Implementing Overdue Reforms to the Unemployment Insurance Trust Fund

Overview: Familiar Challenges with Unemployment Insurance

The Massachusetts Unemployment Insurance (UI) Trust Fund has created perennial fiscal challenges for the Commonwealth for decades. The stressors of the COVID-19 pandemic have further exposed underlying issues with the program, how it is funded, and its benefits structure.

Having a functional and sustainable unemployment insurance system is key to effective public intervention during times of pervasive job loss. And Massachusetts has always met the need for such intervention. The Commonwealth has one of the most dynamic job markets and talented workforces in the country; but, during hard economic times, too often our policy approaches to wage replacement have led to significant borrowing to restore UI Trust Fund balances. The Trust Fund's issues with insolvency today, while very much a function of unprecedented economic circumstances, still in part reflect decades of inadequate reform efforts.

The UI Trust Fund's current deficit is a product of both a public health crisis demanding significant public resources and government-ordered restrictions on commerce that forced business closures and layoffs. Employers were not driving the decision-making that led to job losses, which brought about unprecedented unemployment claims. Though Massachusetts employers were not responsible for the conditions that led to layoffs, they are now on the hook for $7 billion in debt that the Commonwealth has borrowed to finance pandemic-related benefits.

As members of the UI Trust Fund Study Commission, we are committed to implementing overdue reforms to put the Trust Fund on a sustainable path forward. The recommendations at the end of this report reflect our efforts to make the dialogue on UI reforms focus on a multi-faceted approach—one that considers the flaws of the current system holistically and Massachusetts' competitiveness with other states.

Sincerely,

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Background

The Massachusetts UI system is the principal social safety net for those who are legally permitted to work in the Commonwealth but have lost their jobs at no fault of their own. The Unemployment Insurance (UI) Trust Fund is Massachusetts' collective reserves that pay for partial and temporary wage replacement and administration of unemployment benefits. The Fund is financed by taxes on employers, whose contributions to the fund are a combination of (a) the employers' rate, which reflects each employers' share of direct UI costs based on an experienced-weighted rating; and (b) a solvency rate, which reflects an assessment consistent for all employers used to socialize the costs of the Trust Fund for benefits unrelated to employers' share of UI costs.

Massachusetts' challenges with its UI Trust Fund have historically been linked to recession cycles. Though Massachusetts typically experiences below national average unemployment during periods of economic growth, during downturns the scale of unemployment is significantly more volatile than is what is typical in other states largely due to the Commonwealth's industry sector composition. This trend has been well-documented.[1] Unemployment rates tend to rise to levels higher than the average across the country, which leads to surges in unemployment claims and the number of beneficiaries that likewise exceed what many other states experience.

How did COVID-19 impact employers' costs?

Like in past recessions, in the first half of 2020 the UI Trust Fund experienced significant strain as unemployment claims skyrocketed due to business closures and layoffs resulting from public health restrictions. The scale and pace at which claims escalated, however, were without

[1] See Wayne Vroman's *Unemployment Insurance Financing Options* (December 2003): https://www.urban.org/sites/default/files/publication/59531/410922-Unemployment-Insurance-Financing-Options-in-Massachusetts.PDF

precedent. Over the course of 2020, approximately $22 billion in unemployment benefits were distributed to around 1 million claimants, approximately $6 billion of which were outlays from the Massachusetts' UI Trust Fund.[2]

The central driver of increases in employers' UI bills in early 2021 was that Massachusetts enacted a law, following federal guidance, whereby employers were not charged directly for COVID-19 eligibility claims through experience ratings increases.[3] Instead, the Department of Unemployment Assistance (DUA) charged these claims to the solvency account. This practice spread the enormous costs of pandemic-related claims across all companies within the UI system, increasing the solvency rate that every employer pays from 0.58% to 9.23%. Before the COVID-19 pandemic, the solvency account had only been used for much smaller and relatively unimpactful events, such as labor strikes. Employers who had historically not been heavy users of the UI Trust Fund received significantly larger bills without having been responsible for any increase in UI costs within the system.

A short-term legislative solution to the solvency assessment issue

In response to concerns from the business community, on May 28, 2021 Governor Baker signed legislation freezing employer experience-weighted rates for Fiscal Years 2021 and 2022 and authorizing $7 billion in bonding to repay federal advances to cover the cost of COVID-related unemployment benefits. The legislation also transferred all COVID-related UI benefit charges to the solvency account to a new COVID-19 Employer Relief Account. The UI benefit charges to this new account will be paid off over time through the bonding and an additional employer assessment, which in 2021 is equal to 10.5% of every employer's UI rate, retroactive to January 1, 2021.[4] Though the legislation reduced the solvency rate for employers from 9.23% to 1.1%, it was an incomplete fix.

Since the passage of the May 28 legislation, Governor Baker filed a supplemental budget for FY21 with the proposal to dedicate $1 billion of the state's $5 billion tax revenue surplus to help offset the debt of COVID-19 Unemployment Insurance (UI) claims. The Legislature opted to not include the $1 billion designated for UI Trust Fund replenishment as part of their efforts to close the books for FY21 and instead sent to Governor Baker a $303 million supplemental budget to cover outstanding bills for the fiscal year ending June 30, 2021.

Neither the Governor nor the state legislature has indicated specific plans to use some portion of the federal funds via the American Rescue Plan Act (ARPA) to help restore the Fund to pre-pandemic levels. Currently, Massachusetts employers still assume the burden of paying off the $7 billion in debt to meet unemployment benefit charges resulting from state-mandated economic shutdowns.

[2] EOLWD presentation on UI Trust Fund, May 14.
[3] Chapter 81 of the Acts of 2020
[4] "Learn about the COVID-19 Recovery Assessment," Massachusetts Department of Unemployment Assistance. Available here: https://www.mass.gov/info-details/learn-about-the-covid-19-recovery-assessment.

Examining the MA UI System: Financing and Benefits

Massachusetts is among the states in the worst financial position with respect to its UI Trust Fund—and had been at various junctures prior to the COVID-19 pandemic. The combination of the system's eligibility policy, benefits structure, and funding mechanisms have significantly contributed to the Fund's insolvency.

According to reporting from the Department of Unemployment Assistance, as of May 31, 2021, the preliminary Trust Fund ending balance was -$1.8B. The balance exactly one year prior was $733 million. The balance at the end of May 2019 was $1.7 billion. Like in other states, the UI Trust Fund's solvency issues follow a pattern of inadequate reserves to pay for surges in claims during recessions, as the experience of the 2008-2009 Great Recession reflected well before the COVID-19 pandemic.

Reserve Ratio and Average High Cost Multiple

As the Department of Labor Education and Training Administration (DOLETA) notes, the total dollar amount of a state's trust fund at any given time provides a limited view of solvency because the measure does not account for the fund's benefit liabilities or the differences in size or population by state.[5] Two helpful measures more suitable for comparison of solvency are the Reserve Ratio, which measures the trust fund balance as a percentage of total wages, and the Average High Cost Multiple (AHCM), which takes the Reserve Ratio as a percentage of a state's Average Benefit Cost Rate, which is the average of benefits paid over the three highest years over the last twenty years divided by the yearly wages in those years. The idea is to capture sufficient historical data of UI usage relative to wages during past recessions. An ACHM greater than or equal to 1.0 is considered a minimum standard for state solvency going into a recession.

Massachusetts has had a Reserve Ratio of zero since Quarter 2 of 2020, which corresponds to the significant increase in unemployment claims at that time due to pandemic-related business closures and layoffs. The Commonwealth's Reserve Ratio was 0.6 in the first quarter of 2020, when the pandemic first significantly impacted the labor market. This is approximately equal to the average across the ten states with the lowest Reserve Ratios at the time when the pandemic's impact was evident in state labor markets. Massachusetts' Reserve Ratio was 0.8 through most of 2019.

Massachusetts' UI Trust Fund's AHCM has been zero since Quarter 2 of 2020, and the Commonwealth has consistently been in the bottom ten UI systems nationwide as measured by AHCM in the years preceding the pandemic. Massachusetts has not had an ACHM of at least 1.0 for two decades.

Benefits and Wage Replacement

Following the model of recent successful UI reforms in other states, such as Connecticut and New York, discussions focused on reforms to the Massachusetts' UI system must focus on both

[5] For more information, see definitions in DOLETA's State Unemployment Insurance Trust Fund Solvency annual reporting: https://oui.doleta.gov/unemploy/solvency.asp.

the funding side and the spending side. Also like successful reform efforts in other states, Massachusetts' approach must ensure appropriate calibration to ensure that changes, on net, don't create undue costs for employers while still providing adequate wage replacement for residents out of work. The "spending side" here means examination of eligibility policy and the benefits structure of the system and creative approaches to making benefits more sustainable without compromising adequate access to meet residents' needs due to job displacement.

As has been well documented in other reports, by most standard measures Massachusetts has the most expensive UI benefits to employers of all fifty states. The Commonwealth is consistently identified as having among the worst state business tax climates with respect to unemployment insurance by the Tax Foundation's yearly rankings. The Tax Foundation's 2021 Index places Massachusetts in dead last across all 50 states.[6]

The Commonwealth has the longest maximum benefits duration nationwide, 30 weeks, which makes it an anomaly across the other top nine most expensive state UI systems in terms of weekly benefits allowances, the majority of which top out at a maximum of 26 weeks—with the exception of Montana, where maximum duration of benefits is 28 weeks. In Massachusetts, the maximum weekly benefit that UI recipients can claim, when additional allowances are added in, is $1,252. This is 32.6% higher than the state with the next highest maximum plus allowances, Washington, where the maximum weekly benefits plus allowances is equal to $844, and 39.1% higher than the average across the top ten most expensive states by this measure.

Figure 1. Weekly UI Benefits and Allowances by State

State	Max. Weeks of Benefits	Max. Weekly Benefits	Max. Additional Allowance	Min. Weekly Benefits	Max. plus maximum allowance
Massachusetts	30	$855	$397	0	$1,252
Washington	26	$844	0	$201	$844
Minnesota	26	$762	0	0	$762
New Jersey	26	$731	0	0	$731
Connecticut	26	$667	$75	$75	$742
Colorado	26	$649	0	0	$649
Hawaii	26	$648	0	$5	$648
Oregon	26	$648	0	$151	$648
North Dakota	26	$618	0	0	$618
Rhode Island	26	$599	$144	$59	$743
Average	**26.4**	**$700.3**	**$61.6**	**$49.1**	**$762**

[6] "2021 State Business Tax Climate," Tax Foundation. Published October 21, 2021. Available here: https://taxfoundation.org/2021-state-business-tax-climate-index/#UI.

Massachusetts has also consistently had among the highest average weekly benefit (AWB) across all states over the last decade. Over the first quarter of 2021, the most recent period for which data is available via DOLETA, Massachusetts had the highest AWB of all fifty states: $502.33. The U.S. average was $348.49 and the average of the top ten states with the highest AWB for Q1 of 2021 was $455.89. Through calendar year 2020, Massachusetts had the highest AWB in quarters one and four ($551.60 and $468.69, respectively), while only Hawaii exceeded Massachusetts in quarters two and three ($468.03 and $448.25 compared to Massachusetts' $461.90 and $401.45, respectively). In 2018 and 2019, Massachusetts had the highest AWB of all fifty states.

It is reasonable to expect that Massachusetts would have higher benefits than many other states given the Commonwealth's comparatively higher cost of living and higher median wages. The replacement rate, which is the ratio of claimants' weekly benefit to their average weekly wage, provides a view of how much UI benefits replace claimants' wages. According to DOLETA data, the Massachusetts replacement rate was approximately 48% through the first half of 2020 before dipping down to 44% in the latter half of the year. In the first quarter of 2021, Massachusetts wage replacement was approximately the same as the national average (43.9% compared to 44.9%, respectively). Though this does not factor in additional wage replacement through COVID-related federal benefits programs. This makes Massachusetts in line with the general rule of thumb that UI benefits replace approximately half of claimants' weekly wages.

This system-wide percentage, however, does not assess wage replacement in a way that accounts for differences among claimants' base period wages. An overview of the overall distribution of wage replacement across different income levels of UI claimants would provide a more complete picture of wage replacement levels. The US DOL provides general averages and BAM compares weekly benefit amounts to the base period formula in place instead of the entire base year. Without this more nuanced analysis, it is difficult to have a clear sense of what constitutes wage replacement at different tiers of claimants—which is ultimately a critical consideration in looking at the UI system holistically.

To produce a more accurate picture of wage replacement for individual claimants, the state should compare the quarterly wage information reported for the claimant in his or her base period to determine a base period average wage and then compare it to the weekly benefit amount and total benefits payable in the benefit year.

UI Tax Rates and Employer Cost Burden

In addition to having the most expensive benefits across all 50 states, Massachusetts is also among the states with the highest tax burdens for businesses as measured by percentage of both taxable and total wages. In 2019 and 2020, Massachusetts had the fourth highest employer cost burden as measured by percent of taxable wages—3.24% and 2.95%—and had the fifth and fourth highest cost burden as measured by percentage of total wages across all 50 states, 0.81% and 0.72%, respectively. This translates into a high cost per employee for Massachusetts employers. According to the National Foundation for Unemployment Compensation & Workers' Compensation, Massachusetts had the sixth highest average employer contribution per covered employee in 2018 (the most recent data for which analysis is available): $562.[7] Based on analysis from the Massachusetts Joint Committee of Labor and Workforce Development, the UI average cost per employee is $692 in 2021.

Massachusetts is likewise among the states with the highest minimum and maximum rates. An important determinant of an employer's tax rate is its "experience rating", which is based on how much the employer uses the UI system. The experience rating table is a matrix of two things. The first is a list of schedules with different rates based on the fund reserve level of the Trust Fund. When reserves are lower, the rate schedule will be set with generally higher tax rates for each experience rating. The second is the experience ratings themselves. An employer's experience rate determines where it falls on the rating table and thus what the employer's tax rate will be. Generally, experience ratings are set so that heavy users of the UI system pay tax rates consistent with the share of the benefits distributed to claimants that the heavy users are responsible for.

In Massachusetts, the experience rating table covers a much broader range of experience ratings than in other states. We have by far the largest range between our lowest tax rates and our highest. Employers with an experience rating of 17 or more pay the lowest tax rate (0.94% under current schedule E) while employers with an experience rating between -20 and -40 pay the highest tax rate of (14.25% under current schedule E). The Commonwealth's minimum rate of 0.94% is sixth highest nationwide and its maximum rate of 14.25% is highest in the country and approximately double the average across all 50 states. Massachusetts is right in the middle of the pack, though, in terms of its new employer rate of 2.7%--though there is little variance for this rate across all 50 states.

Massachusetts' wages subject to tax set by statute, referred to as the taxable wage base, also puts our UI system in the middle of all states with the 22nd highest across all fifty states at $15,000. For comparison, six other states have the federally mandated minimum of $7,000 and the six states with the highest taxable wage bases have a range between $37,900 and $52,700.

Recommendations

The reforms necessary to sustain solvency for Massachusetts' UI system require modernizing outdated policy for funding the Trust Fund while calibrating benefits to continue to meet the needs of those who require and qualify for unemployment benefits without driving excessive costs to doing business. The following are key principles to guide changes to the UI system:

- An immediate priority should be to stop the bleeding and put in place appropriate measures to mitigate debt obligations as the Commonwealth starts to pay off $7 billion in bonding.
- Before moving ahead with reforms, any proposed changes to the taxable wage base, experience rating table, eligibility, and benefits should be modeled to better understand

[7] "Fiscal Data for State Unemployment Insurance Systems, 2009-2018," National Foundation for Unemployment Compensation & Workers' Compensation Research Bulletin. Published September 2019.

how those changes would impact solvency and the net cost to employers. Reforms to the UI system should be informed by cost per employee differences by state as a matter of assessing any new proposals' implications for Massachusetts' competitiveness relative to other states.

- The UI system needs to be nimbler and more dynamic, with policies that ensure appropriate flexibility for extraordinary circumstances without risking significant surges in costs that ultimately fall on employers. A central goal should be to ensure that the UI system has better controls in place to reduce risk of measures like the socialization of pandemic-related unemployment claims across all businesses with no accounting for differences in their former employees' usage of the system.

The following are specific reform proposals, all of which would contribute to improving predictability and stability in the UI system.

Allocate available federal funds to UI Trust Fund replenishment

An immediate step for the Governor and Legislature should be dedicating some portion of either what remains of the $5.3 billion in federal aid from the Coronavirus State Fiscal Recovery Fund (CSFRF) directed to Massachusetts through the American Rescue Plan Act (ARPA) or the approximately $5 billion in tax revenue surplus from last fiscal year. The Legislature and Administration should dedicate $2 billion of this combined total to UI Trust Fund replenishment to reduce employers' future UI obligations. To date, at least 30 states have dedicated some of their ARPA funds to replenish their UI Funds. An injection of $2 billion would still just cover approximately 29% of the $7 billion in debt, but that would go a long way to alleviating employer obligations.

Follow the example of Connecticut and freeze weekly benefits increases for four years to help stabilize Trust Fund solvency

As part of Connecticut's UI reforms, in addition to increasing the taxable wage base and indexing it to inflation and changing tax rates, the legislation froze maximum weekly benefits for certain claims initially filed in 2024, 2025, 2026, and 2027. Pending results from modeling to determine what impact such a measure would have on Massachusetts' UI Trust Fund solvency, it is worth considering a similar measure in Massachusetts to stem outflows to shore up the Trust Fund balance. This should be done in concert with instituting a dollar cap on annual increases to prevent large spikes, such as the 14% increase to $974 from $855 estimated for 2022.

Reset the maximum benefit duration from 30 to 26 weeks to be more in line with national standards and assess the value of introducing a policy of declining benefit over time

Reducing the maximum number of weeks for benefits eligibility to 26 weeks would make Massachusetts' policy consistent with other states with the longest benefit duration.

Another approach to consider, which would make the UI benefits structure more dynamic, is to use a scale where claimants receive 100% of benefits through half the maximum number of weeks during which claimants are eligible—13 weeks—after which specific categories of claimants receive some tapered benefit (50-75%) for the remaining 13 weeks. The tapered benefits could be designated for specific cases, such as instances of voluntary separations due to "urgent compelling and necessitous circumstances."

Massachusetts should join the mainstream of the other states and use a more moderate and effective eligibility standard, which will limit loopholes and system abuse by preventing eligibility to those without an adequate time period attachment to the workforce

Eligibility triggered by having earnings of 1 ½ X claimants' high quarter of earnings is the most common standard. Moving from the current 30X the WBA to 40X the WBA, with earnings in two quarters, would be one alternative worth considering. At the very least, a requirement of earnings in two quarters, while retaining the current 30X test, would establish a basic minimum time work test (already in place in 49 other states) in addition to the current earnings test.

Implement a cap on the solvency tax

There will always be an inherent challenge in a scenario like a pandemic-induced recession where there is rapid and dramatic surge in claimants. The DOL guidance to refrain from charging individual employer accounts for surging claims and instead put them towards the solvency account is what drove the significant increase on tax bills across the board for all employers in the UI system. To stem future issues resulting from similar conditions, there should be a cap on the solvency tax, determined through assessing balances across employer accounts.

One additional option that is worth additional research is creation of an account that lives separately from the solvency and individual employer accounts, which should be charged in instances where there is extraordinary cause behind the unemployment situations of a sizable number of claimants. This would be an alternative to the COVID-19 Recovery Assessment, which currently levies a 10.5% charge on each employer's tax rate. Such an account would be designed for public health and economic-related anomalous scenarios. For instance, one target group for use of such account could be employees furloughed given public health orders restricting specific types of commerce. The claims from this cohort should be charged to the new account that would be funded by a pre-determined, reliable funding stream. This funding stream, ideally, would be some combination of federal funds and funds from a reliable General Funds revenue resource.

Any changes to the taxable wage base and tax rates, as determined by the experience rating table, should be conditional on a holistic approach that also reduces outlays from the system through benefits and eligibility changes

As stated earlier, Massachusetts' $15,000 taxable wage base places us in the middle of the pack relative to other states. If the Legislature pursues an increase in the taxable wage base, it should be balanced with changes in benefits and eligibility to minimize additional costs to employers. Raising both the taxable wage base and employer UI tax rates concurrently would create significant harms to Massachusetts employers. An increase in the wage base of between $5,000 and $15,000 could be considered in a phased in approach after the COVID debt is paid for or substantially reduced.

Any indexing of the wage base should only be pursued with a linked reform in limiting automatic annual increases in the maximum weekly benefit amount by instituting a dollar amount annual limitation in any increase. Any changes to the taxable wage base should be conditional on a holistic approach that also reduces outlays from the system through benefits and eligibility changes.

Assuming minimal net neutral impact to employers, one new approach to consider is a tiered taxable wage base setting a higher level of wages subject to taxation for those employers who pay the maximum rate. Both Nebraska and Rhode Island have two-tiered systems. In Nebraska, the standard taxable wage base is set at $9,000 and for high tax group employers the base is set at $24,000. In Rhode Island the standard wage base is $24,000, which increases to $25,000 for high tax group employers. Massachusetts could go a similar path and create two tiers: one that keeps the majority of employers at the current taxable wage base of $15,000, or a slightly higher amount, and another tier that is line with Nebraska's and Rhode Island's tier for maximum tax rate employers. This would make sense especially given the gap between what the lowest experience rated employers pay into the system in contributions versus the claimants' benefits charges that they are responsible for. Regardless, there should be careful consideration of what a higher second tier taxable wage base would translate into for max-rated employees. Any creation of a two-tiered wage base should implement gradual increases to the taxable wage base to ensure rate changes are easier to absorb and plan for.

UI Trust Fund Modeling Requests

To better understand the interplay of the various components of solvency on the overall Trust Fund balance, we are requesting modeling for the following proposed changes. In each instance, data from 2019 should be used and all other components should be held constant in order to understand the impact of any specific change. In the next modeling exercise, different iterations of a set of policy recommendations should be run to understand more holistically the systemic impacts and the Trust Fund solvency of these proposed changes.

(1) Wage Base – for each of the following: (1) a minimum wage job, (2) a median salary job and (3) $147,000 job (Social Security cap).
   a. Increase by $1,000
   b. Increase by $10,000
   c. Uncapped Increase

(2) Eligibility
   a. Model benefits based upon 1.5 times the earnings of the highest quarter
   b. Establish a minimum time worked standard of two quarters of work under the current earnings test

c. Disallow workers who voluntarily quit from collecting UI benefits.
d. Raise the earned income threshold from $5,400 to $7,200 with earnings required in two quarters

(3) Benefits

a. Reduce duration of benefits from 30 to 26 weeks
b. Freeze the maximum weekly benefit amount for 4 years

(4) Experience Rating

a. No changes at this time

(5) Use of ARPA Funds to replenish the UI Trust Fund

a. Model a $2 billion contribution of state resources to the UI Trust Fund and the impact of this on borrowing costs including interest and the reduction of the employer COVID assessment that would result