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POLICY BRIEF

Creating Jobs: Reforming Unemployment Insurance in Massachusetts

by Steve Poftak

Including data and analysis from IHS Global Insight's U.S. Regional Service

Executive Summary

As states and nations aggressively promote their business climates, the high cost of doing business in Massachusetts requires ongoing remediation for the Commonwealth to sustain its competitive advantage. While most employers are willing to absorb some higher costs in exchange for access to the Commonwealth's skilled workforce, world-class universities, and innovative culture, they demand a stable, predictable and competitive business cost climate. Unfortunately, the Commonwealth's Unemployment Insurance ("UI") tax system is the most costly system in the nation – and it is potentially costing Massachusetts thousands of jobs.

Massachusetts' UI safety net is the most generous in the nation by several measures, including eligibility and benefit duration. Massachusetts is the only state that provides 30 weeks of benefits; 48 other states provide 26 weeks. Massachusetts also allows an individual who has been working for 15 weeks in only one quarter to be eligible for the same benefits as someone who has been in the workforce for 20 years.

These two features of the Massachusetts UI system have the paradoxical effect of creating an inhibitor to job creation -- an expensive 'per job' tax. In 2010, the 'per job' tax burden due to unemployment insurance costs was $638 in Massachusetts, twice the U.S. average.

Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government..

The Massachusetts High Technology Council strengthens the competitive advantage of member companies and the regional technology economy by:

- Advocating for state, federal and regional public policies that advance tax and cost-competitiveness, defense technology and technology transfer, education and talent development, and clean energy and sustainability
- Facilitating collaboration and rapid access to innovative technologies across sectors
- Providing cost-saving and best practice programs

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To add insult to injury, the state is poised to inflict a 40 percent increase in UI costs for 2011, triggered by a projected depletion in the UI trust fund. This will raise the per job tax burden to $897 and has led to calls from business associations like the Massachusetts High Technology Council to freeze rates and instead recapitalize the state UI fund by borrowing federal funds at little or no interest .

But rather than merely re-apply a band-aid to this problem, the spike in the projected UI rate increase begs for wider reform of the system, not only to curb ill-timed cost increases, but also to provide more predictability and stability to the system.

This policy brief offers four reform proposals:

- resetting benefit duration to 26 weeks, the standard of 48 other states
- requiring greater workforce attachment by moving to the national standard of 20 weeks of work and requiring employment over two quarters.
- charging employers more equitably by making heavy users of unemployment insurance pay more (by reforming the experience table), and
- lengthening the payroll base for the calculation of unemployment taxes to smooth out short-term volatility

These reforms would keep in place a safety net comparable to any other state in the country, while reducing the 'per job' tax burden on Massachusetts employers.

Most importantly, unemployment insurance reform would result in significant job creation. Economic modeling by IHS Global Insight projects that, over the next 10 years, reforms would result in:

- 10,000 additional jobs
- $3.8 billion in additional wages
- $7.5 billion in additional economic output
- $30 million in additional tax revenues

Additional savings to the system and economic impact to the Commonwealth could be achieved by implementing a new rate-setting mechanism, limiting serial utilization of unemployment benefits, and limiting self-triggering abuse of the system; these proposals require further analysis.

Why does UI matter?

Unemployment insurance serves as the primary government-run aspect of the social safety net for newly unemployed persons. Those people who lose their jobs through a layoff are provided with some portion of their salary for a fixed period of time (or until they are re-employed). The intent of the system is to ensure a level of stability for the unemployed person and their dependents, providing funds for necessary items, time to find new employment, and the opportunity to remain in their current living arrangements.

Employers pay for unemployment insurance and are taxed on their payroll and their previous usage of the unemployment insurance system (i.e., companies that frequently lay off employees pay more into the system than firms that lay off infrequently).

Individuals become eligible for unemployment insurance by earning at least thirty times the weekly benefit amount. Benefit levels are based on a percentage of their salary. These factors, as well as the duration of benefits, vary from state to state.

Unemployment insurance matters for several reasons – it's an integral part of the social safety net. But its practical implementation can also be a drag on hiring, creating a per employee 'job tax' that increases at precisely the time when it should be lowest.

Proposed Reforms and Impact

The Tax Foundation's study of business tax climates for 2011 show Massachusetts as having the second least favorable UI tax climate in the US (behind Rhode Island). By contrast, states such as North Carolina and California, which compete for many of the same technology jobs that dominate our economy, ranked as the 6th and 14th most favorable UI tax climate states, respectively.

As this data shows, Massachusetts could become more competitive. This section proposes a number of specific UI reforms, then calculates their impact.

Resetting Benefit Duration to 26 Weeks

The first reform proposes a reduction in the duration of benefits from 30 weeks to 26 weeks. Massachusetts' current maximum benefit duration of 30 weeks is the highest in the nation. Only Montana comes close, offering 28 weeks, while every other state sets 26 weeks as the maximum. This makes Massachusetts a stark outlier when business leaders compare costs across states and evaluate relocation decisions, especially given that the federal government provides extended UI benefits during periods of high unemployment (currently two years running) which is triggered in Massachusetts after only 26 weeks.

The average unemployed person received $354 in weekly UI benefits from the Commonwealth of Massachusetts over the period 2000 to 2008. Over the maximum duration of 30 weeks this would result in total benefits of $10,628. Limiting the duration to 26 weeks would reduce the total benefits to $9,211. By comparison, the U.S. average weekly compensation was $263 (reflecting in part lower personal income levels nationally versus Massachusetts) which would result in total benefits of $6,838 over a 26 week period.

Reducing the benefit duration to the level of 48 other states would result in a reduction of unemployment insurance taxes paid by businesses by $213 million in 2010, with similar reductions in future years. As indicated above, in times of sustained economic hardship and increased unemployment, the federal government will step in and expand benefit durations. This reform would not interfere with the state's ability to access this extended benefit (which has grown during the current downturn to provide up to 99 weeks of coverage as of February 2011).

Requiring Greater Workforce Attachment

The second proposed reform is to increase the level of workforce attachment required in order to be eligible for unemployment benefits. Current Massachusetts law requires workers to earn at least 30 times the "weekly benefit amount" (WBA) and at least $3500. Of the ten other states that utilize a multiple of WBA to determine eligibility, only 3 have multiples lower than Massachusetts. The proposed reform would require the equivalent of 20 weeks of workforce attachment over two quarters in order to qualify for benefits. This would reduce the number of eligible recipients and decrease the total benefits charged to employers in a manner consistent and competitive with the majority of other states.

Reforming the Experience Table

The third proposed reform extends the experience table. The experience table causes those companies who have frequent layoffs to be charged more than those who are steady employees. Massachusetts uses the "reserve ratio" approach, which takes into account each firm's net contribution to the Unemployment Insurance Trust Fund then divides it by their average payroll over a fixed period.

The experience table in Massachusetts currently stretches from -.15 (for firms that layoff frequently) to .16 (for stable employers). This results in per employee contribution levels ranging from the maximum of $1,718 to the minimum of $176. The reform proposal would extend the range to -.23 to .35, increasing the payment for frequent users and lowering it for stable employers. This would result in per employee contribution levels ranging from $22 to $2,070. The intent of the reform would be to make the system more equitable by reducing the cross-subsidization of heavy utilizers by stable employers.

Lengthening the Payroll Base

The concept of a reserve ratio is also relevant to another proposed reform – extending the payroll used as the base for the reserve ratio from 12 months to 3 to 5 years. Of the 33 states that use this reserve ratio method, only two other states (South Carolina and Wisconsin) use a single year. By using a longer payroll period, reserve ratios are less sensitive to short-term volatility in payroll caused by economic conditions.

In 2010, the total unemployment insurance burden in Massachusetts is projected to be $1.575 billion; the proposed reforms would reduce this burden to $1.362 billion—a 14% reduction in employer costs. The economic consulting firm IHS Global Insight was commissioned to determine the impacts of these reforms (and business cost reductions) over the next ten years. By using their proprietary state economic model, IHS Global Insight determined that the additional investment precipitated by UI reforms would lead to the following impacts by mid-decade:

- 4,895 new jobs
- $314 million in additional annual wages
- $618 million in additional economic output
- $10 million in additional general income and induced tax revenues

Extended over the entire decade, these changes would have the cumulative effect of:

- 10,000 additional jobs
- $3.8 billion in additional wages
- $7.5 billion in additional economic output
- $30 million in additional tax revenues

These changes come about as a result of the reduction in business costs due to the proposed reforms. These reductions result in levels of additional investment and employment, to produce the direct and indirect impact of reforms.

Additional Potential Reforms

In addition, other reforms ought to be considered but were outside the scope of the above analysis. These include:

- **Implementing A New Rate-Setting Mechanism** – The current rate-setting mechanism is set up as a series of payment schedules, which increase the level of unemployment insurance taxes as the Unemployment Insurance Trust Fund declines. This presents a problem in that it is pro-cyclical – when the Fund declines due to high unemployment and a weak economy, a rise in unemployment insurance taxes is triggered, providing a disincentive to hiring.
- **Limiting Serial Utilization of Unemployment Benefits** – There are individuals who access unemployment benefits on a regular basis, some for as many as 20 consecutive years. It would require reform at the federal level to curtail this, but limiting this predictable, repeated abuse of the system would preserve some of the Trust Fund for the truly needy.
- **Self-Triggering** – Related to the previous point, certain self-employed and small business owners have the ability to trigger unemployment benefits by effectively laying themselves off. If this is due to an actual disruption to their business, it can be justified. If it's a regular or seasonal method to generate income, it's an abuse of the program and should be eliminated.

Conclusion

Massachusetts, along with the rest of the country, needs to create jobs, but it also has an obligation to provide a safety net for the unemployed. However, Massachusetts' unemployment insurance is the most generous in the nation, in terms of eligibility requirements and benefit duration. This creates an expensive Massachusetts 'per job' tax that serves as an additional cost for employers considering hiring. In 2010, the 'per job' tax burden due to unemployment insurance costs was $638 in Massachusetts, twice the U.S. average.

Employers fund 100 percent of state UI costs and higher UI taxes may prolong the state's economic and fiscal recovery by inhibiting hiring. When business cost increases become uncompetitive, employers may choose to avoid hiring or move jobs to lower, more predictable cost environments.

The reform proposals examined in this paper – resetting benefit duration to the standard of 48 other states, charging employers more equitably, lengthening the payroll base, and requiring greater workforce attachment – would keep in place a safety net comparable to any other state in the country, but reduce the 'per job' tax burden on employers. None of these needed reforms will reduce the amount of weekly benefits paid out to displaced workers, which are the highest in the nation. Most importantly, they would also result in the creation of an estimated 10,000 jobs over the next ten years and $3.8 billion in wages.

About the Author

Steve Poftak is Pioneer's Director of Research and Director of the Center for Better Government. Previously, Steve worked at the Commonwealth's Executive Office for Administration and Finance, where he managed the $1.3 billion capital budget, prepared the state's quarterly cash flow reporting, and monitored non-tax revenue receipts.

About Pioneer

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About the Massachusetts High Technology Council

The Massachusetts High Technology Council is composed of CEOs from the state's top technology employers who work to make Massachusetts a more competitive place for technology growth. The nonpartisan Council has a 33-year record of working with state and federal leaders in a decisive and effective manner on issues of education, taxation, economic development, energy, defense technology and more. Council members run leading global companies from all sectors of the state's diverse innovation economy. For more than thirty years the Council has played a catalytic role in the passage of groundbreaking laws and regulations such as the 2010 Achievement Gap Act and 1993 Education Reform Law, keeping Hanscom AFB and the Natick U.S. Army base open (2005), the John Adams Innovation Fund (2003) and the state's research and development tax credit (1992), state electric utility restructuring (1998), workers' compensation reform (1991), and Proposition 2 & 1/2 (1980). Visit http://mhtc.org for more information.

PIONEER INSTITUTE
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85 Devonshire Street, 8th Floor, Boston, MA 02109 |
T: 617.723.2277 F: 617.723.1880 |
www.pioneerinstitute.org