- ▶ **A two-year extension** on interest-free borrowing from the federal government (until Jan. 1, 2013).
- ▶ **A moratorium** in 2011 and 2012 on the 0.3% annual FUTA credit reductions (see above).
- ▶ **A proposed increase** in the federal taxable wage base from \$7,000 to \$15,000 that will ultimately increase employers' federal UC taxes in order to restore solvency to the federal Fund.

Will the State Make Structural Changes to the UC System?

The CTDOL is recommending a raise in the Fund reserve goal from \$626 million to roughly \$1.2 billion in 2012. Reaching that goal will take several years. (The reserve goal is used by states to determine the ideal level of funding needed to withstand future cycles of unemployment and other economic conditions affecting their Fund reserves.)

Costs per worker under current UC tax structure

| Year | Cost Per Worker | | | | | | | | |
|-----------------------------|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | |
| UI Tax (incl. solvency tax) | Minimum experience rate | \$285 | \$285 | \$285 | \$285 | \$285 | \$285 | \$285 | \$285 |
| | Average experience rate | \$655 | \$740 | \$745 | \$700 | \$620 | \$540 | \$505 | \$505 |
| | Maximum experience rate | \$1020 | \$1020 | \$1020 | \$1020 | \$1020 | \$1020 | \$1020 | \$1020 |
| Special Assessment (SA) | \$40 | \$40 | \$30 | \$15 | 0 | 0 | 0 | 0 | |
| FUTA* | \$56 | \$77 | \$98 | \$119 | \$140 | \$56 | \$56 | \$56 | |

Example (for 2011): **\$285** (UI Tax) + **\$40** (SA) + **\$56** (FUTA) = **\$381** per worker

To compute costs per employer, simply take the cost per employee and multiply that by the total number of workers. The assumption is that each worker will earn at least \$15,000 per year—the state's taxable wage base. For example, an employer at the minimum state UI tax rate (1.9%) that employs 10 workers, can expect the following costs in year 2012: \$2,850 (UI); \$400 (SA); \$770 (FUTA).

* FUTA is payable in January of each year based on the prior year's payroll. Normal costs are \$56 per person (0.8% X \$7,000). Costs increase 0.3% each year until loan principal is paid off in full.)

Note: To address future Fund insolvency, the CTDOL is proposing to increase the Fund reserve goal to \$1.2 billion from its current \$626 million based on the average amount of benefits paid during Connecticut's three worst recessionary years. Although the new fund reserve goal will not immediately increase the above costs, it will increase the length of time that the insolvency tax is imposed.

What Else Can be Done?

While Fund solvency is a major issue, employers also recognize the need for changes to Connecticut's UC benefits administration system and benefit eligibility criteria to ensure that only necessary benefits are paid out of the system.

The business community recommends the following:

- ▶ **Strengthen** measures to guard against and detect fraud. Require the CTDOL to enhance fraud detection measures using available resources.
- ▶ **Enhance** the Department of Labor's efforts to verify claimant work searches:
 - Work with employers (especially larger ones) who use automated job applications to verify that claimants are actually seeking work.
 - Investigate ways to coordinate and integrate claimants' online and automated job applicant activity with the CTDOL's existing technology.
 - Institute a quota or minimum number of calls to be made by each CTDOL employee as a part of their jobs to verify claimant work search efforts.
- ▶ **Streamline and codify** the criteria for determining when available work is "suitable" for a claimant:
 - Clearly define when and what types of work are suitable, so that a consistent and uniform standard is applied by the Bureau of Hearings and Appeals officers.
 - For example, codify a standard for commutable distance to work, amount of compensation based on length of unemployment, similarity in work conditions, etc.
 - Require that current economic conditions be given considerable weight in evaluating the amount of replacement wages and compensation for available positions.
 - Implement a descending scale of compensation for suitable work. Base the scale on the length of an individual's unemployment so that suitable work is defined as that which pays as high a percentage of an individual's last average weekly wage as is reasonable given the economic climate. This standard

of suitability will allow Connecticut to be in line with or more generous than surrounding and competing states.

- In some states, the starting point for compensation of suitable work begins at 80% of an individual's last weekly wage.
- As the duration of unemployment increases, reduce the benchmark for suitable wages as follows:*

| Length of Unemployment | Percentage of Average Weekly Wage |
|------------------------|-----------------------------------|
| Up to 5 weeks | 100% |
| 6 to 12 weeks | 75% |
| 13 to 18 weeks | 70% |
| 18 weeks or more | 65% |

**Iowa's current system*

- ▶ **Require** stricter interpretations of separations regarding quits and fires to include "purposeful and repeated incompetence." CBIA has heard from numerous Connecticut employers that current law regarding "willful misconduct" does not address chronic absenteeism and purposeful incompetence by employees. It is unfair to charge employers with unemployment claims experience for employees who repeatedly failed to perform their jobs adequately after training and other remedial efforts have been made.

- ▶ **Revise** and clarify the concept of "job abandonment" under the law so that an unexplained absence of three or more days—whether consecutive or not—could be grounds for disqualification of benefits.

- ▶ **Institute** a one-week, nonretroactive waiting period for the collection of benefits. Several states, including Maryland, have begun this practice in the last year, and Connecticut is among a small minority of states that do not currently institute a waiting period.

- ▶ **Institute** a moratorium on expanding unemployment benefit eligibility criteria during times of Fund insolvency, unless specifically required to do so by federal law.

Sources

- ¹ Connecticut Department of Labor, "Connecticut's Unemployment Trust Fund" (Jan. 17, 2011)
- ² Connecticut Department of Labor, "December 2010 Employer Information Notice" (Dec. 2010)
- ³ American Payroll Association, "State Unemployment Insurance Taxable Wage Bases 2008–2011" (Jan. 2011)
- ⁴ Connecticut General Statutes, Section 31–225a
- ⁵ Connecticut Department of Labor, Office of Research
- ⁶ Ibid.
- ⁷ U.S. Department of Labor, Employment and Training Administration
- ⁸ Connecticut Department of Labor, "December 2010 Employer Information Notice" (Dec. 2010)
- ⁹ http://workforsecurity.doleta.gov/unemploy/pdf/UIPL_30-83.pdf
- ¹⁰ President Obama's proposed 2012 fiscal year budget, "Putting the Nation on a Sustainable Fiscal Path," Page 24 (Feb. 18, 2010)

