BILL GALSTON

# OMB REVIEWS

Attached are the papers for the OMB reviews of:

-- Unemployment Insurance

-- Targeted Jobs Tax Credit (prepared by Treasury)

-- Employment and Training

To be held on Wednesday, June 29 from 3:00-5:00 in Room 248 OEOB

# Unemployment Insurance

## OMB Entitlement Review

June 29, 1994



JOE MINARIK

# Unemployment Insurance
## OMB Entitlement Review

# I. Overview

# Program Statistics

FY 1994

- $30 billion in benefits.

- $31.9 billion income to Unemployment Trust Fund:
  - $27 billion in tax receipts (FUTA and State UI taxes).
  - $2.6 billion general revenue for EUC.
  - $2.3 billion interest (paid by Treasury on UTF balances).

- 8.5 million beneficiaries.

- $177 average weekly benefit.

- 15 weeks average duration of insured unemployment.

# UI Claimants and the Workforce

- Most workers are covered by UI.
  - 90% of labor force in covered employment.
    - Self-employed not covered.
  - 97% of wage/salary workers covered.
    - Certain agricultural workers excluded.

- Most unemployed workers do not collect UI.
  - 40% of all unemployed to collect UI in FY 1994.
  - 60% of laid-off workers to collect UI.

# Insured and Total Unemployment

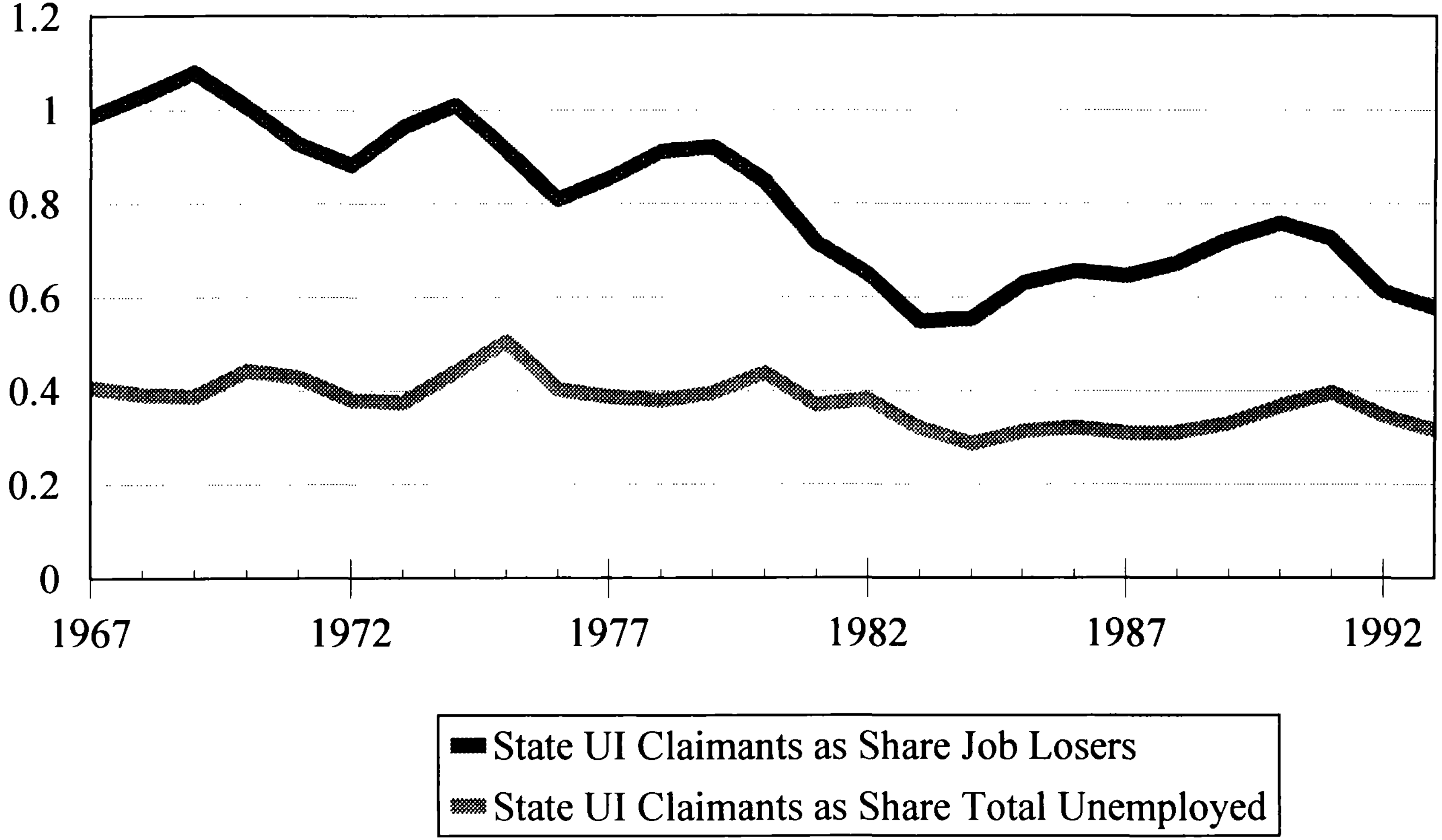
- Some "gap" between number collecting UI and all unemployed is normal:
  - New entrants, short-term, seasonal workers lack required work experience.
  - Voluntary quits, those fired for cause ineligible for UI.

- During 1980's "gap" widened -- about 32% of unemployed collecting UI during 1987-88 compared with 40-45% for similar periods in past.
  - Gap shrank as recession got underway, with more experienced workers laid off.

- Research on gap found various reasons:
  - Geographic and sectoral shifts to States and economic sectors that historically had lower UI benefit receipt levels.
  - Changes in State policies that restricted eligibility for UI.
  - Changes in Federal policies, such as taxing UI which reduced after-tax value.
  - Workers didn't apply -- didn't think themselves eligible.

- Many view gap as evidence of shrinking safety net -- seek to expand UI availability.

# Insured Unemployed



# UI Largely a Middle-Class Entitlement

- 8.5 million UI claimants in FY 1994,
  - Largely male (60%) and white (65%).
  - 3/4 of payments to workers aged 25-54.
- 60% are married and 40% have working spouse.
- 1/3 to 1/2 of UI benefits go to households with children.
- Almost 40% of UI claimants have household incomes -- before transfers -- in top 2 quintiles (roughly $45,000 and up).
  - 35% are in households in bottom 2 quintiles (roughly $30,000 or less).
- About 10% of UI housholds receive Food Stamps.

Various sources

# II. Description of UI System

# UI System

- Objectives:
  - Provide temporary, partial wage replacement to unemployed workers with strong attachment to labor force.
  - Assist in stabilizing national economy during cyclical economic downturns.

- Federal-State partnership:
  - 53 different systems.
  - Two-tiered tax system:
    - Federal unemployment taxes (FUTA),
    - State-levied UI taxes.

# Financing

- Federal taxes:
  - FUTA set at 0.8% of first $7,000 of wages; produces annual revenues of $4.5-6.0 billion.
  - Uses:
    - administrative costs of UI -- $2.5 billion in FY 1994,
    - Employment Service -- $1.1 billion in FY 1994,
    - Federal half of 13-week Extended Benefit (EB) program,
    - loans for States to pay benefits.

- State UI taxes:
  - Annual revenues of $21-24 billion.
  - Rate set by States; base at least $7,000:
    - Average rate 2.1% of taxable wages,
    - Average rate 0.8% of all wages.
  - Uses:
    - Regular UI benefits -- first 26 weeks,
    - State half of EB.
  - Generally levied on employers.
    - Tax rates experience-rated, reflecting layoff experience of individual firms.

# Benefits

## Insurance for layoffs when worker is not at fault.

- States generally determine:
  - qualifications requirements -- earnings/weeks worked,
  - weekly benefit amount and maximum duration.

- UI claimants must be able to work and be available for work.
  - States set own work search requirements and procedures.
  - Federal Government specifies EB work search.

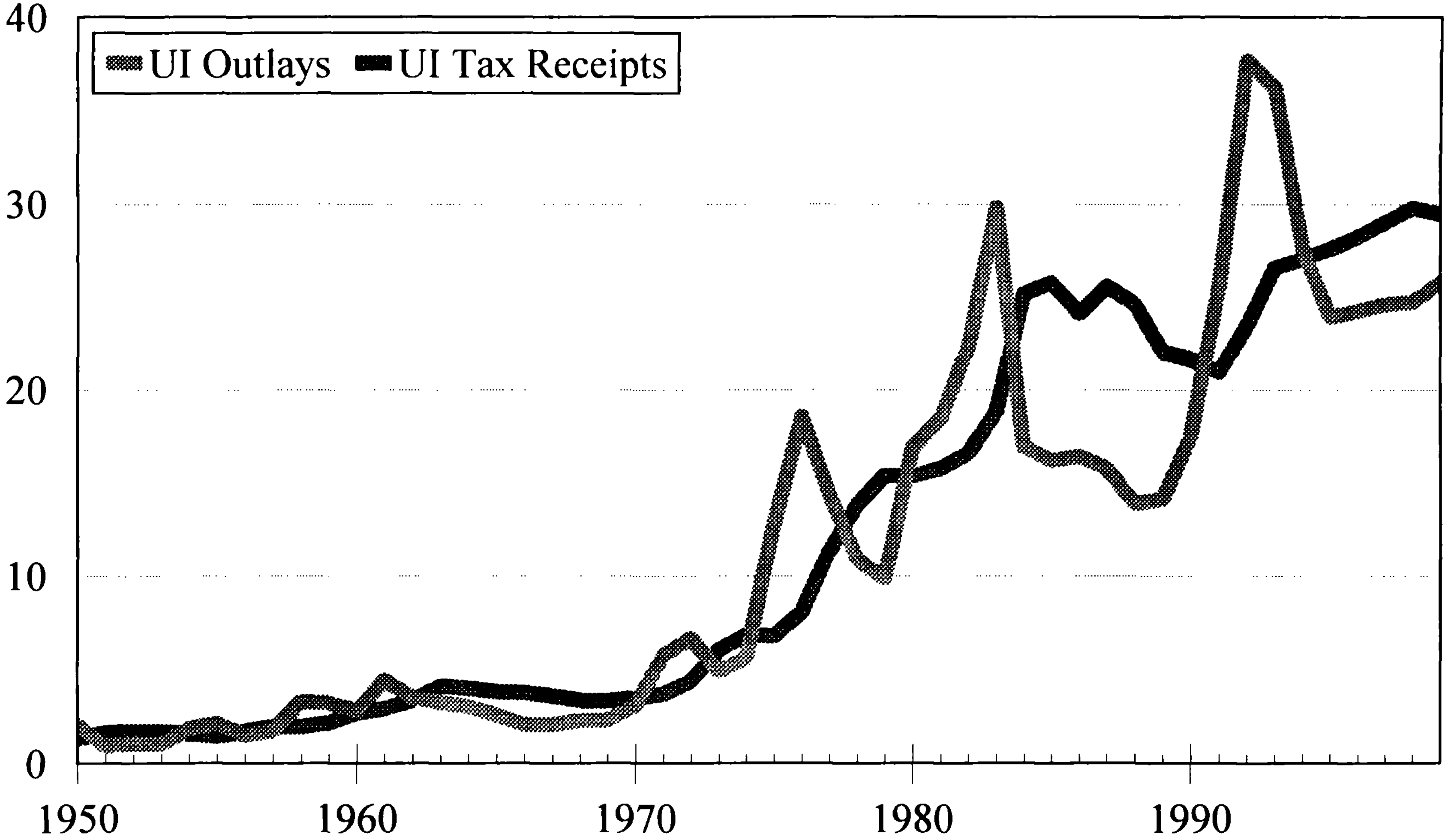
- UI benefits subject to income tax
  - Fully taxed since 1986.
  - Taxes on UI go into general revenues, not back into UTF.

- Progressive benefit structure but varies by State.
  - Nationwide, average benefit ($177) is 36% of average weekly wage.
  - Wage replacement rate is higher for low-wage workers.
    - 50-60% wage replacement for low-wage workers.
    - 40% replacement for average-wage earners.
    - 20-25% replacement for high-wage earners.

# III. UI and the Federal Budget

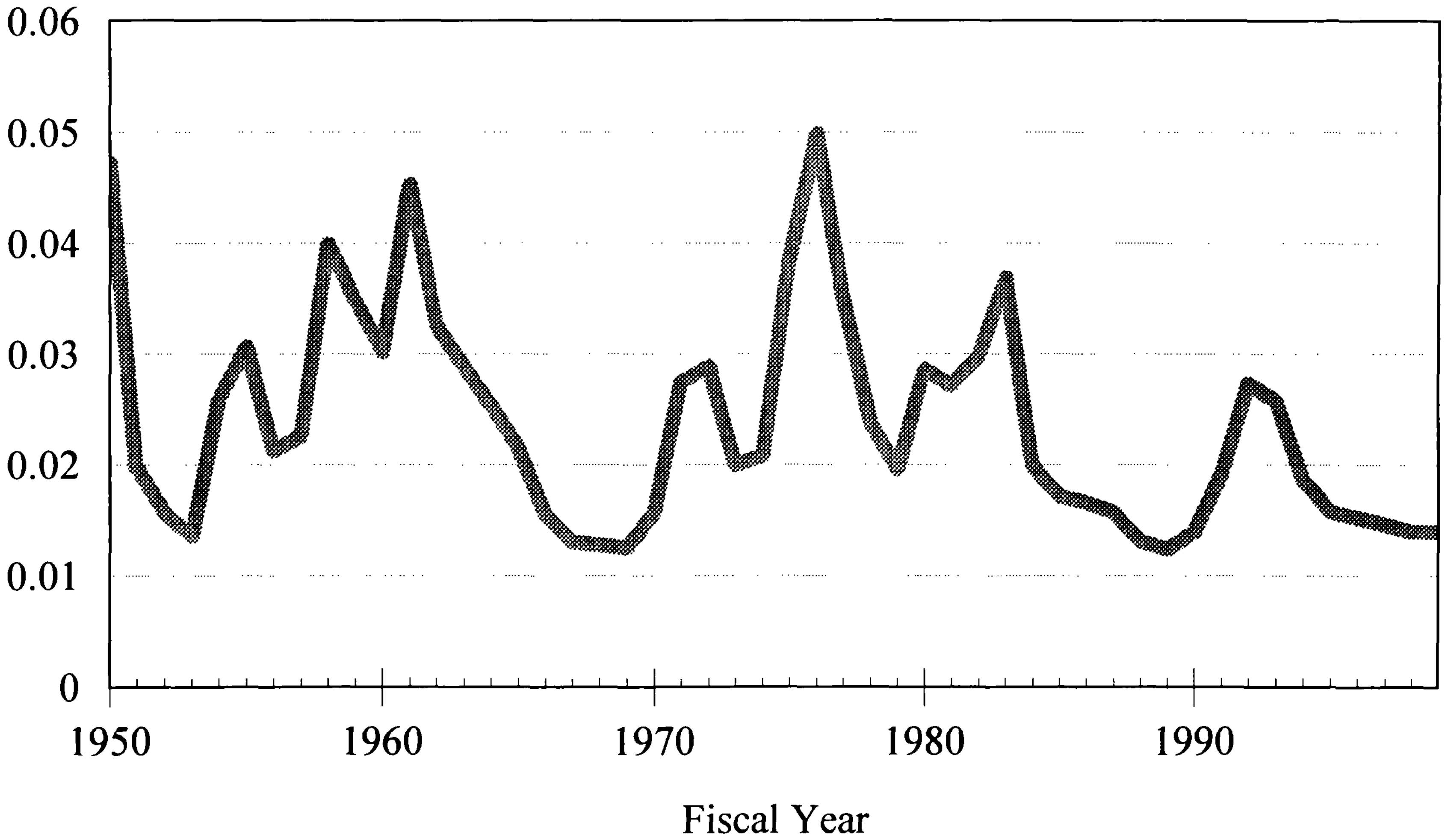
# UI Tax Receipts and Outlays

($ in billions)




Receipts exclude interest; outlays include general fund transfers for emergency programs.

# UI Small but Fluctuating Share of Federal Outlays



# State UI Not Out-of-Control Entitlement

- Regular UI benefits part of a self-balancing system.

- Benefits are paid out of State UTF accounts financed by State taxes.
  - Insolvent States borrow from Federal UTF account.
  - State borrowing is repayable with interest.
  - If States are slow on repayment, employers are hit with gross FUTA tax of 6.2% (instead of 0.8% net FUTA).
    - Compare with average State UI tax rate of 2.1% on taxable wages.

# Federal UI Programs Not Self-Balancing

- EB is countercyclical; spending depends on sensitivity of triggers.
  - Over 1990-93, EB cost $400 million with only 9 States ever on.

- Emergency programs respond to political crises and outpace UTF resources. EUC is example:
  - EUC created in 1991 with $8 billion balances in UTF EB account.
    - By July 1992, EUC extension needed general revenues.
    - Original EUC plus 4 extensions cost almost $27 billion.

- Special programs are created even when EB is operating.
  - From 1970-77, $9 billion spent on EB; $9.4 billion on special programs.

- Unlike State taxes, FUTA rate does not adjust to rebuild UTF balances.
  - FUTA surtax imposed in 1977 to repay borrowing, never removed.

# Additional Drains on UTF

- Administration's Reemployment Act of 1994 proposes to change "unemployment" insurance into "reemployment" insurance.

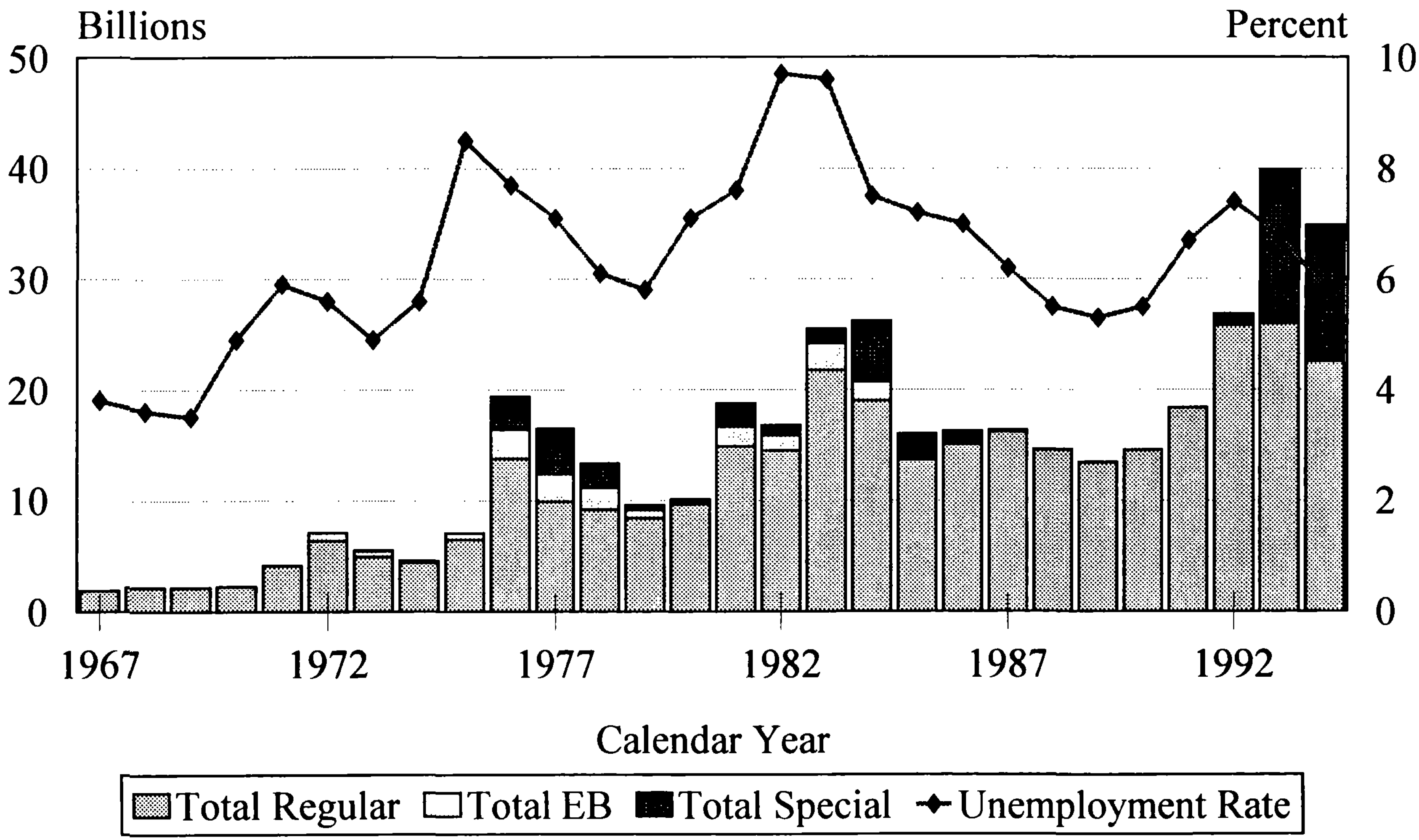
- Creates mandatory program of income support for certain dislocated workers to complete training.

- Funds mandatory retraining income support from FUTA receipts:
  - Over FY 1996-2000, total $2.9 billion transferred.
  - Beginning FY 2001, 20% of FUTA revenues transferred.

- Financed largely by permanent extension of 0.2% FUTA surtax.

# UI Outlays by Program

($ in billions)



# IV. Policies to Reduce the Federal Deficit

# What Is the Problem?

- State UI programs are not out-of-control entitlement.
  - Federal requirements make State programs self-balancing.

- Federal UI programs are not self-balancing.
  - Emergency programs typically outpace UTF balances.
  - New Federal proposals -- retraining income support -- place additional demands on UTF.

- Over time, share of unemployed and job losers who collect UI has declined. This reduces spending but generates concerns about shrinking safety net.

- Federal policy levers can influence State UI programs, but to what end?
  - Scale of regular UI programs can shrink with federally imposed limitations, but State UI taxes will fall in response to lower benefits.
  - No impact on deficit and weakens safety net.

# Federal Policy Levers

- Federal requirements set for Federal programs. Examples:
  - Extended Benefits: work search; implicit waiting week
  - Unemployment Compensation for Ex-Servicemembers: formerly had longer waiting period and shorter duration than regular UI.

- Federal conformity requirements for State law:
  - Severe penalties if State law doesn't meet minimum Federal requirements:
    - Employers will not receive 5.4% tax credit against 6.2% gross FUTA.
    - State will not receive Federal grant to cover UI administrative costs.
  - Federal Government can set conformity requirements. Examples:
    - Experience-rated taxes levied on employers.
    - Ineligibility of certain groups of workers, such as school employees during summer and professional athletes between seasons.
    - Compensation can't be denied to anyone solely because taking part in approved training program.
    - Profiling of new claimants and referral to job search assistance.

# Policy Principles for Incremental UI Reform

(See Section VI for more comprehensive reform options.)

1. UI should be maintained as a Federal-State partnership.

2. UI should be maintained as a social insurance, not a means-tested, program.

3. UI should be designed to balance the need for a temporary safety net with our interest in reemploying people as quickly as possible.

# Policy Principle #1

1. UI should be maintained as Federal-State partnership.

   - Federal Government should not take over existing State responsibility for regular UI.
     - State programs reflect sensitive balance of worker and employer interests.
     - Pressures for stronger Federal role in improving coverage would seek highest common denominator, not lowest.

   - Some Federal role should be retained. (But see p. 53 for the Devolution option.)
     - States need safety net of loan program.
     - States will not want to bear entire responsibility for additional benefits during recessions that States can't control.

# Policy Principle #2

2. UI should be maintained as a social insurance, not a means-tested, program.

- To retain middle class support, maintain as insurance system, not welfare program.
  - UI is largely structured as insurance, and employers are required to pay cost.
    - Individual sees waiting period (i.e., deductible) and partial wage replacement (i.e., co-payment).
    - "Premiums" tied to value of payout. Experience-rated UI taxes mean the more workers laid off with longer durations, the higher the rate paid by employer.
  - UI already has income-progressive features.
    - Benefits are taxed, and wage replacement rates decline as wages increase.

# Policy Principle #3

3. UI should be designed to balance the need for a temporary safety net with our interest in reemploying people as quickly as possible.

- More generous benefits prolong unemployment. Research shows:
  - The longer UI benefits are available, the longer the spell of unemployment.
  - The probability of finding a job increases as claimants near the end of their benefits.

- Current system deals with problem in several ways. Most States:
  - Require UI claimants to register with ES, which serves 21 million applicants not very well.
  - Require specific number of employer contacts and regular reporting. However, some States dropping requirements because:
    - Difficult to monitor accuracy of reports.
    - Unemployment high and no jobs available in claimant's field.
  - Worker profiling will identify claimants likely to have difficulty finding jobs and refer to job search assistance services in other programs.
    - Potential problems: follow-up after job-search assistance program ends.

# UI and the Federal Deficit

## Policy Context

- The Unemployment Trust Fund is on-budget.

- Federal changes in State benefits impinge on the Federal-State partnership.

- The scale of the program can be cut, but State UI taxes may also fall in response to lower benefits -- short-term savings are possible but no long-term reduction in the Federal deficit.

# UTF On-Budget

## PAYGO Implications

- Individual State accounts part of unified budget.

- PAYGO rules affect both the State and Federal accounts.
  - Proposals to increase UI spending -- such as the 50-50 EB program -- need offsets for both the Federal and State shares.

- PAYGO offsets don't necessarily generate State UI revenues.
  - Employers may pay twice -- once in Federal PAYGO offsets and again when States raise UI taxes.

# V. Options for Incremental Policy Changes

# A. Options Affecting Regular UI

# Option 1: Increase waiting period for regular UI

- Current State law: 0 or 1 week wait.
- Proposal: uniform 1 week wait.
  - Alternatives: longer waiting periods.
- Savings: $2.5 billion over 5 years for 1 week wait.
  - Over longer term -- 4-5 years -- State taxes adjust, so deficit is not affected.
- Pro:
  - Eliminates cross-State inequities in wait.
- Con:
  - Impinges on States' ability to set benefits.

# Option 2: Strengthen work search for regular UI

- Proposal: apply EB work search requirements to those in regular UI who have claimed 20 weeks of benefits. EB work search requires:
  - Active search for work.
  - Acceptance of suitable employment paying at least the UI benefit or the minimum wage.
- Current law: each State sets own work search requirements; may suspend employer contacts if State believes no jobs are available.
- Savings: $560 million over 5 years.
- Pro:
  - Workers nearing exhaustion of regular UI need to revise work search strategy and consider lower paying jobs.
- Con:
  - Infringement of State authority on work search.
  - Harassment of employers if require contacts and no jobs are available.

# Option 3: Set solvency standards for State UTF accounts

- Current policy: DOL provides information on solvency measures across States; lets States respond as they choose.
- Savings: no estimates available.
- Pro:
  - Way to achieve long-term reduction in deficit -- create permanent wedge between State taxes and spending.
  - Assures that States will have sufficient funds to pay benefits during recessions, reducing need to borrow.
- Con:
  - Some would oppose because States could decide to reduce benefits instead of increase taxes.

# Option 4: Require more complete experience rating in State UI

- Current policy: States require different degrees of experience rating through their structure of UI tax rates and maximum rates.
  - State UI tax rates often create subsidies across industries -- construction typically pays less in taxes than it costs in benefits.
- Savings and deficit effect uncertain.
  - Some employers are paying taxes now to cover costs of other firms; fewer layoffs would reduce benefits and reduce taxes; could be adjustment lag.
- Pro:
  - Research suggests that more complete experience rating would lead to lower unemployment rates by reducing layoffs.
- Con:
  - Some would oppose because they believe employer is not at fault for recessions.

# Option 5: Increase benefit duration and increase waiting period

- Offset costs of longer benefit duration by savings from longer waiting period, e.g., 4 week wait offset by 8 additional weeks of UI.
- Costs: Could design to be cost neutral.
- Pro:
  - Package changes so that savers at State level equal cost of spenders -- avoid offsetting rate cuts.
  - Avoids paying benefits to rapid reentrants; allows longer benefits for those needing more time to find job.
    - Many workers find jobs quickly -- 30% of dislocated workers find new jobs within 5 weeks of job loss.
- Con:
  - Controversy over appropriate trade-off among job losers.
    - Some workers exploit UI as they exit labor force.
    - Those on short-term layoff, e.g., for model change, lose benefits.

# B. Options for Extended Benefits

# Option 6: Retain EB work search requirements

- Current law: EUC extension of July 1992 temporarily suspended special EB work search requirements through 1994.
- Cost: None if EB work search is reinstituted after suspension ends. If eliminated, cost about $14 million/year.
- Pro:
  - Encourages workers to adjust their earnings and job expectations once they have exhausted regular UI benefits.
- Con:
  - ACUC recommends elimination, largely because of States' implementation problems.

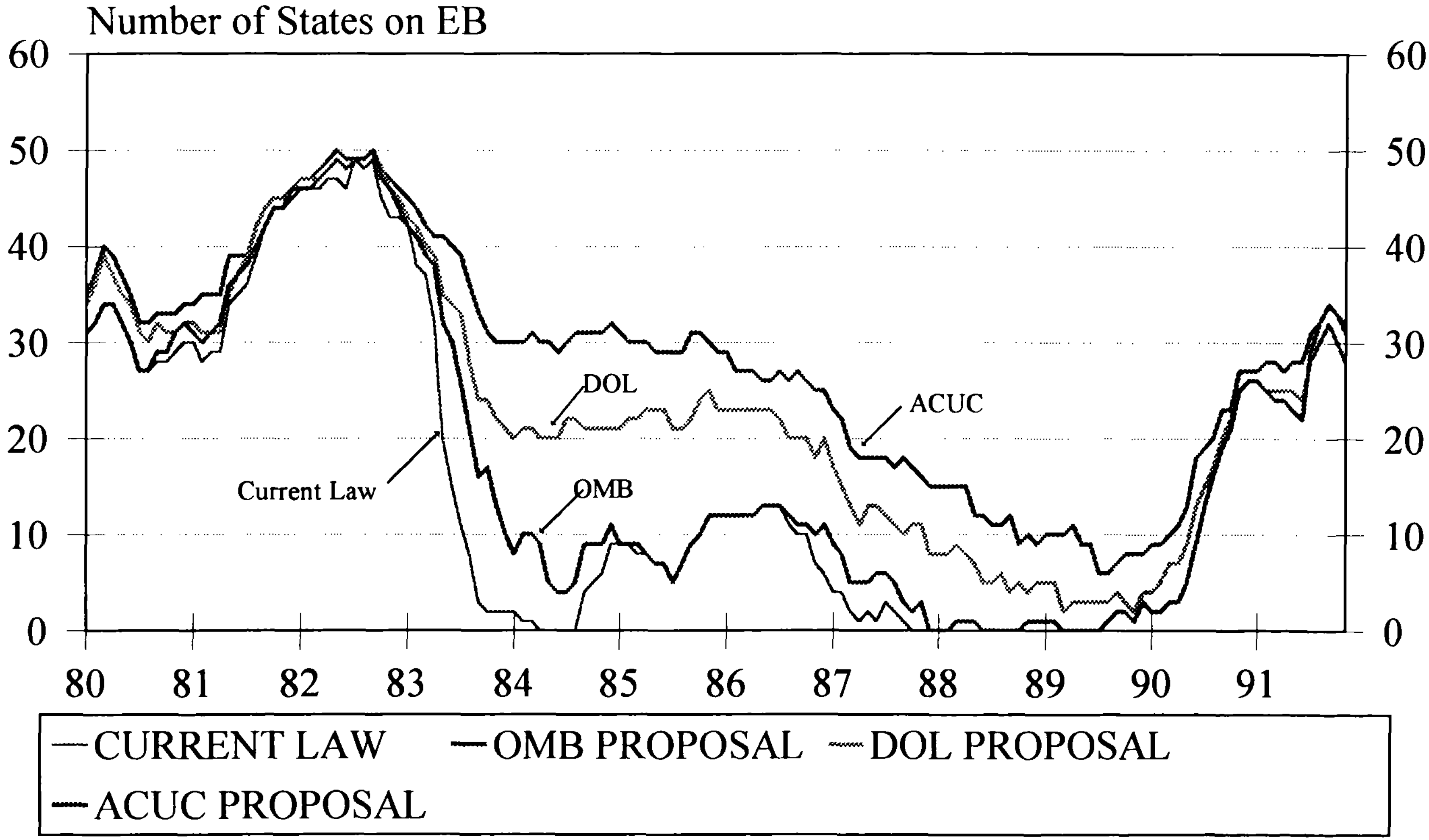
# Option 7: Modify EB triggers so program triggers on more readily in a recession.

- Current law:
  - Triggers based on the insured unemployment rate, which allowed only 9 States to trigger on to EB during the recent recession.
  - July 1992 EUC extension created optional trigger based on total unemployment rate.
    - 8 States have adopted optional trigger; 2 States are on EB using new trigger.
- Cost:
  - Immediate effect to increase spending -- $200-300 million/year for DOL proposal with optional 2-tier trigger.
  - Saver only if assume temporary, emergency programs averted.
- Pro:
  - If going to change triggers, then cheaper -- in PAYGO terms -- to adopt when unemployment is low.
- Policy issues: appropriate trigger level; whether to mandate trigger or make optional for States.

# Alternative EB triggers

- Current law*:
  - 6.5% TUR and 120% of either of 2 prior years
- ACUC proposal:
  - 6.5% TUR, no rising requirement
- DOL proposal:
  - 6.5% TUR and 120% of either of 2 prior years or 7.5% and no rising requirement
- OMB proposal:
  - 6.5% TUR and 120% of either of 3 prior years

# Impact of Alternative EB Triggers




Assumes all States use trigger.

# Option 8: Income screen for special Federal programs

- Proposal: develop income screen for determining eligibility for special Federal UI programs, e.g., those proving income support beyond regular UI.
- Cost/Savings: depend on screen.
- Con:
  - Difficult to means-test UI benefits in current system.
    - Data needed not readily available -- UI agencies don't have family income; tax returns show prior year.
    - If means-test at time of filing for UI, could delay benefits. If do when income tax filed, could amount to 100% tax on benefits.
    - Cross-subsidies across workers if all pay same UI tax, and wages do not differ by family income.
- Pro:
  - Applying to special Federal, non-experience-rated programs avoids perverse incentives in regular UI system for employers to lay off those with working spouses or not to hire unmarried workers.
  - Does not impinge on State control over regular UI.

# Option 9: FUTA surtax extension

- Current law: 0.2% FUTA surtax expires in December 1998.

- Permanent extension of FUTA surtax proposed in Reemployment Act of 1994 to offset increased mandatory spending.

- Savings: $914 million in FY 1999; $1.2 billion and rising in outyears.

# Option 10: Increase in FUTA taxable wage base, reduction in rate

- Proposal: Increase taxable wage base from $7,000 to average weekly wage -- $27,000 in 1995 -- and index. Reduce rate from 0.8% (including surtax) to 0.5%.

- Revenue ($ in billions)

| FY 95 | FY 96 | FY 97 | FY 98 | FY 99 |
|---|---|---|---|---|
| $0.68 | $2.17 | $2.34 | $2.50 | $3.58 |

- Pro:
  - Raises revenues, offsets for other mandatory program changes.
  - If retain link to States in current law, will increase minimum State taxable wage base and make tax more progressive.
- Con:
  - Tax increase.

# VI. Proposed Comprehensive Reforms

# Proposed Comprehensive Reforms

- Means Testing -- Concord Coalition
- Privatization Demonstration -- House Republican Caucus
- Devolution -- early Reagan Administration

# Option 11: Means Testing -- Concord Coalition

- Proposal:
  - Special tax on UI benefits in families with income exceeding $40,000.
    - Would not change eligibility rules and payment levels.
    - Report UI payments with Federal income tax return.
    - Beneficiaries pay larger (not both) of Concord clawback and current law income tax on UI benefits.
    - Same proposal made for Social Security, insurance value of Medicare, Supplemental Security Income, AFDC, and Food Stamps.

  - Tax rate depends on level of family income including benefits.
    - Basic tax rate of 10% on UI benefits when income $40,00-50,000.
    - Rate increases by 10% for each $10,000 increase in income, e.g., family with income of $90,000-100,000 would have UI benefit reduced by 60%.
    - Benefits not reduced by more than 85% (family income of $120,000 or higher).

# Means Testing -- Deficit Impact

- Savings ($ in billions)
  - FY 96 FY 97 FY 98 FY 99 FY 00
  - $2.1 $2.1 $2.2 $2.3 $2.4
- Immediate effect: reduce Federal deficit but not affect UI outlays if tax goes to general revenues.
- Long-term effect: employers may encourage States to means-test UI benefits so they pay lower UI taxes.
- Would be opposed as treating UI as welfare, not as insurance.

# Option 12: Privatization Demonstration

- Proposed by House Republican Caucus for FY 1995 budget resolution.

- Proposal:
  - Let private insurance market develop for regular UI.
    - Permit firms to opt out of UI in exchange for agreement to participate in system of mandatory private unemployment insurance.
    - Limit demonstration to 5% of employees covered by UI.
  - Eliminate Federal role in UI:
    - Eliminate Federal funding of administrative costs.
    - Eliminate Federal share of EB.

# Privatization -- Deficit Impact

- Impact on deficit of privatization of State UI:
  - Short-term increase as result of reduced tax receipts.
  - Long-term effect deficit neutral: reduction in UI outlays as private sector pays benefits, continued revenue loss.

- Elimination of Federal role in funding administrative costs and EB implies elimination of FUTA.
  - Loss of FUTA revenues.
  - Unclear that Congress will resist pressures for emergency unemployment programs.

# Option 13: Devolution to States

- Would eliminate UI as Federal program, giving it wholly to the States.
- Proposed early in Reagan Administration.
- Rejected by States.

# Targeted Jobs Tax Credit

## OMB-Treasury Tax Expenditure Review

June 29, 1994

# Purpose of TJTC

- Purpose: Provide incentive to employers to hire members of certain target groups who are hard to employ.

- Rationale: Tax credit offsets additional costs associated with less productive employees.

# Current Status of TJTC

- Revenue loss amounts to $310 million in 1994.
- Temporary program last extended in OBRA 1993, retroactive to July 1992.
- Credit expires December 31, 1994.
- Extension not requested in FY 95 President's Budget.

# Calculation of Credit

- Credit equals 40% of first $6,000 of wages.
  - 40% of first $3,000 for summer youth.

- Limitations on credit:
  - Deduction for wages reduced by amount of credit.
  - Employers must retain worker for 90 days or 120 hours (14 days or 20 hours for summer youth).

# Nine TJTC Target Groups

- Economically disadvantaged youth, ages 18 through 22
- Economically disadvantaged summer youth, ages 16 and 17
- Economically disadvantaged youth, ages 16 through 19, participating in a cooperative education program
- Handicapped persons referred to employers from State vocational rehabilitation or veterans' affairs programs
- Economically disadvantaged Vietnam-era veterans.
- Economically disadvantaged ex-convicts.
- Recipients of AFDC who have received benefits for 90 days immediately prior to being hired
- Recipients of Federal Supplemental Security Income (SSI)
- Recipients of State/local general assistance payments for at least 30 days

Economically disadvantaged: family income for past 6 months not exceeding 70% of Lower Living Standard Income Level

# Administration of TJTC

- Jointly administered by Departments of Labor and Treasury.
  - DOL/States identify/certify workers' membership in target groups.
  - Treasury may address credits claimed by employers in tax audits.
  - DOL grants of $15 million in FY 94 to cover State administration.

- DOL administration involves vouchers and certificates.
  - Vouchers serve as marketing devices to identify jobseekers as members of target groups.
  - Certificates provided to employers once an eligible individual has been hired.
  - Employers can request certification for new hires who are not pre-vouchered.

# TJTC Beneficiaries

- Almost 430,000 new hires certified as eligible for credit in 1991.
  - Over half of all certifications are for economically disadvantaged youth.
  - Welfare recipients account for 25%.

- Businesses use TJTC mainly for services (42%) and clerical jobs (39%).

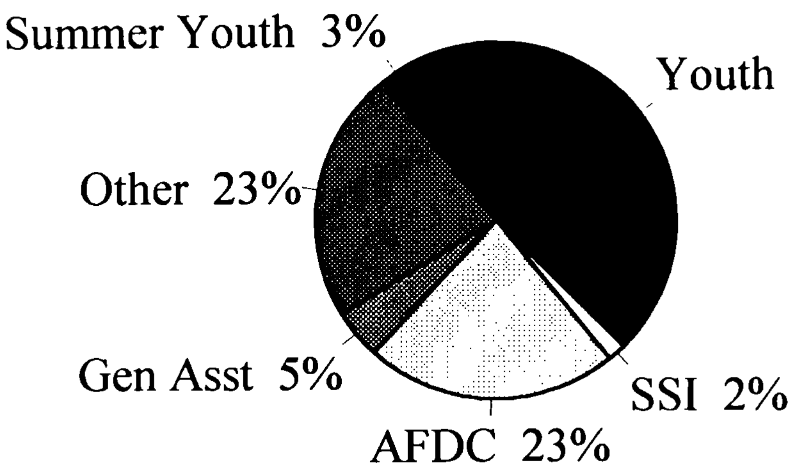
- Jobs are typically low-paying -- 36% paid less than $5/hour and another 42% paid $5-6.

- Consulting intermediaries help employers certify prospective employees.
  - Price Waterhouse estimate: 40% of all TJTC certifications processed by intermediaries in 1988 at average fee of $250 per certification.

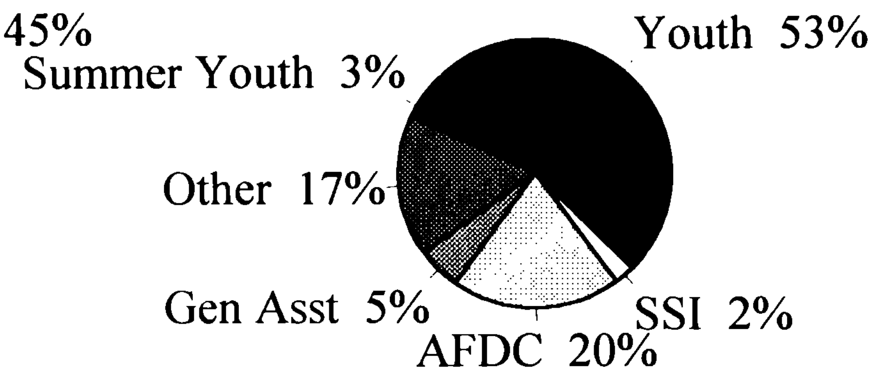
# Vouchers and Certificates

## Calendar 1991

Vouchers
634,568




Certificates
427,701



# Positive Aspects of TJTC

- Promotes private sector employment, rather than public sector.

- Offsets adverse employment effect of minimum wage.

- Gives participant track record of work experience.

# Problems with TJTC

- Cost-effectiveness questioned -- large windfalls for employers.
- Jobs are low wage and short term.
- Vouchers viewed as stigma by potential users.

# General Options

- Let program expire as scheduled.
- Extend current program.
- Extend modified program:  DOL/Treasury recommendation

# Revenue Estimates: TJTC Options

($ in millions)

| OPTIONS | FY 95 | FY 96 | FY 97 | FY 98 | FY 99 | FY 95-99 |
|---|---|---|---|---|---|---|
| Option 1: Let expire as scheduled | 0 | 0 | 0 | 0 | 0 | 0 |
| Option 2: Extend current law 2 years | -80 | -225 | -236 | -133 | -71 | -745 |
| Option 3: Modify and extend 2 years | -57 | -162 | -169 | -96 | -51 | -535 |
| New job tenure requirement | -55 | -154 | -162 | -91 | -49 | -511 |
| TJTC training expense credit | -3 | -7 | -8 | -5 | -2 | -25 |

# Option 1: Let TJTC expire as scheduled

- Cost: None.

- Pro:
  - Program is not cost-effective.
  - Can serve target groups with other employment and training programs, e.g., JTPA.

- Con:
  - Opposed by advocates for disabled and other target groups -- not all groups have program alternatives that emphasize jobs.

# Option 2: Extend current program for 2 years

- Cost: $745 million over 5 years

- Pro:
  - Supported by advocates for the disabled and other target groups.
  - Consistent with Administration initiatives to provide private sector jobs for low-income populations.

- Con:
  - Forthcoming DOL IG report on nationwide sample will still criticize TJTC as not cost-effective.

# Option 3: Extend but modify
## DOL/Treasury recommendation

- Description
  - Temporary, 2-year extension.
  - Lengthen required employment period to 800 hours or 6 months (now 120 hours or 90 days).
  - Provide credit for up to $1,500 of eligible training expenses.
  - Assess long-term impact of program with $1.5 million study.

- Cost: $535 million over 5 years

- Pro:
  - Encourages employers to train targeted workers.
  - Encourages longer term commitment to targeted employees.

- Con:
  - Can't complete study of revamped program in 2 years; will see pressure to continue credit.
  - Employers who take a chance on inexperienced workers run an increased risk of losing the credit if workers quit early.