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# Fixing Unemployment Insurance

***Senate and Assembly budgets propose business bailouts, but fail to achieve solvency for UI trust***

Unemployment insurance (UI), which provides temporary income to laid-off workers, is one of the State's most important economic stabilization policies. Unemployment can both throw workers into poverty and exacerbate recessions by driving down demand; UI counteracts these risks and can soften the blow of an economic downturn. Unfortunately, New York State's UI system has been chronically insolvent due to an inadequate UI tax on businesses, leaving the state unprepared for economic downturns. Given the likelihood of a recession from the economic policies of the Trump administration, as well as rising job losses from federal budget cuts, New York State urgently needs to address the long-standing inadequacies of its UI system.

When unemployment rose sharply during the Covid pandemic, the State had to borrow from the federal government to pay out claims. The State still owes $6.2 billion to the federal government, which automatically results in higher taxes on businesses and lower benefits for unemployed workers. The current maximum benefit level is $504 per week, even though under state law it is supposed to be $840 per week. (By contrast, in Massachusetts the maximum benefit is currently $1,051 per week and in New Jersey it is $874 per week). The benefit cannot rise to its statutorily prescribed level until the debt to the federal government is paid off.

In response to demands from the business community for tax relief, this year's legislative "one house" budgets have each proposed bailout measures: the Senate would spend $1 billion on a UI tax credit for businesses, and the Assembly would spend $7 billion to eliminate the debt to the federal government (and bring the trust to a minimum level of solvency). The Assembly's proposal, while far more costly and generous to the business community, has the merit of eliminating the debt to the federal government and thereby allowing the benefit level to increase. However, each of these proposals fails to solve the *underlying* issue of the inadequate tax structure. Any deal that is worked out between the legislature and the Governor must (i) raise the benefit level for workers and (ii) reform the UI tax to adequately fund the trust.

**Recommendation:** FPI recommends reforming the UI tax to apply to all taxable wages at a rate of 1 percent, enough to raise $6.5 billion annually. This reform would lower the tax rate while raising more revenue by covering a much larger share of wages, and it would more fairly distribute the tax burden to businesses with higher-wage employees.

## Detail on How to Fix the UI Tax

UI tax revenue is so low because the tax only applies to the first $12,800 of an employee's wages (called the "taxable wage base"). While the average UI tax rate is currently 3.3 percent, the tax is applied to such a small share of wages that it raises little revenue. On an annual basis, about $675 billion of wages are paid by covered employers, but the UI tax only *applies* to $105 billion of these wages (about 16 percent) because of the low taxable wage base.[1] The UI tax currently raises $3.5 billion annually—barely adequate to cover $3.1 billion in annual payment obligations, even in this period of low unemployment and with an artificially low benefit level. If the benefit level were unfrozen and set at the statutorily required level, the trust's annual obligations would be $5.5 billion, and it would be unable to cover them—again, even in the current period of low unemployment.

The UI tax must be reformed so that it both (i) raises enough revenue to cover the required benefit level and (ii) will build up a surplus in periods of low unemployment in order to buffer the trust during economic downturns. The best way to reform the UI tax is also the most straightforward: Expand the tax to cover *all* wages, not just a small share of wages, and set the rate to a level sufficient to cover annual liabilities at the appropriate benefit level and build up a surplus in periods of low unemployment.

If the UI tax is expanded to cover all wages, a tax rate of 1 percent should raise $6.5 billion annually, enough to meet the two goals described above.

Broadening and simplifying the UI tax will have other benefits as well. The UI tax relies on an "experience rating" that imposes higher taxes on employers who have laid off more workers, and a lower tax on employers who have laid off fewer workers. In principle this may sound like a good incentive to avoid layoffs, but in reality it can just encourage employers to fight unemployment claims. It also produces a high degree of uncertainty in the UI tax system, as tax rates can range from 0 percent to nearly 10 percent based on the experience rating. In order to ensure revenue stability and permanent solvency, it would be better to structure the UI tax as a simple, flat rate applied to all wages.

Additionally, this reform to the UI tax would equalize the tax burden among business. Currently, employers of lower wage workers shoulder a disproportionate share of the tax burden, while employers of higher-wage workers pay an artificially low tax burden. The employer of a minimum wage worker pays UI tax on that worker's wage of 1.3 percent, whereas the employer of a worker who makes $100,000 per year pays a tax of just 0.4 percent (assuming the current average tax rate).

Finally, this proposed based-broadening reform would make the tax easily adjustable when more revenue is needed for trust solvency. Even a small tax increase on a broad base raises substantial revenue—for instance, marginally raising the tax rate from 1 percent to 1.1 percent would yield an additional $650 million.

[1] All calculations based on the most recent four quarters of data from the U.S. Department of Labor.