UNEMPLOYMENT INSURANCE ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

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CONTENTS

Page

Advisory of April 17, 1997, announcing the hearing 2

WITNESSES

American Federation of Labor and Congress of Industrial Organization, Jonathan Hiatt 70
American Trucking Associations, Kenneth Simonson 37
Association of Christian Schools International, William Bentley Ball 96
California Health and Welfare Agency, Thomas P. Nagle 92
Doherty, Lynn Quigley, Illinois Department of Employment Security, and State of Illinois 60
English, Hon. Phil, a Representative in Congress from the State of Pennsylvania 9
Farr, Hon. Sam, a Representative in Congress from the State of California 14
Georgia Department of Labor, David B. Poythress 22
Gilbert, Gay, Ohio Bureau of Employment Services, and Interstate Conference of Employment Security Agencies 66
Hiatt, Jonathan, American Federation of Labor and Congress of Industrial Organization 70
Illinois Department of Employment Security, and State of Illinois, Lynn Quigley Doherty 60
Interstate Conference of Employment Security Agencies, Gay Gilbert 66
Masur, Richard, Screen Actors Guild 98
Miller, Albert R., Phoenix Closures, Inc 76
Nagle, Thomas P., California Health and Welfare Agency 92
Norwood, Janet L., Urban Institute 45
Ohio Bureau of Employment Services, Gay Gilbert 66
Oxfeld, Eric J., UBA, Inc 25
Peterson, Hon. Collin, a Representative in Congress from the State of Minnesota 85
Phoenix Closures, Inc., Albert R. Miller 76
Poythress, David B., Georgia Department of Labor 22
Red Lake Band of Chippewa Indians, Bobby Whitefeather 86
Screen Actors Guild, Richard Masur 98
Shadegg, Hon. John, a Representative in Congress from the State of Arizona . 15
Simonson, Kenneth, American Trucking Associations 37
Thomas, Hon. Bill, a Representative in Congress from the State of California . 7
UBA, Inc., Eric J. Oxfeld 25
Upton, Hon. Fred, a Representative in Congress from the State of Michigan ... 12
Whitefeather, Bobby, Red Lake Band of Chippewa Indians 86
Wilson, Mark, Heritage Foundation 30

SUBMISSIONS FOR THE RECORD

Allen, W. Ron, National Congress of American Indians, statement and attachment 138
American Legislative Exchange Council, Duane Parde, statement and attachment 124
American Society for Payroll Management, New York, NY, Clark G. Case, letter 127
Anderson, Marge, Mille Lacs Band of Ojibwe Indians, Onamia, MN, statement 135
California Correctional Peace Officers Association, West Sacramento, CA, Don Novey, statement 128
Case, Clark G., American Society for Payroll Management, New York, NY, letter 127

Page
Coalition on Human Needs, Jennifer A. Vasiloff, statement 129
Crooks, Hon. Stanley, Shakopee Mdewakanton Sioux (Dakota) Community, Prior Lake, MN, statement and attachments 179
Eastern Band of Cherokee Indians, Cherokee, NY, statement 130
Echohawk, John E., Native American Rights Fund, statement and attachment 144
Fond du Lac Band of Lake Superior Chippewa Indians, Cloquet, MN, Robert B. Peacock, statement and attachments 132
Knight-Frank, Judy, and Clement J. Frost, Ute Mountain Ute Indian Tribe, Towaoc, CO, and Southern Ute Indian Tribe, Ignacio, CO, joint statement .. 187
Mille Lacs Band of Ojibwe Indians, Onamia, MN, Marge Anderson, statement 135
National Congress of American Indians, W. Ron Allen, statement and attachment 138
Native American Rights Fund, John E. Echohawk, statement and attachment 144
Navajo Nation, statement 142
New Hampshire, State of, Department of Employment Security, Concord, NH, Joseph Weisenburger, statement 150
Novey, Don, California Correctional Peace Officers Association, West Sacramento, CA, statement 128
Ohio State, Hon. George V. Voinovich, Governor, statement and attachment ... 152
Parde, Duane, American Legislative Exchange Council, statement and attachment 124
Peacock, Robert B., Fond du Lac Band of Lake Superior Chippewa Indians, Cloquet, MN, statement and attachment 132
Pennington, Luella, Chicago, IL, statement 173
Shakopee Mdewakanton Sioux Community, Prior Lake, MN, Hon. Stanley Crooks, statement and attachments 179
Sheridan, Mike, Texas Workforce Commission, Austin, TX, letter and attachments 187
Southern Ute Indian Tribe, Ignacio, CO, Judy Knight-Frank, and Clement J. Frost, joint statement 187
Texas Workforce Commission, Austin, TX, Mike Sheridan, letter and attachments 187
Ute Mountain Ute Indian Tribe, Towaoc, CO, Judy Knight-Frank, and Clement J. Frost, joint statement (see listing under Knight-Frank, Judy) 187
Vasiloff, Jennifer A., Coalition on Human Needs, statement 129
Voinovich, George V., Governor of Ohio, statement and attachment 152
Weisenburger, Joseph, New Hampshire Department of Employment Security, Concord, NH, statement 150

UNEMPLOYMENT INSURANCE ISSUES

THURSDAY, APRIL 24, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:35 a.m., in room B–318, Rayburn House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
April 17, 1997
No. HR–6

CONTACT: (202) 225–1025

Shaw Announces Hearing on Unemployment Insurance Issues

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on certain unemployment insurance issues. The hearing will take place on Thursday, April 24, 1997, in room B–318 Rayburn House Office Building, beginning at 10:30 a.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include State unemployment insurance directors, employers, and other experts on unemployment insurance issues. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

BACKGROUND:

The Federal-State unemployment insurance (UI) system is designed to provide temporary benefits to individuals with a recent work history who become involuntarily unemployed. Federal taxes generally support the administrative expenses of the system, with State taxes supporting benefits. Increased skepticism about the efficiency of the system, and especially its administration, have been cited in calls by States and employers for reform.

The Subcommittee is interested in various proposals to reform the administrative financing of the system. One proposal, supported by nine States (Kentucky, New Hampshire, Ohio, Georgia, Missouri, Virginia, Texas, Mississippi, and Oklahoma) would allow States to collect all taxes needed to pay for both administration and benefits (although the Federal Government would continue to set the level of tax that pays for administration). Another proposal would end the Federal tax and replace it with a State-set tax supporting administration. Both would allow the 0.2 percent Federal surtax, currently authorized through December 31, 1998, to expire. Proponents argue that allowing States greater authority to collect administrative funds would lead to lower payroll taxes, reduced business paperwork, and improved efficiency in labor markets across the country. While no pertinent bill has been introduced in the current Congress, the Subcommittee is interested in suggestions for change that promise increased employment and business growth while preserving the principles of the current unemployment insurance system.

A second major area of interest involves State flexibility in administering the UI system. In determining whether a worker's employment record is sufficient to warrant benefits, 47 States consider only wages earned over 4 of the last 5 completed calendar quarters (called the worker's "base period"). A few States also consider the worker's eligibility under an "alternative base period," increasing the likelihood that these workers will qualify for benefits. A recent Illinois Federal court decision (*Pennington* v. Doherty) called into question what formerly was assumed by States—that the Social Security Act provides States with the authority to select their own base period, which need not include the use of an alternative base period. If every State

were required to use an alternative base period, as the *Pennington* decision foreshadows, the consequences could be significant in terms of higher benefit payments and higher payroll taxes.

In announcing the hearing, Chairman Shaw stated: "Keeping the unemployment insurance system operating smoothly and efficiently is important to employees, employers, and the U.S. economy. This hearing is part of our ongoing efforts to ensure that the current system is working well and to explore ways of making it even better in the future."

FOCUS OF THE HEARING:

The hearing will focus on two main issues. First, the Subcommittee will consider testimony on administrative financing reform proposals that would allow greater State control in collecting taxes and administering unemployment insurance programs. Second, witnesses will discuss the implications of the *Pennington* case, a Federal court decision that has drawn into question whether States have full authority to set base periods used in determining eligibility for unemployment insurance benefits. In addition, other witnesses will discuss the way the UI system affects prisoners, Native Americans, actors and poll workers, and others.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Thursday, May 8, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Human Resources office, room B–317 Rayburn House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–225–1904 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman SHAW. If everybody could take their seats we will proceed.

Keeping the UI, unemployment insurance, system operating smoothly and efficiently is important to more than a hundred million employees, to millions of employers, and to the strength and vitality of the U.S. economy.

In keeping with the Subcommittee's oversight of unemployment insurance, this hearing has three goals: One, to consider long-term changes to improve the system in years to come; two, to examine steps Congress must take in the coming months to keep the system running efficiently; and, three, to hear about a variety of proposals to improve the individual components of the system.

We have a distinguished panel of Members to lead off our hearing, who will testify about a range of issues, including the treatment of Indians, actors, poll workers and prisoners under the current system.

After we hear from Members, our first panel will examine proposals designed to increase State flexibility in operating their unemployment insurance system. Bipartisan proponents argue that reforms can lead to lower payroll taxes, less paperwork, and improved efficiency in labor markets across the country.

Significantly, nine States and employer groups led by UBA, Inc., have come together to support a detailed reform proposal, and the Subcommittee is eager to hear about this and other proposals to strengthen the UI system.

It is my hope to draft legislation, hold a hearing on the bill, and to proceed to markup on a reform proposal that features the type of changes we will hear about today.

Our second panel involves an issue that demands our immediate attention. Since its inception in the thirties, there has been universal agreement that States have the right to set base periods used to determine eligibility for unemployment insurance benefits. Until now. A Federal court decision in Illinois in the *Pennington* case means that more than 40 States now face a possibility of being forced to adopt a new, more liberal standard for determining eligibility for unemployment benefits.

Unless Congress acts quickly, almost every State will be forced to pay higher unemployment insurance benefits, resulting in more redtape, higher taxes on employers, and less job creation. Overall, added cost could reach as high as $1 billion each year.

For our final panel, expert witnesses will present further testimony about several issues that Members have raised. Unfortunately, Charlton Heston could not join us again, which means that we will have been spared the deluge of bad puns that everyone had to endure at our last hearing on this particular topic. Probably all

for the best, so those of you who are waiting to see Charlton Heston, I apologize, but he will not be with us this morning.

[The opening statement follows:]

Opening Statement of Hon. E. Clay Shaw, Jr.

Keeping the unemployment insurance system operating smoothly and efficiently is important to more than 100 million employees, to millions of employers, and to the strength and vitality of the U.S. economy. In keeping with this Subcommittee's oversight of unemployment insurance, this hearing has three goals: (1) to consider long-term changes to improve the system in years to come; (2) to examine steps Congress must take in the coming months to keep the system running efficiently; and (3) to hear about a variety of proposals to improve individual components of the system.

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On our final panel, expert witnesses will present further testimony about several issues Members raised earlier.

Chairman SHAW. Sandy, do you have an opening statement?

Mr. LEVIN. Yes, I do.

But I think other very charismatic people are here, so no one should leave.

Mr. Chairman, I want to begin by thanking you for scheduling this hearing. As we discuss the proposals on administration financing reform and on the *Pennington* case that are the stated focus of this hearing, I would strongly urge that we keep in mind the overall features of the unemployment insurance system so that we do not lose sight of the forest for the trees.

First, unemployment is a national problem. The unemployment insurance system was designed as a Federal-State partnership, and we must maintain the basic structure of shared responsibility and oversight between the Federal Government and the States.

Unemployment hits regions of our country at different times and to different degrees. People move from State to State seeking new employment. It is a national priority to support these individuals and assist in their transition to new employment.

Second, fewer and fewer workers are qualifying for unemployment benefits. This is especially true of low-wage workers, even those who have a strong attachment to the labor force, and the increasing proportion of our work force engaged in part-time or tem-

porary employment also experiences great difficulty in obtaining income support and employment services through the UI system.

Finally, more and more workers are facing permanent dislocation. The rate at which unemployed workers exhaust benefits has climbed steadily since 1945. Conversely, the percent of individuals losing their jobs on a temporary basis has fallen substantially since 1965.

Almost one-half of those workers permanently displaced from their jobs end up making less than 80 percent of their prior income or not finding employment at all. We must do a better job of assisting these workers in their search for new skills and new employment.

I recognize that our method of allocating administrative funds is frustrating to the States and the employers who pay these taxes. There ought to be ways of addressing these issues on a bipartisan basis.

In approaching the issue, we should give due consideration to the fact that the current allocations take workload and, therefore, recipiency rates into account. The Federal taxable wage base has not kept pace with wage growth in the economy. And we should address the shortcomings of the extended benefits program designed to fill in during tough economic times, which nearly every expert agrees doesn't work.

But these issues cannot be considered in a vacuum. We must reexamine the initial purpose of the unemployment insurance system as a whole within the context of our rapidly changing economy. Is the system still able to meet the goals of providing temporary wage replacement to unemployed workers with a labor force attachment?

Is the system still able to provide for the stabilization of the economy? Until the UI system addresses the needs of unemployed workers with a labor force attachment, including the reemployment needs of the permanently displaced, I would argue that we are failing to achieve the legitimate goals of the system.

We cannot afford to do all that some would like, but we should try to find some things we can all support. I look forward, Mr. Chairman, to addressing these important issues with you on a bipartisan basis.

[The opening statement follows:]

Opening Statement of Hon. Sander M. Levin

Mr. Chairman, I want to begin by thanking you for scheduling this hearing. As we discuss the proposals on administrative financing reform and on the Pennington case that are the stated focus of this hearing, I would strongly urge that we keep in mind the overall features of the unemployment insurance system so that we do not lose sight of the forest for the trees.

• First, unemployment is a national problem. The unemployment insurance system was designed as a federal-state partnership, and we must maintain the basic structure of shared responsibility and oversight between the federal government and the states. Unemployment hits regions of our country at different times and to different degrees—people move from state-to-state seeking new employment. It is a national priority to support these individuals and assist in their transition to new employment.

• Second, fewer workers are qualifying for unemployment benefits. This is especially true of low-wage workers, even those who have a strong attachment to the labor force. The increasing proportion of our workforce engaged in part-time or temporary employment also experiences great difficulty in obtaining income support and employment services through the UI system.

• Finally, more and more workers are facing permanent dislocation. The rate at which unemployed workers exhaust benefits has climbed steadily since 1945; conversely, the percent of individuals losing their jobs on a temporary basis has fallen substantially since 1965. Almost half of those workers permanently displaced from their jobs end up making less than 80% of their prior income or not finding employment at all. We must do a better job of assisting these workers in their search for new skills and new employment.

Now, I recognize that our method of allocating administrative funds is frustrating to the states and the employers who pay these taxes. There ought to be ways of addressing these issues on a bipartisan basis. In approaching the issue, we should give due consideration to the fact that current allocations take workload, and therefore recipiency rates, into account, and that the federal taxable wage base has not kept pace with wage growth in the economy. And we should address the shortcomings of the extended benefits program—designed to fill in during tough economic times—which nearly every expert agrees doesn't work.

But these issues cannot be considered in a vacuum. We must re-examine the initial purpose of the unemployment insurance system as a whole within the context of our rapidly changing economy. Is the system still able to meet the goals of providing temporary wage replacement to unemployed workers with a labor force attachment? Is the system still able to provide for the stabilization of the economy?

Until the UI system addresses the needs of unemployed workers with a labor force attachment, including the reemployment needs of the permanently displaced, I would argue that we are failing to achieve the legitimate goals of the system. We cannot afford to do all that some would like, but we should try to find some things that all can support. I look forward to addressing these important issues with you on a bipartisan basis.

Chairman SHAW. Thank you, Mr. Levin.

We have our panel of members. I see Mr. Farr is not with us yet, but he hopefully will be joining us. We will lead off with two Members of our Committee, a senior Member, Mr. Bill Thomas, and Phil English, who is not only a Member of the Full Committee, but also of this Subcommittee; Fred Upton from Michigan; and John Shadegg from Arizona.

We're pleased to have you gentlemen with us. As usual we have your full statement which will be made a part of the record. You may feel free to summarize as you might wish.

Mr. Thomas.

STATEMENT OF HON. BILL THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. THOMAS. Thank you very much, Mr. Chairman. It's a pleasure to be with you to discuss a bill that I have, H.R. 562, and there are several others that I would like to mention at the end of my statement as well. I would tell my friend from Michigan that I think a mobile labor force indeed argues for a national labor policy.

But my bill, and perhaps several others, will, I think, focus on some anomalies that when States make judgments that for themselves seem prudent, and you have a national labor law, oftentimes there are some catch-22 situations. And I would like to address what I believe to be one of those in the bill that I have offered which would correct the problem.

California voters established what was called a joint venture program in 1990. It was a work program for inmates incorporating private contractors and other folks. The wages that the prisoners were to earn were to be used for a number of purposes, among them, to compensate victims, to offset incarceration costs, and then some

set-aside funds—about 20 percent—so that when they're released from prison they would have some money available for them.

Because of the mix with Federal labor law, the Department of Labor said that you can deny unemployment benefits in only three instances. One, if a worker's income exceeds certain limits; two, if the claim is fraudulent; or, three, the employee was fired for misconduct.

Well, the reason the prisoners lost the jobs under this program was because they left prison. And the Department of Labor argued that these prisoners then deserved unemployment compensation at the time they left prison, because it didn't meet any of the three Federal requirements for not giving them unemployment compensation.

The people of the State of California passed last year Proposition 194, which was an initiative on the ballot that said we want to deny unemployment compensation upon release of these prisoners who were in a program that we otherwise think is a good program. This created a situation which I hope will be resolved with the Committee and the Congress in the signing into law of H.R. 562, because all this does is basically say, that the conundrum that the States are now in would be resolved.

H.R. 562 changes the law to treat all prison inmates who participate in work programs the same. Their services would be exempt from the FUTA tax, and that you don't get into this anomaly because it's a private structure which we happen to think provides job opportunities that enhance the chances of the prisoner once they leave prison, that when they leave prison, because they're in that program, they deserve unemployment compensation.

That's the sum and substance of H.R. 562, Mr. Chairman, and if I might just very briefly, as Chairman of House Oversight that oversees all Federal election laws, this deals with another anomaly between Federal law and States.

The gentleman from Michigan and the gentleman from California have H.R. 961, and I would like to speak very briefly in favor of the idea of not allowing poll workers who are designated to have a job for 1 day out of the year to be eligible for unemployment compensation, and I would underscore our friend from Illinois, Mr. Crane's H.R. 125, to overturn the Federal court decision as well.

And with that, Mr. Chairman, I thank you for your time.

[The prepared statement follows:]

Statement of Hon. Bill Thomas, a Representative in Congress from the State of California

Mr. Chairman, I appreciate this opportunity to explain my bill, H.R. 562, to the Subcommittee. Briefly, I want to give States an extra tool for reforming criminals. Today, federal law is discouraging States from adopting innovative approaches to reintegrating prisoners into the workforce by requiring states to pay unemployment benefits to some criminals just because they are released from prison. That should be a matter states decide for themselves in choosing methods for reforming prisoners.

As background, California voters established the Joint Venture Program in 1990, creating a private work program for inmates. Prisoners' wages are used to compensate victims, offset incarceration costs, and set aside funds (20%) for the inmate's support upon his or her release from prison. Last year, California voters overwhelmingly passed an initiative (Proposition 194) to deny unemployment benefits to criminals participating in the Joint Venture Program. That is where the trouble started.

The Department of Labor says unemployment benefits have to be paid to ex-prison inmates who worked for private companies in these cooperative work programs. Since FUTA taxes are paid on behalf of some prisoners, Labor ruled that these prisoners must be paid unemployment benefits upon their release from their "job"—essentially, when they are released from prison. Failure to comply is serious: California employers, for example would lose tax credits worth $1.7 billion for FUTA taxes they pay on other workers if the California program is disqualified.

Why does Labor take this position? The federal unemployment insurance program only permits denial of employment benefits in three cases: if the worker's income exceeds certain limits; the claim is fraudulent; or the employee was fired for misconduct. Since prisoners lose their jobs when paroled or released from prison, they do not fit the exceptions.

This creates a conundrum for states: if they have someone work in the prison laundry, they do not have to pay benefits, but if they try to create an innovative program in cooperation with a private company, the prisoners in that program must be paid unemployment when they are released. For states like California where voters have clearly said unemployment benefits are not to be paid in such cases, the only answer may turn out to be foregoing cooperative ventures with the private sector that could very well help prisoners prepare themselves for reentry into society. Allowing employers to lose $1.7 billion in credits for taxes they pay on the services of ordinary working people is not an option, needless to say.

H.R. 562 changes the law to treat all prison inmates who participate in work programs the same: their services would be exempt from the FUTA tax. This would effectively deny unemployment benefits to released prisoners and prohibit the Department of Labor from placing such a ridiculous requirement on the states. The bill's enactment would give states an additional tool to use in trying to reform criminal behavior and I hope you will report the bill in the near future.

Chairman SHAW. Thank you.

Mr. English.

STATEMENT OF HON. PHIL ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. ENGLISH. Thank you, Mr. Chairman. I want to thank you for the opportunity to testify, and I wanted to thank you and our fellow Members of the Subcommittee for having this hearing to focus on some, I think, important issues in improving the Federal system of UC, unemployment compensation.

As many of you know, early in my career I served as research director of the State Senate Labor and Industry Committee dealing with many of the issues being discussed today. And from my own personal perspective, I think the current unemployment insurance system is badly in need of basic structural reform.

Earlier this year I introduced legislation designed to empower States to meet the needs of the long-term unemployed. The current UC system is structured to help States combat short-term unemployment. Unfortunately, many skilled workers who are laid off from their jobs now are less likely to return to their previous jobs than in the past, and I think the system needs to be moved to adequately address that.

H.R. 940, the legislation that I introduced, will make several important changes to the current UC system. First of all, we will provide extended unemployment benefits to workers who have been unemployed for long periods of time, by broadening the trigger States use to access extended benefits.

Research has shown that the combination of the reduction on the insured unemployment rate, and the increase in the trigger level

during the recession of the eighties resulted in the failure of extended benefits to trigger on as unemployment continued to rise.

In my view, it is absolutely essential to reform this part of the program prior to the onset of the next recession.

Second of all, this legislation would encourage States to maintain sufficient UC trust fund balances to cover the needs of unemployed workers in the event of a recession. In the early eighties, Pennsylvania was one of a number of States that had a problem of a massive structural deficit in the UC program.

States under my bill that would maintain adequate reserves based on their own experience to cover expenses in future recessions would receive slightly increased interest earnings on part of their trust fund. States that fall short would receive slightly reduced interest earnings, a financial incentive to do the right thing.

Third, this legislation would allow interest-free cash flow Federal loans only for those States that have sufficient trust fund reserves to last through a future recession.

Fourth, it would allow States to collect the Federal share of unemployment insurance taxes from employers, allowing employers to fill out one form, and write one check, not two.

Fifth, it would require States to distribute information packets explaining fully unemployment insurance eligibility conditions to unemployed individuals. All of these provisions are based on recommendations by the Advisory Council on Unemployment Compensation's Collected Findings and Recommendations for 1994 through 1996.

If these provisions were enacted into law, as I propose, States like Pennsylvania would have the tools to assist workers facing long-term unemployment.

Another issue I would like to briefly address is the current tax on unemployment compensation benefits. Prior to 1979, UC benefits were excluded from income for tax purposes.

UC benefits are currently placed on a par with wages and other ordinary income, with regard to taxation. I have introduced H.R. 937, the Unemployment Tax Repeal Act, to once again exclude UC benefits from Federal taxation.

The UC tax is not a tax on income. It is a tax on benefits, benefits received during one of the most difficult times in a person's life. The UC tax imperils the economic security of workers throughout America. Our unemployment insurance system should be structured to extend a safety net, not dump penalties on the unemployed.

The tax on unemployment compensation kicks workers when they're down. Unemployment benefits are intended to stabilize the income of individuals and families that face layoffs, yet someone who experiences lengthy unemployment will face a large and usually unexpected tax liability the next year.

For many of those who are struggling to survive a layoff and get back on their feet, this tax bill is the last straw.

I urge the Subcommittee to review these issues, and to also hear the testimony from the Screen Actors Guild later on in this hearing in support of another bill that I have introduced, H.R. 841, which corrects a section of the Federal Unemployment Tax Act that oper-

ates to the detriment of senior entertainment industry professionals.

Mr. Chairman, in conclusion, by emphasizing my strong support for reforming our unemployment system, it is my hope that our Subcommittee will give its strongest consideration to moving forward legislation to encompass many of the suggestions heard today.

Following through on these recommendations will be a big boon for American workers.

Thank you.

[The prepared statement follows:]

Statement of Hon. Phil English, a Representative in Congress from the State of Pennsylvania

Mr. Chairman and fellow Members of the Subcommittee, I want to thank you for scheduling this important public hearing and for affording me the opportunity to address the Subcommittee on the urgent issue of unemployment insurance reform. As most of you may know, early in my career, I served as Research Director for the Senate of Pennsylvania's Labor and Industry Committee. During my tenure, I dealt with many of the issues being discussed today and I can tell you from my own hands-on experience that the current unemployment insurance (UI) system is badly in need of basic structural reform. States are poorly positioned to tackle unemployment in the 90's with a UI system that has changed very little since its inception and in some important respects become frayed over the last two decades. I want to take this opportunity to discuss several changes to the system I am proposing as well as the unfair taxation of benefits during my testimony today.

Earlier this year, I reintroduced legislation designed to empower states to meet the needs of the long-term unemployed. The current unemployment insurance system is structured to help states combat short-term unemployment. Unfortunately, many skilled workers who are laid off from their jobs now are less likely to return to their previous jobs as in the past—and long-term unemployment is increasing. The current system cannot adequately address long-term unemployment.

Unemployment is hard enough on families, without the worry that benefits will not be available because of the arcane structure of the system. H.R. 940, the legislation I introduced, will make several important changes to the current system:

1.) Make it easier for states to provide extended unemployment benefits to workers who have been unemployed for long periods by broadening the trigger states can use to access benefits.

Research has shown that the combination of the reduction in the Insured Unemployment Rate and the increase in the trigger level during the recession of the 1980's resulted in the failure of the Extended Benefits program to trigger "on" as unemployment continued to rise. As a result, Congress found it necessary to pass a series of emergency extensions of UI benefits. Put simply, no state was able to tap into Extended Benefits during the most recent recession. Therefore, it is absolutely necessary to reform the program prior to the onset of the next recession. Emergency extensions of benefits are a jerrybuilt policy prescription neither well-timed nor well-targeted.

2.) Encourage states to maintain sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession. States that maintain adequate reserves (based on their own experience) to cover expenses in future recessions would receive slightly increased interest earnings on part of their trust fund; states that fall short would receive slightly reduced interest earnings.

3.) Allow interest-free, cash-flow federal loans only for states that have sufficient trust fund reserves to last through a future recession.

4.) Allow states to collect the federal share of unemployment insurance taxes from employers, allowing employers to fill out one form and write one check, not two.

5.) Require states to distribute information packets explaining unemployment insurance eligibility conditions to unemployed individuals.

All of these provisions are based on the Advisory Council on Unemployment Compensation's Collected Findings and Recommendations for 1994–1996. As most of you know, the Advisory Council was established under the Emergency Unemployment Compensation Act of 1991. That law instructs the Council to evaluate the unemployment compensation program and make recommendations for improvement. The long process of drafting H.R. 940 (previously H.R. 3738 in the 104th Congress) allowed me to utilize my experience when considering the effects each recommendation

would have on the UI system. I have concluded that if the recommendations were enacted into law, as I propose in H.R. 940, states (like Pennsylvania) would have the tools to assist workers faced with long-term unemployment.

Another important issue I would like to address is the current tax on unemployment compensation (UC) benefits. Before 1979, UC benefits were excluded from inclusion in income for tax purposes. UC benefits are currently fully subject to tax. This tax treatment, in place since 1987, puts UC benefits on a par with wages and other ordinary income in regard to income taxation. I introduced H.R. 937, the "Unemployment Tax Repeal Act," to again exclude UC benefits from inclusion in gross income for tax purposes. The pre-1979 exclusion was upheld by Internal Revenue Service rulings based on three arguments: 1.) the law did not explicitly require taxation of UC, 2.) the benefits were viewed as part of the social welfare system and not regarded as wages, and 3.) taxation would undercut UC's income support objectives. I feel the final justification is particularly true. The UC tax is not a tax on income, it is a tax on benefits—benefits received during one of the most difficult times in a person's life. The UC tax hurts the economic security of workers throughout America. Our system should be structured to provide benefits to taxpayers, not dump penalties on the unemployed.

Mr. Chairman, I have talked to literally dozens of people in Western Pennsylvania who have collected unemployment benefits—and then paid taxes on the benefits as normal income. Their experiences highlight how grossly unfair the tax is.

The tax on unemployment compensation kicks workers when they are down. Unemployment benefits are intended to stabilize the income of individuals and families in the face of layoffs. Yet someone who experiences lengthy unemployment—a situation which depletes the financial reserves of most middle class families—will face a large (and usually unexpected) tax liability the next year. For many who have struggled to survive a layoff, this tax bill is the last straw.

Simply allowing tax withholding on these benefits is no solution: it merely depletes the value of compensation that is already merely adequate. I would argue that however this tax is administered, it is fundamentally inequitable and perversely burdensome to a beleaguered middle class.

At a time when many in Congress have expressed the creditable concern that the tax code taxes certain kinds of income more than once, we need to recognize that the UC tax represents what amounts to double taxation of a very vital stream of income for workers. These benefits are financed by taxing workers' jobs, with most of the practical consequences of a direct tax on the workers themselves. To further tax these benefits adds a new layer of taxation, dramatically increasing the tax burden on vulnerable working families at the expense of tax equity.

You will also have the opportunity today to hear from Mr. Richard Masur, President of the Screen Actors Guild, in support of another bill I introduced, H.R. 841. As he will describe, H.R. 841 would correct a section of the Federal Unemployment Tax Act (FUTA) that operates to the detriment of senior entertainment-industry professionals.

Mr. Chairman, I will conclude by emphasizing my strong support for reforming our unemployment system. It is my hope that our Committee will give its strongest consideration to developing legislation that will encompass many of the suggestions heard here today. Following through on these recommendations will result in a more manageable system and a more secure U.S. workforce.

Thank you for the opportunity to testify today.

Chairman SHAW. Thank you, Mr. English.

Mr. Upton

STATEMENT OF HON. FRED UPTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. UPTON. Thank you, Mr. Chairman. I'm going to submit my full statement for the record. But I just want to say that I appreciate your holding this hearing and allowing us again to testify as you did last year.

I want to read briefly a letter that I received this week from our Secretary of State, parts of her letter.

Under current Federal regulations, an elections official who files for unemployment benefits is entitled to those benefits even though he or she may work only 2 or 3 days a year.

Recently, a claim was filed against the city of Grand Rapids by an elections inspector who only worked the August primary and the November general election. Incredibly, the city was responsible for paying a portion of his unemployment benefits, primarily because he lost his job through no fault of his own—the election was over. The polls closed at 8 o'clock.

When our legislature tried to amend Michigan law to remedy the problem, the U.S. Department of Labor informed them the change would first need to be made on the Federal level. The bill that Sam and I have introduced, H.R. 961, makes the necessary changes in Federal law and allows States to make their own individual changes should they so choose.

Ordinarily, those who work in the polls are volunteers who feel working at elections is part of their civic duty or is service to the community. They are compensated, but their position is not treated as full-time employment opportunity.

The possible abuse to our unemployment system under the current regulations places an unjust burden on local governments and I encourage—this is a letter to Chairman Archer—I encourage your full support of and leadership in passage of the bill, H.R. 961.

Earlier this week, I might note that Bill Archer did send me a letter, and it says this: Our intent at this point is to consider this issue in the context of a larger unemployment bill this year. Using our vehicle, I expect your provision to be included along with a few others, and I expect the Committee will act on this this year.

So even though last year I had the great job of sitting next to Charlton Heston, our bill didn't move. This year when I don't sit next to him, if our bill moves, I'll be even happier, and I appreciate the bipartisan support and certainly the leadership of my colleague Sam Farr on this issue as well.

[The prepared statement follows:]

Statement of Hon. Fred Upton, a Representative in Congress from the State of Michigan

Chairman Shaw, thank you for allowing me to testify today on this important issue. I applaud your commitment to reforming our nation's unemployment system.

The 105th Congress is looking for as many ways as possible to relieve local governments from unnecessary federal regulations. HR 961 accomplishes this goal by eliminating the requirement that States pay unemployment compensation on the basis of services performed by election workers.

Under current law, cities in our districts are responsible for paying unemployment benefits for people who work as an election official, even if they only work two days a year. An unemployment claim was filed against one city in Michigan by an Election Inspector who worked the August Primary and November General elections in 1994. Amazingly, the city is now responsible for paying unemployment benefits to this worker.

Recognizing this injustice, the Michigan State Legislature attempted to change unemployment laws in Michigan. However, the U.S. Department of Labor was quick to point out that this situation must first be corrected by amending the Federal Unemployment Tax Act, known as FUTA. HR 961 makes this correction in FUTA and allows the States to provide this exemption, if they chose to do so.

The Congressional Budget Office has assured me that this bill is budget neutral. HR 961 simply gives the States the freedom to run their unemployment compensation programs as they see fit.

Municipal budgets are already tightly stretched to provide our constituents with the services that they need and deserve. I know of no opposition to this bill and have received many letters of support from local governments across the country.

I'm pleased that you, Mr. Chairman, expressed support for my bill during a hearing on this issue last year and I look forward to working with you in the months ahead. It is time to free local governments from a costly and unnecessary requirement and pass HR 961.

Chairman SHAW. Charlton Heston, I saw him move a sea. It seems like he could have done something with legislation. [Laughter.]

Mr. UPTON. Well, I was with Mohammed Ali yesterday, and he still can move a sea.

Chairman SHAW. Mr. Farr.

STATEMENT OF HON. SAM FARR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FARR. He could move a sea, but we couldn't move a bill.

Thank you, Mr. Chairman. I am here to support Congressman Upton's legislation that we cosponsored together.

There is a problem that needs fixing. Federal law determines who must be covered by unemployment compensation, and who may not be. And the interpretation of that law has rendered an incredible problem that I think you would all agree is just outrageous.

We had a poll worker in Santa Cruz County come volunteer to be a poll worker, and was paid the minimum amount to be a poll worker. And then, because it was a 1-day event, he filed for unemployment compensation. And because he had been a prior county employee, the elections department had to pay him $12,000.

And if you can imagine how many people could take advantage of this loophole—I think Los Angeles County has 40,000 people that work for them on election day—it's just unfathomable how many people could take advantage of a law that never intended to be that way.

It is a loophole, and this bill closes it. It's a very simple bill. It leaves it up to the States, and it uses the same threshold the Federal Government has already determined and used in other cases for income tax and Medicare—that is, a $1,000 threshold.

And so this bill would continue to leave it up to the States. The State of California did repeal the law last year, but it is dependent upon Federal action to be implementable.

I think this bill remedies the problem, and we hope you will move it in due haste. I'd be glad to answer any questions you might have.

[The prepared statement follows:]

Statement of Hon. Sam Farr, a Representative in Congress from the State of California

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to testify on behalf of H.R. 961, legislation introduced by myself and Congressman Fred Upton to fix a serious flaw in the unemployment compensation system.

Unemployment compensation is designed to give temporary assistance to workers who would otherwise suffer from serious hardship due to a sudden, unexpected loss of employment. It provides unemployed workers with a small "cushion" of support

while looking for a new job, easing a tremendous burden for those who lose their sole source of income.

Interestingly, election poll workers—individuals who serve their community on election day at a polling place—are *also* eligible for unemployment compensation. This seems odd, since the very nature of the job is temporary (for one day only). And because poll workers receive a small reimbursement for their time and expenses (usually fifty-five to eighty dollars) they generally do not rely on their service as a poll worker as their main source of income.

In the majority of cases, unemployment compensation is reserved for long-term employees, preventing poll workers from qualifying for these benefits. But more and more have exploited their eligibility to obtain significant unemployment benefits, creating a financial drain on local governments and increasing costs to the American taxpayer.

In my own district, a poll worker was eligible to receive up to $12,000 in unemployment compensation after "losing his job" when the election ended. Because he had held, and retired from, a prior job with the county elections board, the county was liable for the entire benefit—an enormous financial burden they could scarcely afford.

States have tried to close this loophole themselves. However, they have learned that *only federal law* can specify who is not eligible for unemployment compensation.

H.R. 961 would allow states, *if they so choose,* to close this loophole. It uses a $1,000 dollar per year compensation threshold—based on the reimbursement reasonably expected to be paid to the average poll worker volunteer—to separate poll workers from longer-term, wage-based election workers. I would note that election workers earning under $1,000 per year are *already* exempt from paying Social Security and Medicare taxes.

Our legislation has been endorsed by county elections offices and country clerks around the country, as well as the California Secretary of State. It would prevent an abuse of the unemployment compensation system which drains taxpayer dollars and hurts the very people who need this assistance the most. I thank the Subcommittee for their consideration of this important measure.

Chairman SHAW. Thank you, Mr. Farr.

Mr. Shadegg.

STATEMENT OF HON. JOHN SHADEGG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARIZONA

Mr. SHADEGG. Thank you, Mr. Chairman. I appreciate the opportunity to be here today and to testify in support of H.R. 294, the Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments of 1997.

This bill is one bill of a package of three pieces of legislation designed to promote economic development on America's Indian reservations. You have already received written testimony, and you will receive compelling testimony today from people who will benefit from this legislation on why it is needed and essential.

I would like to focus my remarks on why I introduced it, since I represent a district which is urban in nature, has no Indian reservations, and has a Native American population of less than 2 percent.

The bottom line issue here is economic development on America's Indian reservations. I believe that is essential for the good of the Nation as a whole. Yet, since about the seventies, the greatest economic development which has occurred on America's Indian reservations has occurred in the form of Indian gambling.

Indian gambling is now an explosion growth industry on all of the reservations across America, and yet I believe if we searched our consciences, we might conclude that it is not the principle type

of economic development we ought to be encouraging on Indian reservations.

Based on my experience as a special assistant attorney general in Arizona, I saw a number of problems associated with professional gambling, from corruption of those operations, to addiction to gambling, to moral decay. The price of gambling is fairly high.

Recently, the National Indian Gambling Commission reported that nearly one-half of the Nation's 273 tribal gambling operations had failed to meet Federal standards designed to keep their casinos free of crime.

Federal officials announced that information last week, and also announced that 17 people, including several linked with a prominent organized crime family, had been indicted on charges of attempting to infiltrate and control the now-defunct gambling casino at the Rincon Indian Reservation north of San Diego.

I believe very firmly that in the long run, the Native American communities and tribes of this Nation will suffer as a result of Indian gambling. The Rincon indictments, I think, are just the beginning.

What then is the right remedy? Well, the right remedy is, I believe, legitimate economic development on Indian reservations.

Congress has punted on that issue to date, and has not done what it could and what it should do. A part of the answer is to fix the Federal unemployment tax act, and the problem it is creating for Indian reservations. The problem, Mr. Chairman, is that under recent rulings by the IRS, the Internal Revenue Service is now treating tribal governments as though they were businesses for the collection of unemployment taxes. They are treating them the same as private sector commercial employers. That is, they are requiring them to pay in unemployment insurance and employment taxes as though they were profitmaking operations.

Congress didn't change this law. The IRS did. And the result has been extremely unfair to some tribes, because the IRS, on an ad hoc basis, is going after some tribes, requiring them to be treated as though they were commercial businesses in the payment of unemployment insurance taxes, but not after all tribes.

H.R. 294 would solve this problem by amending the Federal law to clarify expressly that tribal governments when they act in their governmental capacity should be treated just like States and local units of government for purposes of collection of Federal unemployment insurance taxes.

H.R. 294 would also authorize tribal governments, like State and local governments, and tax exempt organizations, to contribute to a State unemployment insurance fund on a reimbursable basis for unemployment benefits actually paid out to former employees.

It's one step toward providing legitimate economic development on America's Indian reservations. I believe it is a step in the right direction. I believe it will help provide the right framework to encourage legitimate economic development which will be there at some point in time when, I hope, we can see a reduction in Indian gambling on America's Indian reservations.

And I urge your support for its passage, and appreciate the time.

[The prepared statement follows:]

Statement of Hon. John Shadegg, a Representative in Congress from the State of Arizona

Thank you, Mr. Chairman, for the opportunity to testify today in support for H.R. 294, the Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments of 1997. I appreciate your consideration of this legislation I sponsored. H.R. 294 is one of three bills I have introduced which promote economic development on Indian reservations.

You have received written testimony and will later hear compelling testimony in support of this legislation from those who would benefit. Additionally, I understand you have received a number of letters of support which show broad support for this legislation. I want to speak briefly about why I introduced this legislation and why I think it is important in the long term.

Economic development on American Indian reservations is essential for the long-term prosperity of Native Americans. Since the 1970s more and more Indian tribes have turned to gambling as a solution to their economic needs. In 1988 Congress passed the Indian Gaming Regulatory Act to address problems emerging with Indian gambling which was increasing at a rapid pace across American Indian reservations and providing significant economic development for the first time on many reservations. Gambling, however, is not the principle type of economic development which we should be encouraging on Indian reservations and ultimately I believe it will be detrimental to Native Americans and all Americans.

Based on my experience as a Special Assistant Attorney General for the State of Arizona, I saw first hand the problems associated with professional gambling. From corruption to addiction to moral decay, the price of gambling is not worth the temporary profits to be gained.

I believe that the passage of the Indian Gaming Regulatory Act, while well-intentioned by some in Congress, was a mistake. While I understand that at the time of its passage IGRA was meant to provide a consistent regulatory framework for Indian gaming, it has failed.

For example, the National Indian Gaming Commission recently reported that nearly one-half of the Nation's 273 tribal gambling operations had failed to meet a federal standards deadline designed to keep casinos free of crime. Moreover, federal officials announced last week that 17 people, including several linked to a Pittsburgh organized crime family, have been indicted on charges of attempting to infiltrate and control the now-defunct gambling casino at the Rincon Indian Reservation north of San Diego. I believe very firmly that in the long run, the Native American communities and tribes in this nation will suffer as a result of gambling. The Rincon indictments, I fear, are only the beginning.

According to a 1994 study, for every dollar that a community will receive from gambling revenues, three dollars will be needed to cover the additional costs incurred by gambling such as infrastructure expenditures, regulatory costs, expenses to the criminal justice system and large social-welfare costs.

Last year, Americans spent $550 billion in legal gambling—a 3200 percent increase since 1974 when casino gambling was prohibited in every state but Nevada. Close to 10 million Americans now have a gambling habit that is out of control. The cost of treatment for gambling addicts ranges from $18,000-$50,000 per person.

Unquestionably, compulsive gambling is linked to the accessibility and acceptability of gambling in communities. According to one study, the number of compulsive gamblers will increase between 100–550 percent when gambling is brought into an area. Research now shows that gambling is the fastest growing teenage addiction. In my state of Arizona alone there are 14,000 young compulsive gamblers. And 20 percent of compulsive gamblers attempt suicide.

Fundamentally, increased gambling results in ruined lives and destroyed families and businesses. Apart from the social price, gambling presents huge economic costs to our communities.

Again, my commitment to sound economic development on Indian reservations is sincere. I have felt very strongly for a long time that promoting gambling on America's Indian reservations as a way to assist Native Americans is dead wrong. We owe Native Americans and their communities far more than that. Congress, in effect punted on the issue of promoting economic development in 1988 and it is our responsibility to pick up the ball and provide legitimate, long-term solutions for Native Americans. One way is to fix the Federal Unemployment Tax Act (FUTA) problem.

The FUTA problem is this, Mr. Chairman—in the early part of this decade the IRS reversed its prior practice and began to treat more and more tribal governments as if they were private-sector commercial business employers for purposes of deter-

mining how they must participate in unemployment insurance programs under FUTA.

But Indian tribes are essentially governmental in nature. They are not businesses and there are important public policy reasons for treating them differently from the private sector.

Congress did not change the law. What changed was the interpretation given the law by some over-eager tax collectors at the IRS. The result has been very unfair as the IRS has begun to go after some tribes who have never paid into nor taken anything out of the FUTA system.

My bill, H.R. 294, would amend FUTA to clarify, in express terms, that tribal governments, when acting in their governmental capacity, should be treated just like state and local units of government are treated for FUTA purposes. Under this bill the IRS would have no authority to assess federal FUTA taxes against tribal governments, just as it cannot do so against like state and local governments and tax-exempt organizations.

In addition, H.R. 294 would authorize tribal governments, like state and local governments and tax-exempt organizations, to contribute to a state unemployment insurance fund on a reimbursable basis for unemployment benefits actually paid out to former employees. Simply, tribes would pay as they go. If a tribe doesn't lay off anyone, it doesn't pay and if a tribe lays off a lot of employees, the tribe reimburses the full amount.

As I said before, H.R. 294 is one of three bills I have introduced to provide additional, legitimate, economic development for Native Americans. I appreciate your consideration of H.R. 294 as a part of this legislation and urge you to support its passage. It is a small step in promoting economic development for Native Americans. Thank you again for your time and attention to this important matter.

Chairman SHAW. Thank you, John.

Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. Thank you, Mr. Upton, for taking the time to testify today. And I would ask—I notice that you mentioned this letter you received from our Secretary of State regarding this bill, and I would ask unanimous consent to make the entire letter part of the record.

Chairman SHAW. Without objection.

[The information follows:]

STATE OF MICHIGAN

CANDICE S. MILLER, Secretary of State
MICHIGAN DEPARTMENT OF STATE
TREASURY BUILDING, LANSING, MICHIGAN 48918

April 22, 1997

The Honorable Bill Archer
Chairman, Ways and Means Committee
United States House of Representatives
1236 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Archer:

As Michigan's Chief Elections Official, I am writing to urge your support of House Resolution (HR) 961, introduced by Congressmen Fred Upton and Sam Farr, which deals with poll workers and unemployment benefits.

Under current Federal regulations, an elections official who files for unemployment benefits is entitled to those benefits, even though he or she may work only two or three days per year. Recently, a claim was filed against the City of Grand Rapids, Michigan, by an Elections Inspector who only worked the August Primary and the November General Election in 1994. Incredibly, the City was responsible for paying a portion of his unemployment benefits.

When our Legislature tried to amend Michigan law to remedy the problem, the U.S. Department of Labor informed them that the change would first need to be made on the Federal level. House Resolution 961 makes the necessary changes in Federal law and allows states to make their own individual changes should they so choose.

Ordinarily, those who work in the polls are volunteers who feel working at elections is a part of their civic duty or a service to the community. They are compensated, but their position is not treated as a full-time employment opportunity. The possible abuse to our unemployment system under the current regulations places an unjust burden to our local governments. I encourage your full support of and leadership in passage of HR 961.

Sincerely,

Candice S. Miller

Candice S. Miller
Secretary of State

cc: Congressman Fred Upton
Congressman Sam Farr

Mr. CAMP. And I appreciate that the State is supportive of your fix, as well as the Chairman of the Committee. I know you mentioned his support.

Can you tell me, Has the U.S. Department of Labor commented officially in any way on your proposal?

Mr. UPTON. I don't think they have commented. I can't imagine there is a lot of objection to what we want to do. In essence it allows the States to make a decision. Sam, do you know if they've given any position?

Mr. FARR. Well, we have a letter here I'm just seeing for the first time. Essentially, it says why we have to amend the law.

Mr. UPTON. It clearly needs a fix, because it can't happen without a legislative fix, and that's why we're here today. And again we're not aware of any objection to what we want to do.

I've talked to the Chairman, Chairman Archer, about it. It really does close a loophole. Those of us that are opposed to fraud and abuse—I think everybody here—I have got to believe would be supportive of the effort, and it ought to be, as Mr. Shaw said last year, a no brainer.

Mr. CAMP. Well, I certainly support what you're doing, and want to work with you.

Mr. UPTON. You do support it, and I appreciate your help here on the Subcommittee to get this thing done.

Thank you.

Mr. CAMP. Thank you, Mr. Chairman.

Chairman SHAW. I think that provision has good bipartisan support.

Mr. Levin.

Mr. LEVIN. I'll resist the temptation to ask questions. I thought all the testimony was interesting, and I think we need to explore further the activities of the Indian reservation units as to why they're covered.

And also as to Mr. English's testimony, I personally very much support its thrust, and I think it will be interesting to see what comments some of the panelists who come have on it.

Thank you, Mr. Chairman.

Chairman SHAW. Thank you. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. Mr. Shadegg, as I understand your proposal, you want to basically have tribal governments treated as State and local governments with respect to FUTA taxes.

But you also include another provision that would authorize tribal governments to contribute to a State unemployment insurance fund on a reimbursable basis.

Is that something the State and local governments are authorized to do now, or must they do that?

Mr. SHADEGG. I believe it is what they are authorized to do now. I don't know that they are required to do it. They are authorized to contribute. So we would make—in both regards—we would make tribal governments, when they are acting in their governmental capacity, the same as a State or local government, or a tax-exempt organization.

Mr. MCCRERY. OK. Thank you.

Chairman SHAW. Mr. Collins.

Mr. COLLINS. No questions.

Chairman SHAW. Mr. Coyne.

Mr. COYNE. No questions.

Chairman SHAW. Mr. English.

Mr. ENGLISH. No questions.

Chairman SHAW. Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman. I'm very interested in this. We have a lot of Native Americans in Oklahoma, and I'm trying to see how broad this would be as far as taxes in dealing with the Indian tribes, because there is a great question of them utilizing their funds today as a business or industry or as a government, especially in contributions in campaigns, a lot of them being heavily involved.

If they're going to be treated as a government entity, would they be allowed also to contribute to campaigns?

Mr. SHADEGG. Mr. Watkins, I am certainly not advocating that they get some special status for contributing to campaigns, and I, quite frankly, don't know their status for contributing to campaigns.

Our goal here is simply to say—it's actually to correct an inconsistency. The original interpretation of the law by the IRS was that tribal governments when they employ people in a governmental type capacity were to be treated, and in fact were treated by the IRS, I think until the beginning of this decade, routinely as being governmental entities and not required to pay in on an advanced basis for the employees in anticipation of an unemployment tax claim.

At some point in this decade, the IRS came along and with regard to some tribes—and I think it's worth your looking into the situation in Oklahoma, because it is not inconsistent across the country with regard to some tribes the IRS has come along and said, No, we don't think you really are a governmental entity, and so we're now going to start treating you as though you were a private business.

It would be intent, Mr. Watkins, that when the tribe acts in a business capacity, let's say it owns, as some tribes in Arizona do, a sand and gravel operation, or a block manufacturing plant, or some other business enterprise, I think it ought to be treated as a business in that capacity.

But in my view, when it is acting as a governmental entity, administering the tribe, I think it ought to be treated like other units of government. It's more governmental in nature at that point.

Now, whether or not someone ought to take a look at whether that governmental entity can make campaign contributions, that might be a parallel question.

Mr. WATKINS. I've read your letter, and it's very interesting, because I agree with your letter here. I've been trying to get some of the tribes in Oklahoma to not only lift their vision, but to be able to do more in economic development. And I helped tribes—two of them—in developing their overall economic development plan, trying to move them from just smoke shops and gambling, into more manufacturing and other types of job opportunities.

Mr. SHADEGG. Certainly, I think that's in the best interest of all Americans.

Mr. WATKINS. Definitely.

Mr. SHADEGG. If we force them to rely solely on gambling, then they are going to rely on gambling, and that's going to create, I think, long-term problems.

For one thing, there is the danger that those operations will be infiltrated, as this report suggests is a possibility, and I'm not certain that those kinds of operations with that large amount of cash aren't particularly susceptible to exploitation.

Mr. WATKINS. I look forward to working with you maybe on some other things dealing with the problem.

Thank you.

Chairman SHAW. Mr. Ensign.

Mr. ENSIGN. No questions.

Chairman SHAW. I thank this panel, and now invite the next panel to come to the table. Eric Oxfeld is president of UBA, Inc., of Washington, DC; Mark Wilson, labor policy fellow at the Heritage Foundation; Kenneth Simonson, vice president and chief economist of the American Trucking Associations; Dr. Janet Norwood, senior fellow at the Urban Institute; and the gentleman from Georgia who will be introduced by Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. It's with pleasure that we welcome again David Poythress, the commissioner of the Georgia Department of Labor.

Mr. Poythress has been involved in State business for a long time, having once served in the capacity as Medicaid director, and medical services director in Georgia, and also Secretary of State, and for some time has been commissioner of the Department of Labor. He does an outstanding job, and I welcome David Poythress.

STATEMENT OF DAVID B. POYTHRESS, COMMISSIONER, GEORGIA DEPARTMENT OF LABOR, ATLANTA, GEORGIA

Mr. POYTHRESS. Thank you, Mr. Collins. Mr. Chairman, I appreciate the opportunity to be here.

Chairman SHAW. The Subommittee has all of your full testimony which will be made a part of the record. Please feel free to summarize. We have several other panelists today, so we would appreciate your sticking with the 5-minute rule.

If you tend to go over, I will very politely go like this. If you continue to go over, I will very rudely go like that. So if you would continue.

Mr. POYTHRESS. Thank you, Mr. Chairman. I will, indeed, summarize.

As Mr. Collins implied, and as I think most Members of the Subcommittee know, I have been pushing this rope for the last 3 years, and have briefed this Subcommittee before, and testified last year.

Since then I am pleased to tell you that the proposal we discussed then has been essentially adopted intact by nine States as well as UBA. It has been renamed from devolution, which we discussed last year, to administrative reform, and it is essentially a composite proposal.

I think I can say that it has been studied in great detail by lots of people in the private sector, as well as in government, who are thoroughly familiar with this. While it is a complex proposal, it is fairly simple to administratively implement, if the Congress approves the legislation.

It is fiscally sound, and I think it is politically realistic to see it accomplished.

The proposal does essentially four things. It combines the FUTA administrative tax with the State benefit tax, to be collected by the States. The savings to the Federal Government and to the private business sector are very, very consequential—about $100 million a year in IRS costs would be eliminated simply by their duplicate collection of the tax. At least $500 million would be saved by the private sector not having to fill out duplicate forms and undergo duplicate audit procedures.

Our proposal likewise eliminates or allows the two-tenths Federal surtax on FUTA to expire at the projected December 31, 1998, deadline. Third, it lays the foundation to significantly downsize the U.S. Department of Labor.

We are very mindful, as was pointed out, that there needs to be a national system. There must be Federal oversight. But we feel it can be done in a more general way than the current level of micromanagement.

Finally, we believe, and we are quite confident that this proposal lays the foundation for very, very significant tax cuts at the State level in terms of both benefits and administrative costs.

Mr. Chairman, again, in summary, I think it is a very practical and a very opportune moment to truly return responsibility to the States, to lighten the paperwork burden on the private sector, to save millions on tax dollars, and to lay the foundation for future tax cuts.

[The prepared statement follows:]

Statement of David B. Poythress, Commissioner, Georgia Department of Labor, Atlanta, Georgia

Mr. Chairman and Members of the Subcommittee, my name is David Poythress, and I am Commissioner of Labor in Georgia.

I appreciate the invitation to appear today and present my views on both a multistate Proposal to Restructure the Employment Security System and my support for passage of H.R. 125 introduced by Congressman Phil Crane in response to a recent Illinois Federal court ruling in the *Pennington* Case.

RESTRUCTURING OF THE EMPLOYMENT SECURITY SYSTEM

I testified to this Committee on July 11, 1996 in support of my proposal as Georgia's Labor Commissioner to transfer the Administration and Financing of the Employment Security System to the States. I am pleased to announce that, subsequent to that hearing, agreement has been reached to combine my proposal with proposals from New Hampshire, Virginia and the UBA into a single proposal to Restructure the Employment Security System. A copy of this proposal has previously been submitted to the Committee and distributed for today's hearing. Since this agreement in early March, at least 9 sates have endorsed the proposal and, based on discussions with administrators in other states, I expect the majority of the states to be formally on board by mid-year. A brief overview of the current system and the proposed changes are included below.

The Employment Security System is composed of two major components. The Unemployment Insurance System (UI), created by the Social Security Act of 1935, is designed to provide workers with insurance against involuntary unemployment by partial replacement of lost wages. The Employment Service (ES), established by the Wagner-Peyser Act of 1933, is designed to provide job search assistance to individuals and recruitment and referral services to employers to get workers back to work as quickly as possible.

The UI and ES programs are highly integrated, and each depends on the other for efficient administration, success in serving job seekers and employers and keeping employer payroll taxes as low as possible.

Currently each state sets and collects a state payroll tax for UI benefits and deposits those funds into state-specific Benefit Accounts maintained by the federal government as part of the Unemployment Trust Fund (UTF). A separate federal payroll tax, collected by the Internal Revenue Service (IRS) under the Federal Un-

employment Tax Act (FUTA) is a dedicated employer tax to support administration of the Unemployment Insurance (UI) laws and the Employment Service (ES). FUTA was established as a contract with private sector business that these dedicated taxes would be used only for unemployment and employment services.

The concept of transferring most of the management of the Employment Security System from the U. S. Department of Labor to the states has been studied carefully for many years in labor department circles. It is fiscally sound, administratively simple and politically realistic. As I said last July, I believe the time to implement it is now.

This very straightforward proposal does four main things.

1) It establishes a single payment, state-collected payroll tax for both UI benefits and UI/ES administration,

—Eliminating the current duplicative tax system and saving private sector employers approximately half a billion dollars annually in filing costs;

—Eliminating IRS collection of the federal payroll tax, thus saving $100 million each year;

—Making the marginal additional costs to the states to collect "both" taxes negligible.

These savings could begin as soon as states—instead of the IRS—begin collecting the FUTA tax. State FUTA collections would be deposited in state specific accounts in the UTF to avoid any adverse impact on the federal deficit.

2) It eliminates micro-management of state programs by the U. S. Department of Labor (USDOL) and establishes the foundation to downsize the USDOL bureaucracy by 50% to 75%.

3) It assures that the employers who pay FUTA taxes get the full benefit of those taxes. Reduction of IRS and USDOL roles will greatly reduce the costs and improve the efficiencies of the system.

4) It allows the 0.2 percent Federal surtax, currently authorized through December 31, 1998, to expire.

Mr. Chairman, as I stated in July 1996, this is a wonderful opportunity to:

—Truly return responsibility to the states;

—Lighten the paperwork burden on American business;

—Save millions in wasted tax dollars; and

—Lay the foundation for future tax cuts.

I strongly encourage the Committee's favorable consideration of this proposal.

SUPPORT OF H.R. 125

The Social Security Act of 1935 gave states broad discretion to design their own unemployment insurance programs including allowable benefits, amount of earnings necessary to qualify for benefits, and all other eligibility requirements within broad fairness guidelines.

The 1994 decision by the Seventh Circuit Court of Appeals (*Pennington* v. *Doherty*) ruled that the base period process used by the Illinois Unemployment Insurance Act is an "Administrative Provision" subject to the "when due" clause of the Social Security Act. This ruling is plainly contrary to the universal understanding, throughout the 60 year history of the Unemployment Insurance program that "base period" determination is an eligibility requirement within the ambit of state authority. The base period concept is not a matter of administrative convenience. It represents the public policy judgment of states that UI benefits should be payable only to persons with a demonstrated continued attachment to the workforce.

The Social Security Act of 1935 clearly envisions broad latitude by states in designing their unemployment insurance programs. I urge you to support H. R. 125 making congressional intent clear that states are responsible for determining the terms and conditions under which unemployment benefits are paid including the establishment of base period.

Thank you for this opportunity to present my views on both Restructuring the Employment Security System and H.R. 125. I respectfully request your favorable consideration of these matters and welcome any questions you may have.

Chairman SHAW. Thank you.

Mr. Oxfeld.

STATEMENT OF ERIC J. OXFELD, PRESIDENT, UBA, INC.

Mr. OXFELD. Thank you, Mr. Chairman. My name is Eric Oxfeld. I'm the president of UBA. We're a business association specializing in unemployment and workers' compensation.

We also head the Coalition for UC Tax Reform, which we founded in 1995 to oppose the administration proposals to extend the two-tenths FUTA surtax, and to require monthly instead of quarterly payment of unemployment taxes.

We appreciate your commitment to strongly oppose those objectionable proposals.

UBA supports a sound unemployment compensation program which provides short-term wage replacement to individuals with a strong attachment to work who involuntarily lose their jobs.

We think Congress can best help meet this objective by restructuring the Federal and State roles in administrative financing of the unemployment program rather than by increasing FUTA taxes.

Legislation is also urgently needed, and I know it's the subject of the second panel, to keep Federal courts from preempting State discretion to efficiently determine the base period used to measure eligibility for State benefits. That's the *Pennington-Bradshaw* issue.

Restructuring administrative financing is a win/win/win. It will improve services for workers who lose their jobs. It will cut redtape for State unemployment agencies. We estimate it will save about $4 billion for employers.

Now, payroll taxes, as this Subcommittee knows, make it more costly to hire new workers. That's why it's especially troublesome that the FUTA is already at a rate that is far higher than necessary.

Currently, the Federal Government returns to the States only about 60 cents on the dollar. Mr. Chairman, in your State it's less than 40 cents on the dollar. And for all the Members who are here, it's in the range of 60 to 40 cents on the dollar, returned to the States. The rest piles up in the Unemployment Trust Fund where it's improperly used to disguise the true extent of the Federal budget deficit.

This money can only be spent on unemployment compensation.

Despite the large surpluses in FUTA, States are getting less in grants than they need to administer the program properly. As a result, this has led to a cutback in services to jobless workers. It's no coincidence to us that the average duration of an unemployment claim has been steadily getting longer, even as unemployment has gone to record low levels.

That's driving up the expense of unemployment claims, which is also included in the Federal budget. And many States have made up the shortfall in money for administration by imposing supplemental State taxes on employers. There are 18 States that have done that.

We think it's time to clean up this mess, and we recommend that—as Commissioner Poythress has mentioned—that each State should decide and determine how much it needs to run its own unemployment agency.

We reached agreement with nine States on a compromise plan to do this. We can talk about how we did that and the compromise, but in effect this will put the decisionmaking closest to where it

can be best made as to how much money a State needs to run its program correctly.

Each State would have its own account for administration. Surpluses in that account would automatically flow into the State benefits account where it could be used to further reduce unemployment taxes. And under this plan there are no reductions in protections for workers, not one. In fact, some present Federal restrictions would be repealed.

Although employers think that unnecessary taxes should be returned to taxpayers, I should also point out that having additional money in the State trust funds would give States the opportunity, if they wish, to improve benefits for workers.

Another advantage would be tax simplification, because as the Commissioner says, employers would only have to complete a single form instead of the two. That would also improve FUTA tax compliance.

The proposal would shorten unemployment claim duration by not only increasing funding for administration to the proper levels, but by tying employment services more closely to unemployment claimants.

Using a very conservative estimate, if we could reduce duration of claims by just 1 week on average, it would save more than $1.5 billion a year, more if unemployment rates are higher.

In addition to restructuring, we are strongly supportive of Congressman Crane's bill on *Pennington,* H.R. 125.

Today the unemployment compensation program is at a turning point. We can keep the status quo which ill serves workers and employers. We can accept the administration's proposals to increase the FUTA tax, or we can adopt legislation restructuring the administrative financing of the unemployment system and help keep it sound into the 21st century.

Mr. Chairman, and Members of the Subcommittee, thank you.

[The prepared statement and attachment follow:]

Statement of Eric J. Oxfeld, President, UBA, Inc.

Good morning, Mr. Chairman and members of the committee. My name is Eric Oxfeld, and I am President of UBA. UBA is a national association specializing exclusively in public policy issues involving unemployment and workers' compensation. Our members are employers across the country of all sizes and industries, who pay federal and state unemployment taxes. UBA advocates a sound unemployment compensation program for workers and employers. We appreciate the opportunity to appear before you this morning to discuss the need for U.C. legislation relating to several important issues, principally administrative financing of state U.C. administrative agencies and clarification of federal law governing U.C. eligibility (the *Pennington* issue).

From the inception of the unemployment compensation program, there has been debate about the optimum role for the states and the federal government. A significant part of that debate has been whether states or the federal government should be responsible for financing the state unemployment agencies which administer the program. We believe that we have a need—and a historic opportunity—to restructure the financing of unemployment compensation administration, and thereby, improve services for jobless workers, reduce taxes on employers, and alleviate the financial pinch on administrators. Now that's what I'd call a "win/win/win" situation.

UBA has developed a proposal to do just that. Before I describe it, however, I would like to comment on terminology. For better or for worse, and we think mostly for worse, the short-hand name for this topic has come to be known as "devolution." I believe, however, that there have been so many different devolution concepts that the very word may deter consideration of helpful changes in administrative financing. For example, the word "devolution" inevitably seems to distract attention to

questions about "winners and losers" and "federalism" when what we should be thinking about is really, how can we make sure the state unemployment agencies have adequate but not excessive funds to provide high quality services to jobless workers, while making sure that the tax burden on employers is both fair and no more than necessary. Consequently, we use the term "administrative financing reform" rather than "devolution" as a more neutral description of what we seek to accomplish.

Now I'd like to describe our proposal. First, let me observe that it is a departure from past tradition at UBA that we have decided to advance a "UBA proposal." I would be the first to acknowledge that there are several other "devolution" proposals, and I want to say that we have found much of merit in all of them. We wanted to develop a proposal that drew on the excellent work and thought that had already been done. We sought to borrow the best of what we found. Sensitive to what is politically and fiscally feasible, we formed a representative working group from among our members and asked them to focus on the bottom line for employers.

In preparing the proposal, we were guided by 3 principles:

1. Eliminate the 0.2% FUTA surtax on employers (rather than extend it through the end of 2007, as recommended in the administration's FY 1998 budget proposal).
2. Impose employer taxes to finance the system consistent with sound unemployment compensation operations rather than federal deficit reduction.
3. Provide financing for the unemployment program at levels that are neither excessive nor inadequate.

Following the development of the original UBA proposal, we entered into discussion with representatives of a number of state officials who shared our interest in improving U.C. administrative financing. In March, UBA and 9 states reached agreement on a common proposal closely resembling the original UBA plan—we refer to this agreement as the UBA/states proposal.

Under the UBA/states proposal, the basic framework of the federal-state U.C. partnership would remain intact, and all benefits and legal protections for jobless workers would be unchanged. There would be no change in the rules governing the state unemployment trust accounts used to finance U.C. benefits. The 0.2% surcharge would expire, and employers would continue to pay FUTA and state unemployment taxes quarterly. However, instead of pooling all FUTA payments in a single national U.C. administration account (ESAA), FUTA taxes paid by employers in each state would be credited to a new administration account to be set up for each state. Each state legislature, rather than Congress, would determine how much it needs to administer its U.C. program. A small amount would be transferred into a special account to be used for additional grants to states which require additional funds to administer their program. Funds that are not needed for administration—about half or less of present FUTA revenues in many states, as shown in the attachment—would automatically flow into the state's U.C. benefit account. Employers would no longer be required to fill out separate FUTA and state unemployment tax forms. This approach would simplify tax payment and collections for employers and states, as well as the federal government. Each state would also be responsible for financing the portion of federally mandated extended unemployment benefits (EB) now financed out of the Federal Unemployment Tax. Accountability for use of the money would be enhanced by requiring each state agency to report annually to its legislature and the public on services provided to U.C. claimants.

We believe our proposal would have many advantages over the present system, under which the federal government collects 100% of FUTA receipts but returns only 60% back to the states—in effect, keeping the remainder to disguise the true extent of the federal budget deficit in general revenue funded programs, and leading to enactment of many state add-on taxes on employers to make up for the shortfall in federal grants. These advantages are as follows:

- More resources for administration of the U.C. program. Nearly all states would be "winners" in a financial sense, because few states currently receive administrative grants equal to the amount of FUTA paid by employers in that state.
- Greater responsiveness to local needs and circumstances. State legislatures, rather than federal Department of Labor and OMB personnel in Washington, D.C., would determine how much is needed to run their U.C. programs, resulting in greater flexibility for state U.C. agencies and greater accountability for states, which already are responsible for establishing benefit levels and eligibility, salaries of state employees, and other factors that affect the cost of administering the state program.
- Jobless workers will receive better service because states will have the necessary resources and flexibility—as well as greater oversight by worker and employer groups at the state level.
- Less paperwork for employers, who would need to complete a single unemployment tax form rather than separate state and federal unemployment tax forms.

• Greater accuracy in collection of the administrative tax. Currently enforcement efforts relating to the FUTA are low priority, but states would be motivated and have the ability to catch delinquents more easily.

• Savings to the Federal government. Staffing levels at DOL and the Treasury Department would be reduced.

• Lower net taxes on employers. Currently the federal government keeps 40% of the FUTA contributed by employers. If the additional revenue flows into state benefit trust accounts, employers will pay lower state U.C. taxes, in some cases automatically, and in other cases through reductions in state U.C. tax rates.

• Greater employment opportunities. Because U.C. taxes are based on payroll, a reduction in these taxes will make it easier for employers to hire additional workers—such as individuals coming off welfare rolls.

• Currently the federal government keeps 40% of the FUTA contributed by employers. If the additional revenue flows into state benefit trust accounts, employers will pay lower state U.C. taxes, in some cases automatically, and in other cases through reductions in state U.C. tax rates.

• Elimination of the 0.2% FUTA surtax, which would save employers $1.5 billion a year.

• Additional savings are possible through release of surpluses in FUTA receipts into state benefit accounts and through repeal of state tax diversions, which would no longer be necessary.

• There would be no diminution in legal rights or unemployment benefits for workers. However, better service to U.C. claimants would reduce U.C. claim duration, which has been growing as a result of the squeeze on state U.C. agencies. An average reduction of as little as 1 week would save another $1.5 billion a year for employers by reducing their state unemployment tax. To many of our members, this is the element—along with elimination of the 0.2% FUTA surtax—that offers the greatest promise of future savings.

We recognize that today the U.C. program is not in a "crisis" mode and therefore may not be high on the agenda for immediate action by Congress. However, this is the most propitious time to institute meaningful reforms that can save money for the federal government, free resources for the states, reduce the tax burden on employers, and improve service to jobless workers. The UBA/states administrative financing reform plan is sound public and fiscal policy, and we respectfully urge your support for it. Of course, we also urge that Congress approve adequate funding for system administration until a restructured system can be implemented.

Alternate Base Period Issue

We would also like to address another, more immediate concern—the *Pennington* decision, which misinterpreted federal law to require that states expand eligibility despite the additional burden on state agencies and employers. This problem was created by the U.S. Court of Appeals for the Seventh Circuit, which has recently ruled that federal law requires Illinois to expand eligibility. *Pennington* is not only a dramatic expansion of the federal role in determination of basic unemployment benefits after 60 years in which this was considered a state issue, but—unless corrective action is taken—it will add more than $1 billion a year to federal spending and to the federal budget deficit. A similar lawsuit has now been filed in federal court in California, California AFL-CIO v. Bradshaw.

The specific issue in *Pennington* and Bradshaw is whether the federal government can override state laws that govern the qualifications for benefits. Under the U.C. program, an eligible worker must demonstrate sufficient attachment to work in order to qualify. In most states, a worker must have sufficient wages during a specific period of employment as provided in state law—the "base period"—typically the first 4 of the most recent 5 completed calendar quarters. This method is an efficient means of making these determinations, because states do not have more recent wage information, and it is prohibitively costly to collect it, while comparatively few individuals would be affected. In *Pennington,* the court held that Illinois must adopt an "alternate base period" (ABP) that would result in payment of benefits to workers who did not qualify under the present test but who might qualify if more recent wages were considered. The court failed to take into account the large administrative costs to state unemployment compensation agencies and employers in attempting to collect more recent wage information. These added costs are estimated to be more than $1 billion annually, if *Pennington* were applied nationwide, as is likely to be the case. The added costs incurred under *Pennington* will be reflected in the federal budget because federal and state unemployment compensation taxes and state unemployment benefits are accounted for in the unified federal budget. Any added costs, therefore, will add directly to the task of balancing the federal budget,

as well as adding to the tax burden on employers and upsetting the balance at the state level in making benefit determinations.

Historically, states have been given the responsibility for determination of who is eligible for unemployment compensation, along with other basic benefit design issues. We believe that this decision should remain at the state level, because states are closest to striking an appropriate balance between benefits for workers and cost to employers, as well as efficient administration of the program.

Employers, including our members who have operations in California, feel strongly that the decision to use an alternate base period should not be imposed by the courts. Legislation clarifying that use of an alternate base period remains a state, rather than federal, decision has been introduced as H.R. 125. We respectfully urge that the Congress give expedited consideration to the enactment of this legislation.

FUTA Grants and Taxes by State (FY 1995)

State	FUTA Contributions	Federal Grant	% Grants/ Contributions
ALABAMA	86.9	41.5	47.8
ALASKA	11.4	29.5	258.8
ARIZONA	90.2	39.1	43.3
ARKANSAS	49.9	27.2	54.5
CALIFORNIA	645.5	500.6	77.6
COLORADO	91.6	43.1	47.1
CONNECTICUT	74.2	63.7	85.8
DELAWARE	18.2	10.7	58.8
DIST. OF COL.	18.1	15.4	85.1
FLORIDA	319.1	113.8	35.7
GEORGIA	170.5	66.3	38.9
HAWAII	25.6	17.8	69.5
IDAHO	22.9	20.5	89.5
ILLINOIS	278.3	151.5	54.4
INDIANA	136.5	50.0	36.6
IOWA	62.6	29.0	46.3
KANSAS	57.1	25.2	44.1
KENTUCKY	77.7	33.3	42.9
LOUISIANA	82.4	37.3	45.3
MAINE	24.5	20.6	84.1
MARYLAND	101.7	67.6	66.5
MASSACHUSETTS	139.1	84.3	60.6
MICHIGAN	210.5	127.0	60.3
MINNESOTA	114.9	51.8	45.1
MISSISSIPPI	53.4	25.8	48.3
MISSOURI	121.9	57.9	47.5
MONTANA	14.2	14.1	99.3
NEBRASKA	34.8	18.7	53.7
NEVADA	42.7	25.3	59.3
NEW HAMPSHIRE	26.6	14.1	53.0
NEW JERSEY	169.5	113.0	66.7
NEW MEXICO	30.0	19.2	64.0
NEW YORK	345.7	241.2	69.8
NORTH CAROLINA	174.3	63.8	36.6
NORTH DAKOTA	11.8	14.0	118.6
OHIO	259.4	101.6	39.2
OKLAHOMA	59.9	30.9	51.6
OREGON	70.0	47.8	68.3
PENNSYLVANIA	251.0	166.9	66.5
PUERTO RICO	34.7	39.0	112.4
RHODE ISLAND	20.8	20.3	97.6
SOUTH CAROLINA	80.1	36.8	45.9
SOUTH DAKOTA	13.7	10.9	79.6
TENNESSEE	123.3	43.6	35.4
TEXAS	400.0	167.3	41.8
UTAH	42.3	30.3	71.6
VERMONT	12.3	10.5	85.4
VIRGIN ISLANDS	1.7	3.2	188.2

FUTA Grants and Taxes by State (FY 1995)—Continued

State	FUTA Contributions	Federal Grant	% Grants/ Contributions
VIRGINIA	148.7	57.9	38.9
WASHINGTON	115.1	89.4	77.7
WEST VIRGINIA	30.5	20.3	66.6
WISCONSIN	125.0	63.2	50.6
WYOMING	9.3	13.1	140.9
TOTAL	5731.7	3227.3	56.3

Dollars in Millions.
Source: U.S. Department of Labor

Chairman SHAW. Thank you, Mr. Oxfeld.
Mr. Wilson.

STATEMENT OF MARK WILSON, REBECCA LUKENS LABOR POLICY FELLOW, HERITAGE FOUNDATION

Mr. WILSON. Mr. Chairman, and Members of the Subcommittee, thank you for inviting me to testify on unemployment insurance reform. Thank you for accepting my written testimony into the record. Obviously, I'd like to summarize some of the key points that I would like to make, summarize the key principles I think are necessary for UI reform, and then highlight some important differences between the two major competing reform plans that are out there. And I'd also like to note that the following testimony is my own view, and does not necessarily reflect the views of the Heritage Foundation.

As the 105th Congress begins its debate over the unemployment insurance system, legislators should consider three important principles to ensure that both workers and employers receive the greatest benefit from any reform.

Number one, the taxing and spending authority for the UI/ES system should be at one level of government, and not split between the Federal Government and the States. Effective program accountability requires States to be responsible for both raising and spending the revenue to run the UI/ES system.

Maintaining the current bifurcated taxing and spending authorities diminishes direct responsibility and accountability.

Number two, ensure and maintain the integrity of the national employment security system by continuing the FUTA offset for States that provide public employment services with universal access where individuals can file UI claims and receive reemployment services.

National standards regarding benefit coverage, FUTA conformity standards, benefits for out-of-state claimants should continue.

Number three, there should be, however, a minimum of Federal control and a maximum of flexibility for the States. Burdensome Federal mandates that cause inefficiencies and impose increased costs on the States should be eliminated. And States should be empowered to provide programs that improve both employment services for job seekers and employers and have the flexibility to address the needs of workers that may be unique to their State.

These principles form the foundation of sensible employment security reform that will improve UI/ES services while reducing administrative and payroll taxes.

Two separate plans to reform the employment security system have come forward in the past year. The principles that I have summarized and the recommendations that are outlined in my written testimony have been endorsed by ALEC, the American Legislative Exchange Council, and form the foundation of the ALEC plan.

Another plan that is supported by UBA and several State employment security administrators represented by Dave is presented in their written testimony.

Although there are some similarities between the ALEC plan and the UBA ES administrators' plan, three fundamental differences separate them. The most important distinction is that the UBA ES plan maintains the FUTA, while the ALEC plan effectively eliminates it.

Under the ALEC plan, the taxing and spending authority for the UI/ES system would be transferred to one level of government, thereby improving accountability.

Each State would have direct control over their taxes, rather than continuing to receive revenue from a fixed Federal FUTA tax that is set in Washington and rarely changed.

Governors and State legislatures are in the best position to determine the needs of their unemployed workers and to establish the appropriate wage base and tax rate to meet those needs.

Moreover, the employee security agencies would have to justify their budgets directly to the citizens of those States. Under the UBA ES plan, the current bifurcated tax and spending arrangement between the Federal and State governments would continue indefinitely.

For many States, the UBA ES plan does not solve the problem of over taxation, over FUTA taxation. For example, Mr. Chairman, in your home State of Florida, employers would continue to send over $230 million to Washington in FUTA taxes.

But with even a 30-percent increase in the State UI/ES agency's budget, Florida would spend only $150 million.

This means that over $80 million per year would be pulled from Florida workers and employers and continue to build up in Washington trust funds. Eventually they would roll over into the State benefit accounts, but here, too, they would continue an unwanted buildup.

Under the ALEC plan, Florida would have direct control over the level and rate of both the administrative and benefit taxes. In fact, Florida's legislature recently passed a benefit tax moratorium explicitly to limit the size of their benefit trust funds.

Only the ALEC plan would enable them to do so on the administrative side of the ledger. Under the ALEC plan, workers and employers would be saving over $1 billion each year in payroll taxes. And by maintaining the FUTA tax rate, UBA and the ES plan also preserves the continued mountain of burdensome paperwork requirements that are required because of the current Federal/State grant process and the overregulation of State programs.

The UBA ES plan does not eliminate the FUTA grant process. It only changes the grant formula to 100 percent passthrough.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Mark Wilson, Rebecca Lukens Labor Policy Fellow, Heritage Foundation

Mr. Chairman, Members of the Committee, thank you for inviting me to testify on unemployment insurance reform. Today, I would like to discuss how transferring the administration and financing of the Employment Security system to the states would reduce payroll taxes, increase jobs and take-home pay, reduce paperwork burdens, improve services for unemployed workers, and more effectively decrease the duration of unemployment. Please accept my written testimony and enter it into the record. It should also be noted that the following testimony is my own view and does not necessarily reflect that of The Heritage Foundation.

BRIEF OVERVIEW OF THE EMPLOYMENT SECURITY SYSTEM

The Employment Security (ES) system consists of the Employment Service and unemployment insurance programs. The Employment Service was created in 1933 by the Wagner-Peyser Act to make available, free of charge, job search and placement assistance to individuals, and recruiting and referral services to employers. Services are available in more than 1,800 Employment Service offices nationwide. More than 18 million people were served by the Employment Service system in 1996 with about 8 million referred to jobs. Over 3 million individuals found jobs after receiving re-employment services at a cost of about $250 each. In 1982, Congress amended the Wagner-Peyser Act to devolve most Employment Service administrative responsibility to the States. Financial responsibility (revenue and appropriations) for the Employment Service, however, remains with the Federal government.

The unemployment insurance (UI) system was federally mandated on the states by the Social Security Act of 1935.[1] Together the Federal Unemployment Tax Act (FUTA) and the Social Security Act established the framework for administering and financing the UI system. FUTA generally determines covered employment, and imposes certain requirements on state programs, but states generally determine eligibility, weekly benefit amounts, and the duration of benefits.

The UI/ES system currently is financed by two separate taxes, with two different tax forms, by two levels of government. A Federal Unemployment Tax (FUTA) of 0.8 percent on the first $7,000 of each employees wages and state unemployment insurance taxes that average 0.9 percent of total wages. The current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax of 0.2 percent.[2] The surtax was first passed in 1976 to restore depleted state UI accounts and was suppose to expire in 1987. Since 1987, the surtax has been extended four times primarily to fund extended benefit programs and is now suppose to expire in 1998. The revenue raised by FUTA is designated for UI administration and maintaining a system of ES offices. Portions of FUTA revenues also fund the federal half of the Extended Benefits Program.[3]

The state unemployment insurance tax varies from state to state, is paid by employers on behalf of their employees, and is experience-rated (employers with few layoffs typically have the lowest tax rates). State legislatures determine the tax rate and the taxable wage base. Twelve states limit taxable wages to the federal minimum of $7,000, other states have ceilings raging from $8,000 in eight states, to $25,500 in Hawaii.

State UI tax revenues fund their weekly UI benefit payments and the state half of the Extended Benefit Program. FUTA revenues are deposited in three federal accounts and state UI tax revenues are deposited in 53 state accounts maintained by the federal government (one for each state, D.C., Puerto Rico, and the Virgin Islands). At the end of fiscal year 1997, state accounts in the UI Trust Fund are fore-

[1] The Social Security Act provided business a competitive disadvantage if their state did not enact UI. The tax for employers in states that meet all federal requirements is 0.8 percent. The tax for employers in states that don't meet federal requirements is 6.2 percent.

[2] The current FUTA tax rate is 6.2 percent, but employers in states with programs approved by the federal government receive a credit of 5.4 percentage points, making the effective FUTA tax rate 0.8 percent.

[3] Half of the revenue to pay for extended benefits comes from FUTA. The other half comes from the state benefit taxes. The extended benefits program provides for an additional 13 weeks after a recipient has exhausted regular UI benefits, but is only available if a state's unemployment rate rises significantly.

cast to have balances totaling $42.9 billion and the three federal accounts had balances totaling $18.8 billion.[4]

Like the Social Security Trust Fund, any positive balance in the UI Trust Fund effectively is used to fund other federal programs for as long as there is the federal budget is running a deficit. General revenues are used to fund federal unemployment benefit programs and allowances such as Trade Adjustment Assistance and NAFTA Transitional Adjustment Assistance.

WHY THE UI/ES SYSTEM SHOULD BE TRANSFERRED TO THE STATES

When the UI/ES system was created in the 1930's, Congress intended it to be a federal-state partnership. The federal government was to set broad parameters for the system, provide adequate and equitable funding for state administration, and oversee state law and operations to ensure compliance and conformity. The states were to be responsible for carrying out the program while complying with all federal laws and regulations, as well as their own state requirements. Over the years, several serious problems have developed with this divided arrangement.

Overtaxation. In FY 1996, only $3.38 billion, or 58%, of $5.85 billion in FUTA tax collection was actually returned in federal grants to administer state unemployment offices. The rest was spent on DOL bureaucracy, IRS tax collection, and labor market information programs; or deposited in two seldom-used federal accounts to pay for extended unemployment benefits and make loans to state unemployment benefit trust funds. For example, in FY 1995, employers in Tennessee paid $120.8 million in FUTA taxes but the state received only $43.6 million in FUTA grants to administer their UI/ES program, a loss of $77.2 million. Employers in Florida paid $309.9 million in FUTA taxes but the state received only $113.8 million back from the federal government, a loss of $196.1 million. In 1995, 19 states receive less than half the FUTA they sent to Washington. All told the federal government collected $5.85 billion in FUTA taxes in FY 1996 and after skimming money off the top for bureaucracy, demonstration projects, and federal trust funds, it then returned on average 56 percent back to the states.

Unnecessary paperwork. Employers now have to fill out both a federal and a state unemployment tax return, the federal return for the administrative tax and the state return for the benefits tax. This costs employers an extra $291 million in costs associated with double filing, when all taxes could be paid on a single state return. It also costs employers $70 million per year for the IRS to process all of the FUTA forms.

Unused funds. Years of overtaxation have caused an immense amount of money to pile up in Washington trust funds: $18.8 billion.[5] Even though FUTA revenues collected for UI and ES administration have been more than sufficient, Congress continues to extend the 0.2 percent FUTA surtax on jobs and limit UI and ES administration appropriations. This effectively masks the true size of the federal deficit. Moreover, federal budget constraints have had a detrimental effect on the services provided to unemployed workers by the state UI system and ES offices. This in turn has led to longer periods of unemployment for workers[6] and unnecessarily high payroll taxes—contrary to the primary purpose of the UI/ES system.[7]

Inefficient service delivery. When the federal government raises tax money from the states and it is transmuted into "federal funds," hosts of rules, restrictions, and requirements suddenly appear that hinder efficient service delivery. The federal government has also used the state conformity process to frequently upset the balance of administrative funding and workloads by dictating that states absorb the

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[4] U.S. Department of Labor, "UI Outlook," February 1997.

[5] The balance in the Employment Security Administration Account will be $2.7 billion in September 1997. This is $1.3 billion more than the statutory limit. There is also a $6.7 billion balance in the Federal Unemployment Account that has been built up using surplus FUTA payroll taxes. In fiscal year 1997, Congress will withhold over $1.3 billion in FUTA revenues.

[6] Lawrence F. Katz and Bruce D. Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," National Bureau of Economic Research, Working Paper No. 2741, October 1988. This study concluded that extending the duration of UI benefits from 6 months to 1 year will increase the mean duration of unemployment by 4 to 5 weeks. Examples of federal programs that increase the duration of UI benefits are the extended benefit programs and trade adjustment assistance.

[7] Daniel S. Hamermesh, "New Estimates of the Incidence of Payroll Tax," Southern Economic Journal, Winter 1979. Research on the incidence of taxation has generally concluded that payroll taxes are predominantly, if not completely, borne by labor in the long-run through lower real wages.

costs of administering additional programs.[8] Moreover, the state conformity process has resulted in a "one-size fits all" approach that does not address the needs of individual states, nor provide states with the flexibility to address the needs of individual workers.

THE KEY PRINCIPLES FOR REFORM

As the 105th Congress begins its debate over the UI/ES system, legislators should consider three important principles to ensure that both workers and employers receive the greatest benefit from any reform.

1. The taxing and spending authority for the UI/ES system should be at one level of government and not split between the federal government and the states. Effective program accountability requires the states to be responsible for both raising and spending the revenue to run the UI/ES system. Maintaining bifurcated taxing and spending authorities diminishes direct accountability.

2. Assure the maintenance and integrity of a national ES system by continuing the FUTA offset credit for states that provide public employment services with universal access where individuals could file UI claims and receive re-employment services. National standards regarding benefit coverage, FUTA conformity standards, benefits for out-of-state claimants should continue.

3. There should, however, be a minimum of federal control and maximum flexibility for the states. Burdensome federal mandates that cause inefficiencies and impose increased costs on the states should be eliminated. States should be empowered to design programs that improve employment services for job seekers and employers, and have the flexibility to address the needs of workers that may be unique to their state.

These principles form the foundation of sensible Employment Security reform that will improve UI/ES services while reducing administrative payroll taxes. To implement these principles Congress should:

• Allow the temporary 0.2 percent FUTA surtax to expire at the end of 1998.[9]

This will remove an unnecessarily high payroll surtax that limits job growth and workers' take-home pay and return $1.4 billion each year to workers and employers. This revenue loss is already accounted for in the CBO baseline budget and will not effect the deficit.

• Increase the FUTA employer offset credit from 90 to 100 percent, and transfer the taxing authority for administrative purposes to the states.

This will effectively eliminate the FUTA tax for states that continue to maintain conformity with the amended FUTA requirements. The taxing and spending authority for the UI/ES system would be transferred to one level of government. Each state would then be responsible, and accountable, to their workers and employers for the UI payroll tax dollars and for the administration and effectiveness of their UI/ES system. The combined state tax would remain dedicated to funding only those activities covered by the UI/ES system.

This will also save employers $291 million per year in paperwork costs associated with filing the FUTA tax returns and an additional $70 million per year for the IRS to process all of the FUTA forms.

• Establish 53 new "state" administrative accounts in the U.S. Treasury. States would be required to deposit revenue raised for ES administration into their federally managed administrative account. Each state would be permitted to pay for their administrative expenses from their new accounts. States would continue to pay for their UI benefit expenses from their benefit accounts. States would, however, be permitted to make withdrawals only to pay for benefits and administration of its UI law.

• Use the existing balance in the federal Employment Security Administration Account (ESAA) for transition purposes. Set aside $150 million in the old federal ESAA to "hold harmless" for 5 years those states that receive more in FUTA grants than their employers pay in FUTA taxes in FY 1995. Transfer the remaining ESAA balance to the new 53 state administrative accounts in proportion to their share of covered employment. Distribute the hold harmless set-aside into the states' administrative accounts in proportion to their most recent FUTA revenue/FUTA grant shortfall. Eliminate ESAA after a 5 year hold harmless period.

This will hold-harmless those states that do not have a sufficient tax base to fund their UI/ES system for a 5 year transition period.

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[8] Edwin M. Kehl, "Administrative Simplification of Unemployment Compensation Programs," in W. Lee Hansen and James F Byers eds., "Unemployment Insurance: The Second Half-Century," The University of Wisconsin Press, 1990.

[9] This is already in the CBO baseline budget.

• Repeal the federal-state extended benefit program and discontinue the Extended Unemployment Compensation Account (EUCA). Transfer the EUCA balance to the 53 state benefit accounts in proportion to their share of covered employment. Amend FUTA to enable States, at their option, to provide their own extended benefit program with their own triggers.

States currently have the responsibility to determine the number of weeks regular UI benefits are paid. State legislatures should be able to establish an extended benefits program that best meets the needs of their workers and determine the duration of those extended benefits as well. As it is, the current extended benefit program "trigger" requirements are so high, few states qualified for activation of the program during the last recession. There will be no impact on the federal budget because the state benefit accounts, like EUCA, are included in the federal budget.

• Discontinue the Federal Unemployment Account (FUA) and distribute the balance to the 53 state benefit accounts in proportion to their share of covered employment. Provisions should be made for interest bearing loans from federal general revenues to state trust funds with the same repayment provisions that currently exist. States should, at their option, be able to borrow from other sources as well.

Funds in the FUA come from a portion of the FUTA payroll tax on jobs.[10] When the FUA is not being used for state loans, the surplus that builds up in the account is essentially used to fund other government programs and amounts to a tax on jobs to reduce the deficit. At the end of September 1998 there will be a $7.0 billion surplus in the FUA. In recent years, states have borrowed from other sources to obtain lower interest rates and avoid losing the FUTA offset credit. Provisions should be made, however, for interest bearing loans from federal general revenues if they are needed quickly. There will be no impact on the federal budget because the state benefit accounts, like FUA, are included in the federal budget.

• Ensure state trust fund security and accuracy by continuing to require the deposit of all state unemployment insurance taxes in the federal Unemployment Trust Fund accounts. Funds should be deposited on a timely basis and be invested by the U.S. Treasury in federal securities. Interest earned would accrue to the appropriate state trust fund account.

• Repeal Title III of the Social Security Act (Grants to States for UI Administration) and transfer certain requirements to FUTA.

Full payment of benefits when due (prompt and accurate) and the opportunity for a fair hearing when claims are denied would be moved to FUTA.

Title III elements that would be eliminated include provisions that: Make the Secretary of Labor the judge of what constitutes the proper and efficient administration of a state's UI law; requiring states to replace and administrative moneys lost or improperly expended; requiring states to provide information to federal agencies administering public works or assistance through public employment; and requiring cooperation with federal agencies administering any UI law.

Requirements to disclose authorized information to the Food Stamp program, child support agencies, and other agencies, as well as deducting child support payments from UI checks would remain in other statutes after their repeal in Title III.

• Amend FUTA to require states to provide public employment services with universal access where individuals could file claims for unemployment benefits and receive re-employment services.

To assure the maintenance and integrity of a national ES system FUTA should be amended to require states to provide the UI and employment services currently required under the Wagner-Peyser Act. National standards regarding benefit coverage, FUTA conformity standards, benefits for out-of-state claimants should continue. Each state, however, should have the flexibility to deliver employment services in a manner which meets the needs of its job seekers and employers.

• Repeal the Wagner-Peyser Act.

By amending FUTA to include the provision of employment services (section 7 of Wagner-Peyser) the act would no longer be necessary.

• Repeal the Disabled Veterans' Outreach Program and Local Veterans' Employment Representative program and amend FUTA to require states to provide preferences to veterans seeking unemployment insurance benefits and re-employment services consistent with Title 38 of the United States Code.

The administrative efficiency of the ES offices could be significantly improved by repealing barriers to the integration of veterans' services with other employment services. As the Vice President's National Performance Review noted in calling for

[10] FUTA funds are indirectly deposited the FUA when the EUCA and Employment Security Administration Account (ESAA) have reached their statutory limits.

the removal of barriers,[11] DoL's Veterans' Employment and Training Service provides for state-employed, federally funded, employment specialists to serve veterans in local state employment service offices. However, these staff are legally prohibited from helping non-veterans." So, if a local office is crowded with non-veterans," points out the NPR, "these specialists cannot help out—even if they have no veterans to serve." Employment Service staff would be used more efficiently and the public better served by eliminating this requirement.

• Require state laws to conform to certain provisions that would remain, or be added to, FUTA. These include:

To qualify for the FUTA tax credit, states must cover:

Employers who paid at least $1,500 in wages during any calendar quarter or who employed at least one worker in at least one day of each of 20 weeks in the current or prior calendar year; Employers who paid cash wages of at least $20,000 for agricultural labor in any calendar quarter or who employed 10 or more farmworkers in at least one day in each of the 20 different weeks in the current or prior year; domestic service employers who paid cash wages of $1,000 or more during any calendar quarter in the current or prior year.

FUTA would also continue to require coverage of nonprofit organizations who employed at least four workers for one day in each of the 20 different weeks in the current or prior year, and state and local governments without regard to the number of employees.

• Amend Title IX to eliminate the general UI and ES administrative grants to the states and reflect the elimination of the EUCA and FUA accounts.

• Amend Title IX of the Social Security Act to eliminate restrictions on Reed Act funds previously distributed and allow states to retain administrative funds used for real estate as well as equity.

Current rules are so restrictive they act against the efficient operation of the state UI/ES systems. The states are in the best position to determine the use of capital equipment and local facilities that will best serve the needs of their workers and employers.

• Permit states to carry out certain national activities, with costs reimbursed by federal general revenues. These include:

Federal unemployment claims (UCFE, UCX, TAA, DUA); BLS cooperative programs (ES–202, CES, LAUS, OES); Compilation of economic data (initial claims, continued claims, covered employment); ensuring state statutes conform to FUTA requirements; and Alien Labor Certification.

• States would share in the cost of contracts for some activities maintained by a consortium of states include: Interstate and combined wage claim coordination, and America's Job Bank.

• Any remaining Department of Labor and Department of Treasury oversight would be funded with general revenues.

KEY POINTS OF COMPARISON BETWEEN THE TWO EMPLOYMENT SECURITY SYSTEM REFORM PROPOSALS

Two separate plans to reform the Employment Security system have come forward in the past year. The principles and recommendations that I have outlined today have been endorsed by the American Legislative Exchange Council (ALEC) and form the foundation of the ALEC plan. Another plan is supported by UBA Inc., and several state Employment Security Administrators (UBA/ES plan) and has been presented in the testimony of the other panelists. Although there are some similarities between the ALEC plan and the UBA/ES plan, three fundamental differences separate them.

1. The most important distinction is the UBA/ES plan maintains FUTA while the ALEC plan effectively eliminates it.

• Under the ALEC plan the taxing and spending authority for the UI/ES system would be transferred to one level of government thereby improving accountability. Each state would have direct control over their taxes rather than continuing to receive revenue from a fixed federal tax (FUTA) that is set in Washington and rarely changed. Governors and state legislators are in the best position to determine the needs of their unemployed workers and establish the appropriate wage base and tax rate to meet those needs. Moreover, Employment Security agencies would have to justify their budgets (and thus the administrative tax level) directly to the citizens

[11] From Red Tape to Results, Creating a Government That Works Better and Costs Less, Department of Labor, Accompanying Report of the National Performance Review, Office of the Vice President, September 1993, p. 80.

of their states. Under the UBA/ES plan the current bifurcated tax and spending arrangement between the federal and state governments would continue indefinitely.

• Under the ALEC plan, workers and employers may be able to save over $1 billion each year in payroll taxes since many states would be able to equal or exceed their current federal grant revenue with lower tax rates. Under the UBA/ES plan, many state Employment Security agencies could receive substantial revenue windfalls of over 50 percent before any taxes are cut.

• By maintaining FUTA, the UBA/ES plan also perseveres the mountain of burdensome paperwork required by the current federal/state grant process and the over-regulation of state programs by Washington bureaucrats. The ALEC plan, on the other hand, would free up these resources for state Employment Security agencies to use to improve re-employment services.

2. Unlike the UBA/ES plan, the ALEC plan would eliminate the unnecessary Federal Unemployment Account (FUA) and distribute more than $7.1 billion proportionally to the state benefit accounts. This would significantly improve the solvency of the state benefit trust funds and may trigger automatic benefit tax cuts under existing state law. It may also encourage some state legislatures to reduce benefit tax rates or even declare a benefit tax moratoria (as North Carolina has already done). At the least, these funds will permit the absorption of benefit increases without raising taxes.

3. Only the ALEC plan provides states with the flexibility to establish their own extended benefit programs that will best meet the needs of their workers. The UBA/ES plan continues the extended benefit program as an unnecessary mandate on the states.

CONCLUSION

The recommendations presented here for transferring the Employment Security system to the states constitutes a modest, achievable proposal that will not unduly affect the federal budget. In fact, they were characterized by one state Employment Security Commissioner as "fiscally sound, administratively simple, and politically realistic.[12] If enacted such a transfer will enable states to reduce payroll taxes, increase jobs and take-home pay, reduce paperwork burdens, improve services for unemployed workers, and more effectively decrease the duration of unemployment.

Chairman SHAW. Thank you, Mr. Wilson.

Mr. Simonson.

STATEMENT OF KENNETH SIMONSON, VICE PRESIDENT AND CHIEF ECONOMIST, AMERICAN TRUCKING ASSOCIATIONS, ALEXANDRIA, VIRGINIA

Mr. SIMONSON. Good morning, Chairman Shaw and Members of the Subcommittee. Thank you for the opportunity to testify. You may not see them on my head, but I am actually wearing three hats today.

Besides speaking for the 35,000 trucking businesses that belong to the American Trucking Associations and its State and national affiliates, I'm appearing on behalf of the UI Tax Working Group, an informal coalition of employers, service providers, and State governments whose focus is the FUTA proposals in the administration's budget and their relationship to UI reform.

In addition, I'm appearing as chair of the tax Committee of the Small Business Legislative Council, a permanent independent coalition of nearly 100 trade and professional associations that share a common commitment to the future of small business.

The administration's budget contains two FUTA proposals that can only be described as gimmicks. One is yet another extension,

[12] David B. Poythress, Statement before the House Committee on Ways and Means, Subcommittee on Human Resources, July 11, 1996.

this time through 2007, of the so-called temporary 0.2-percent surtax, first enacted in 1976, to eliminate an unemployment trust fund deficit that was retired a decade ago.

This budget proposal comes despite an unemployment rate that has thankfully stayed below 6 percent for over 2½ years, and which the budget, naturally, forecasts to stay there as long as the budget window is open.

In fact, a straight extension of the surtax this time would create an embarrassment of riches in the form of surpluses in the various unemployment trust fund accounts that would have to be forwarded to the States, and therefore not help make the deficit look smaller.

To avoid this result, the administration proposes to raise the levies around these funds so the money won't spill over outside the budget.

The second proposal is even more shameless, to the point that it gives the word gimmick a bad name. This proposal would require employers to pay both Federal and State unemployment taxes monthly rather than quarterly.

It's no coincidence that the plan would start up just in time to accelerate payments otherwise due in fiscal year 2003 into fiscal year 2002. While the Treasury would get help that year from a one-time speedup of 2 months' worth of unemployment tax receipts, employers, the IRS, and State governments would be saddled with higher filing and processing costs every year.

I would direct your attention to the charts distributed with my testimony. The first charge shows the current system, in which employers make a total of eight quarterly submissions per year—four each to the IRS, and four to a State agency.

The second chart vividly shows that the administration would triple this burden to 24 monthly filings each year. Similarly, the processing and reconciliation burden would triple for Federal and State agencies. That's what makes this proposal even more objectionable than the other tax speedup gimmicks considered in the past.

The only rationale offered for this idea is that it might enable the IRS to identify nonpayers more rapidly. But as ICESA, the Interstate Conference of Employment Security Agencies, points out, State agencies do nearly all of the unemployment tax enforcement.

The more resources they must devote to processing payments, many of which would be for very small amounts, the less they would have available for compliance. In any case, ICESA finds that compliance is high and would not be improved by speeding up payments without documents to reconcile them.

The administration has not suggested that it would support higher spending by either Federal or State authorities to process these additional tax filings. Clearly, the extra work would be burdensome. Even their proposal includes an exemption for some small employers with limited FUTA liability. But many smaller businesses that add or replace employees, or hire seasonal workers, would not qualify for the exemption, since new FUTA liability accrues with each new hire, including replacement employees.

This deposit acceleration rule makes no sense for businesses, large or small, and an exception for small business won't fix this fundamentally flawed concept.

I was pleased, Mr. Chairman, that you addressed those in your floor statement earlier this year.

This proposal doesn't seem to pass anyone's straight face test. When representatives of the UI Tax Working Group visited the administration offices before the budget came out, both OMB and Labor Department staff disavowed authorship of the speedup proposal in unusually candid terms.

Even the Treasury staff presented no defense other than to ask us to propose another revenue idea if we wanted this one dropped. They did not suggest IRS would be given extra funds, or was capable of handling the additional work without them.

Rather than move forward with complicated budget gimmicks, as proposed in the administration's budget, Congress should seek to streamline and consolidate the tax consolidation process. There are many UI reform proposals, as you've heard this morning.

Let me call attention to just the tax piece. Instead of the toothy tangle shown on my second chart, we believe now is the time to adopt a combined quarterly submission that would enable employers to file taxes quarterly with just one agency, as shown on the last chart.

Being flanked by experts on unemployment insurance reform plans, I will not try to address those, believing that devolution is in the details.

Instead, let me close by urging you to stay away from these two budget gimmicks that will cause genuine, long lasting pain, in exchange for unjustified or one-time fiscal gain.

Thank you.

[The prepared statement and attachments follow:]

Statement of Kenneth Simonson, Vice President and Chief Economist, American Trucking Associations, Alexandria, Virginia

Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to testify today on selected unemployment insurance ("UI") issues. I am Vice President & Chief Economist of the American Trucking Associations, the national trade association for over 35,000 trucking businesses of all sizes, types and regions. I am appearing on behalf of the UI Tax Working Group, an informal coalition of employers, service providers and state governments whose focus is the Administration's Budget Federal Unemployment Tax Act ("FUTA") proposals and their relationship to UI reform. In addition, I am appearing as Chair of the Tax Committee of the Small Business Legislative Council ("SBLC"), a permanent, independent coalition of nearly 100 trade and professional associations that share a common commitment to the future of small businesses.

Our working group has involved a broad array of organizations: the American Payroll Association, the American Society of Payroll Management, the American Trucking Associations, the Interstate Conference of Employment Security Agencies, Inc., the National Association of Manufacturers, the National Federation of Independent Business, the Service Bureau Consortium, the Society for Human Resource Management, and UBA, Inc. These organizations oppose the Administration's FUTA proposals and believe that any restructuring of the FUTA/State Unemployment Insurance ("SUI") tax rules should only be considered in the context of broad-based UI programmatic reforms such as those now being considered by the Subcommittee. Furthermore, we believe any reform of the UI system should include a streamlining of the FUTA/SUI collection system, thereby creating greater efficiencies and reduced costs for the federal and state governments and for employers.

We are deeply concerned that the FUTA proposals contained in the Administration's FY 1998 budget would create substantial new burdens for both taxpayers and state government administrators. If enacted, the budget scoring of these proposals

would make meaningful UI reform more difficult to achieve. Mr. Chairman, we applaud your publicly stated opposition to the Administration's FUTA proposals and your commitment to consider FUTA restructuring only in the broader context of UI reform.

Recommendations to reform the UI system and the collection of unemployment taxes address a wide range of issues related to the goals, financing and administration of the system. With respect to tax collection issues, there is broad agreement that the current duplicate collection system results in unnecessary expense for federal and state government administrators. For employers, this system is both expensive and complex. They must deal with two levels of tax administration for payments, record keeping and audit. Furthermore, they must confront varying FUTA/SUI tax rate structures and wage bases, as well as definitions of covered employment that differ between the federal system and the states—and among the states. For multi-state employers, like many in the trucking industry, the system has become extremely complex.

At hearings before this Subcommittee last summer, witnesses estimated that the present system of collecting separate state and federal unemployment taxes each quarter costs employers up to $500 million more per year in processing and related administrative costs than would be required under a unified collection system. Clearly reform is needed.

THE ADMINISTRATION'S FY 1998 UI PROPOSALS

The Administration's FY 1998 budget contains two FUTA tax proposals: the first proposal would extend the current .2 percent FUTA surtax scheduled to expire at the end of 1998 through the year 2007; the second would accelerate, from quarterly to monthly, the collection of most federal and state UI taxes beginning in the year 2002.

Surtax Extension. The FUTA surtax was enacted in 1976 to eliminate a deficit in the Unemployment Trust Fund. Although that debt was retired in 1987, the surtax has not been allowed to expire. The proposal to again extend the tax was designed to respond more to out-year budget considerations than to demonstrated UI funding needs. It must be evaluated with full appreciation of the significant current balances in the federal UI trust funds and the continuing state frustration with federal practices regarding reimbursement of administrative expenses. We doubt that you will find any justification for a further extension of this "temporary" tax. Private sector employers are unanimous in opposing it.

UI Tax Deposit Speed-Up. Accelerating the collection of existing federal and state UI taxes is a device that generates a *one-time* artificial revenue increase for budget-scoring purposes and real, *every year* increases in both compliance costs for employers and collection costs for FUTA and SUI tax administrators. The Administration's proposal is fundamentally inconsistent with every reform proposal that seeks to streamline the operation of the UI system and with its own initiatives to reduce paperwork and regulatory burdens.

The proposal would increase federal revenues in FY 2002, as taxes scheduled to be collected in FY 2003 are accelerated into the previous year.[1] *No new revenues* would be collected by the federal or state governments by virtue of this proposal—the federal government would simply record, in FY02, revenues that would otherwise be received a year later.

This proposal is even more objectionable than other tax speed-up gimmicks considered in budget reconciliation proposals in the past. For example, proposals that might move an excise tax deposit date forward by one month into an earlier fiscal year make little policy sense, but also do not create major additional administrative burdens. This particular proposal would result directly in significant *and continuing* costs to taxpayers and to the federal and state governments. By tripling the number of required UI tax collection filings from 8 to 24 per affected employer each year, the proposal would exacerbate current inefficiencies and substantially raise costs to employers and both federal and state UI tax administrators. Tripling the required number of deposits can only dramatically escalate the cost to employers of the duplication inherent in the current separate FUTA/SUI quarterly collection practices—now estimated to cost employers several hundred million dollars a year.

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[1] Ironically, the amount of revenue recorded through this one-time accounting speed-up results from yet another budgeting device. State UI tax revenues are included as assets of the federal government for budget-scoring purposes, notwithstanding the fact that the federal government does not mandate the rate of this tax, collect it, or even have the right to use the proceeds. All state monies in these Trust Fund Accounts are automatically transferred back to the states to pay UI benefit obligations as they occur. In the interim, they cannot be used by the federal government for any other purpose.

Furthermore, the one-time, budget score-keeping gain will be far more than offset by the real, *every year* administrative costs of additional FUTA tax collection to the IRS and SUI tax collection to the states. Monthly submission requirements can only increase the $100 million to process and verify the quarterly FUTA deposits the IRS now receives from the UI Trust funds.

In addition, since the federal government is required to reimburse states for their UI administrative costs, reimbursement of states for the added costs of monthly SUI collection is another hidden federal outlay cost in this ill-conceived proposal.[2] To the extent the federal government does not reimburse the states for these higher SUI collection costs, the states will experience yet another form of unfunded mandate.

The Administration implicitly recognizes that the added federal and state deposit requirements would be burdensome, at least for small business, since the proposal includes an exemption for certain employers with limited FUTA liability. Many smaller businesses that add or replace employees or hire seasonal workers would not qualify for the exemption since new FUTA liability accrues with each new hire, including replacement employees. Further, this new exemption would add still another distinction to the many already in the tax code as to what constitutes a "small" business. This deposit acceleration rule makes no sense for businesses large or small, and an exception for small business does nothing to improve this fundamentally flawed concept.

THE NEED FOR REFORM

Rather than move forward with complicated budget gimmicks as proposed in the Administration's budget, Congress should seek to streamline and consolidate the tax collection process as has been proposed in the various reform proposals that have been presented to you.

State governments collected approximately 80 percent of the $28.6 billion in the total federal/state UI taxes collected in FY96. Transfer of the FUTA tax collection to the states would place responsibility for the collection of the entire tax on the administering authority having the most compelling interest in maintaining an efficient and comprehensive collection system. Consolidation would also eliminate the need for duplicate tax submissions by every employer, the redundant verification of tax deposits, and multiple audits now necessitated by two separate collection systems.

The notion of consolidating tax collection with state administrators is neither new nor radical. The 1980 UI Commission chaired by the late Wilbur Cohen proposed the concept. The 1995 Advisory Council chaired by Janet Norwood endorsed it.

CONCLUSION

UI reform should focus on simplifying the system, reducing the burden of our employers and reducing the costs of administration to federal and state governments. Transferring FUTA tax collection to the states would dramatically simplify the system and save hundreds of millions of private and public sector dollars annually.

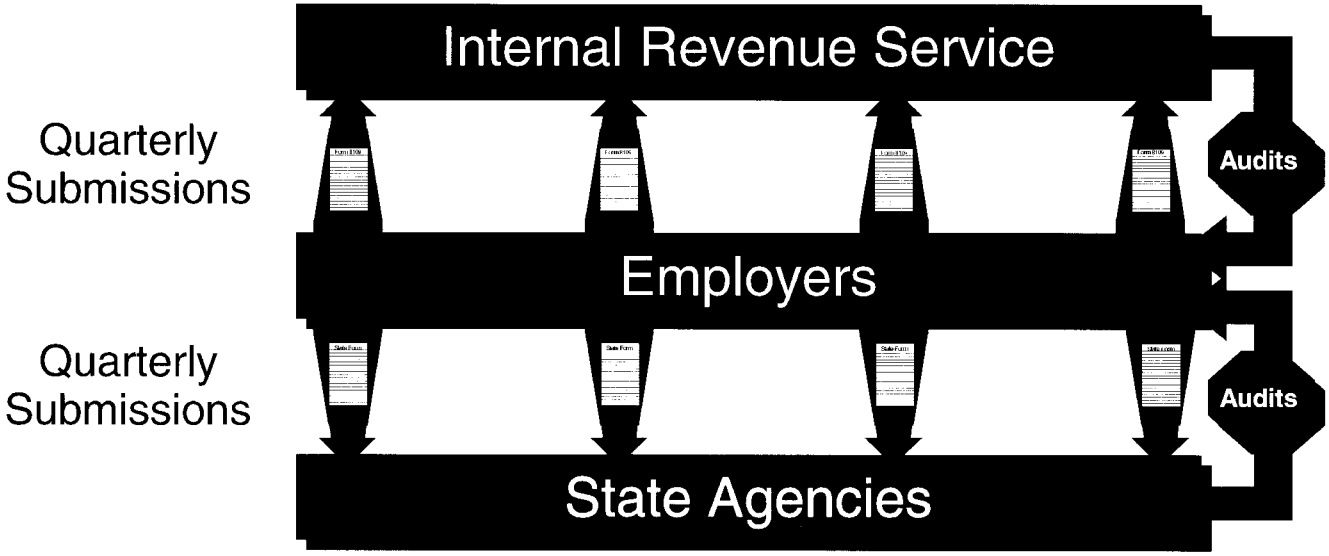
Mr. Chairman, as you evaluate the tax collection aspects of these reforms, we would ask that you keep in mind the three charts that the UI Tax Working Group has supplied to the Subcommittee. They contain a simple but important message:

- Where we are;
- Where we need not go; and
- Where simplification can take us.

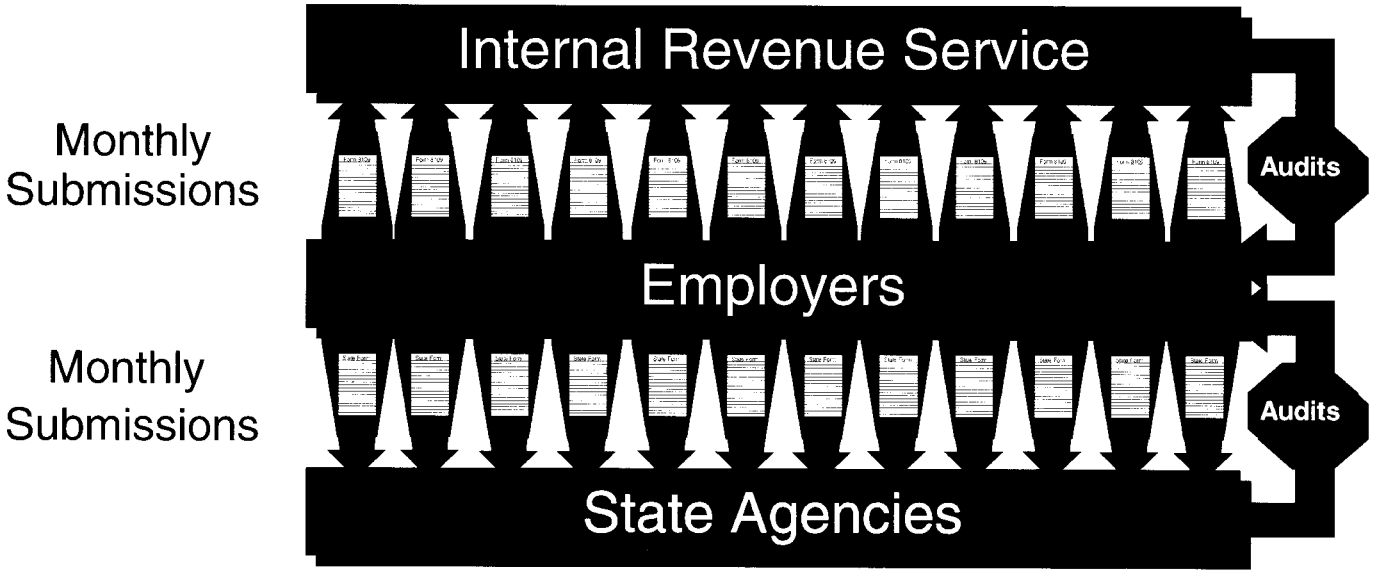
Thank you.

[2] The Administration's budget does not appear to factor in such increased federal and state collection costs as an outlay offset to the increased FUTA revenues projected.

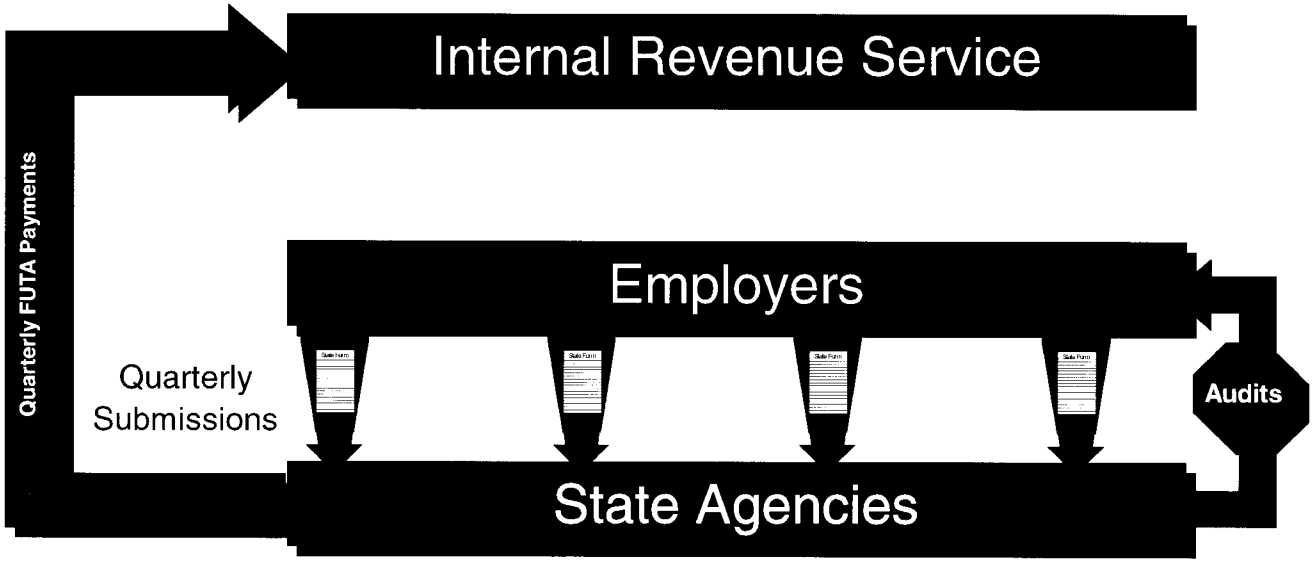
Current UI
Tax Collection System



Administration FY 1998 Budget Proposal



Simplified UI
Tax Collection System



Chairman SHAW. Thank you, sir.
Dr. Norwood.

STATEMENT OF JANET L. NORWOOD, SENIOR FELLOW, URBAN INSTITUTE

Ms. NORWOOD. Thank you, Mr. Chairman, and Members of the Subcommittee. As you know, I spent 3 years after having left the Bureau of Labor Statistics studying the unemployment insurance system with a council that represented labor, management, the States, and the public.

We found a number of things that I think are terribly important. The first point is that the unemployment insurance system, which, as you know, is 60 years old, was set up at a time when the labor market was very different from what it is today.

We have a lot more people in services. The unemployment insurance system was set up really for a manufacturing work force with recessions that were short lived, and the people who lost jobs were rehired. And we have a large number of part-time and contingent workers.

The council found that there was a long-term, downward trend in recipiency, since 1947; the unemployment insurance program really has been serving a decreasing proportion of the unemployed.

In fact, the range of unemployed receiving UI that we found was about 17.6 percent in one State to 65 percent in another. So there is a big difference among the States.

But what I would like to do today is to focus basically on two issues. The first is the Federal and the State role in unemployment insurance. The Nation's unemployment insurance system is one of shared responsibilities and powers.

And I think it's important that those responsibilities be shared effectively. We must maintain the interests of the States, but we must also maintain the national interest.

We spent a good deal of time looking at the basic concepts that ought to be the basis of a Federal/State cooperative program, and although we had very differing views on the council, we unanimously agreed that where the interests of the States and the Federal Government coincided, which are many in the unemployment insurance system, the Federal Government does not need to be involved.

But where the interests are different, it is important for there to be a Federal presence.

We found seven areas in which we felt that the Federal Government needed to protect the national interest. The first is to ensure there is a UI system in all States.

The second is to promote forward-funding of the unemployment insurance system, and that's terribly important, because there are two purposes of this system. One is to pay workers who lose their jobs through no fault of their own, to tide them over until they find employment.

But the other is to prime the economy. It's a pump-priming effect in a period of economic downturn. And you can't do that if you don't have adequate State trust funds at the time of a recession.

The third is to coordinate the collection of information and to monitor developments. The fourth is to maintain supplemental benefit programs that trigger on automatically in recessions, and avoid, therefore, the costly Federal emergency benefits.

The fifth is to coordinate a more efficient pooling of risk through loans to the States with serious recessions, and change the way in which interest rates are paid. And finally, ensuring the eligibility of workers with strong labor force attachment with some minimum level of benefits.

In other areas, the programs should be left to the States. And we had a list of areas where we thought the Federal Government should leave issues to the States.

The second point I want to make is that we did find there was a race to the bottom among the States. And the reason for that is basically that there is a lot of competition among the States for lower taxes. The easiest way for a State to handle trust fund inadequacy is, we found, to raise eligibility requirements.

We found some real discrimination against low-wage workers. I'm particularly concerned about that, because as we move forward toward more and more workers coming into the labor force as a result of welfare reform, we're going to have people with much less labor force attachment, much less experience and training, who will have more spells of unemployment.

If we continue to tighten eligibility and have workers—and there are some figures in my statement—if we have workers who work half the year, say, part time, or work a full year part time at the minimum wage, cutoff for unemployment compensation, even though they have worked and have strong attachment to the labor force, I think we're going to have some serious difficulties in coping with this group of the labor force.

Mr. Chairman, we made 52 recommendations. I'm proud to say that most of them—not quite all—but most of them were unanimous, and I would ask that this pamphlet summarizing them be noted in the record.

Thank you very much.

[The prepared statement follows:]

Statement of Janet L. Norwood, Senior Fellow, Urban Institute [1]

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to discuss the nation's unemployment insurance program with you this morning. As you know, I chaired the Advisory Council on Unemployment Compensation (ACUC), having been appointed to the Council by both Presidents Bush and Clinton. The Council, established in Section 908 of the Social Security Act as amended, had 11 members appointed by the Congress and the President who, by law, were representatives of state governments, business, labor, and the public. The ACUC reviewed the entire Unemployment Insurance program (UI), held meetings and public hearings in different parts of the country, visited state offices, and met with groups of businessmen and with workers seeking benefits. Members of the Council also visited a number of state UI offices and staff at the U.S. Department of Labor. The Council convened two economic research conferences and sponsored a legal symposium to facilitate the exchange of ideas and to ensure a full understanding of the operation of the UI program. The three reports of the Council contain, I believe, a useful summary of the operation of the program—both the parts that are working well and areas which could be improved. Although many different

[1] Any opinions expressed herein are solely the author's and should not be attributed to the Urban Institute, its officers, or funders.

perspectives were represented on the Council, most of the recommendations were unanimous.

The nation's system of unemployment insurance is now more than 60 years old. As the oldest federal-state cooperative program, it has served the nation well and, in fact, should be seen as a prime example of cooperation between the states and the federal government. The UI program provides economic security to millions of American workers who, through no fault of their own, are temporarily laid off or permanently lose their jobs. We should ensure that the program continues to meet the needs of workers in a labor market that is considerably different from that of the past.

Our country's labor force today is much more diverse, made up of men and women, skilled and unskilled, minorities and immigrants. More than 136 million people are in the labor force, and the labor force participation rate has climbed to over 67 percent. Almost 8 out of every 10 workers are employed in a service-producing industry. Factory workers, who were the prime recipients of UI benefits when the program began, today make up only 20 percent of nonagricultural employment. Part-time work has become more prevalent, much of it because people prefer it, but more than 4 million workers are forced to work part-time because full-time jobs are not available. In addition, nearly 8 million workers (6.1 percent of all employed workers) were multiple jobholders, that is, they held more than one job.

The fact that the unemployment rate—at 5.2 percent—is relatively low and that job creation continues makes this a very good time to review the UI program. This is a period when the demands on the UI system are relatively low and when, therefore, we should be planning for the future. It is important to note that according to data for the first week in March, only 37.4 percent of the unemployed in our labor force survey are receiving UI benefits. There are many reasons for this discrepancy, of course, since the UI system does not cover new entrants to the labor force or those long-term unemployed who have already used up their benefits. Nevertheless, the long-term downward trend in recipiency since 1947 shows that the UI program has been serving a decreasing proportion of the unemployed.

The ACUC made a number of recommendations for improvement of the system, and they are all useful. But I would like to focus my testimony this morning on two issues that I consider especially important. The first is the sharing of responsibility between the federal government and the state governments and the solvency of the UI trust funds. The second is the treatment of part-time and low-wage workers.

Defining the Federal and State Roles in the Unemployment Insurance System

The nation's unemployment insurance system is one of shared responsibilities and powers. It is important that those responsibilities be shared effectively so that the interests of the states and of the nation as a whole are best served. The federal government has a responsibility to protect the national interest in cases where the interests of the states do not coincide with those of the federal government. In cases where the interests of the two levels of government coincide—which is very often the case—the program should be left to the states. The ACUC made a number of specific recommendations about activities in the program which should be left to the states. Our report laid out a useful conceptual foundation for dealing with the responsibilities of the two levels of government in programs which must have the cooperation of both to succeed. I believe that the research that we did on this issue can be applied to many other programs and that the UI system should be seen as a useful model as we move more responsibility to state governments.

The Council found that the federal government had a responsibility to protect essential national interests in seven areas and to leave most responsibility for other areas to the states. The recommendations were that the federal government should: (1) ensure that each state maintains a UI system; (2) Promote forward funding of the UI system; (3) coordinate the collection of labor market information and the monitoring of developments; (4) maintain supplemental benefit programs that trigger on automatically in recessions, thereby avoiding costly federal emergency benefits; (5) coordinate a more efficient pooling of risk through loans to states with serious recessions; (6) assure the eligibility of workers with labor force attachment for a minimum level of benefits; and (7) promote the efficiency and quality of program outcomes.

In other areas, the Council found that program details could best be left to the states. We recommended that many federal laws, regulations, and federal oversight be changed to leave the states unencumbered in areas best handled by them. For example, states should determine whether to disqualify certain groups of workers (i.e., school employees between terms or professional athletes), whether benefits should be reduced if workers received retirement benefits, and a variety of oversight functions about performance outcomes.

Our research showed that the pressures under which many of the states were operating encouraged a "race to the bottom," which affected two extremely important areas—trust fund solvency and low-wage workers. Although some states maintained a degree of forward funding of the trust funds, others did not. Since one important purpose of the UI program is the provision of purchasing power during an economic downturn, the federal government has a responsibility to ensure that this is done. State trust funds must be adequately maintained in good times so that when recession hits, payments can be made to the workers who need them. The funds needed for these payments should be secured in periods of economic expansion and not in the midst of an economic downturn. I am concerned that insufficient attention is currently being given to building up the trust funds in some states now while we are in an economic expansion for use during some future recession.

Low-Wage Workers

Research conducted by the Council staff found that the competitive pressures among the states to attract business could well lead to a continued decline in the percentage of unemployed workers who received benefits. We were concerned to find that this problem disproportionately affected low-wage workers. When a state experiences insufficient trust funds to cope with the demand from workers entitled to benefits, often the first step taken is to tighten eligibility for those benefits. The brunt of this tightening hits especially those working part-time and those earning low wages. For example, our research found that a minimum wage person who worked half time or for 20 hours each week the year round would not qualify for UI benefits in nine states. But a comparable part-time, full-year worker earning $8.00 an hour would qualify in all states. The point is that a worker with strong labor force attachment can be disqualified for UI because his earnings were too low. In the same way, we found that a worker employed two days per week for a full year at the minimum wage would not qualify for benefits in 29 states. But that worker would be eligible in all but two states if his earnings were $8.00 per hour. Thus, low-wage and part-time workers are disqualified either because of their low earnings or because they work only part-time.

The ACUC report for 1995 declared: "Because of the structure of earnings eligibility requirements, low-wage, part-time workers must work more hours to qualify than higher-wage workers." This means that the system in some states discriminates against the working poor, exactly the group we most need to help in our society. I believe that this is an issue that will become more important as an increasing number of people move from welfare to jobs as the result of the recent welfare legislation. The former welfare recipients tend to have little labor force experience and frequently do not have much training; they can, therefore, be expected to suffer more spells of unemployment than the rest of the labor force.

Mr. Chairman, I have focused my brief remarks on only a few of what I believe to be among the most important issues covered by the careful study and review of the Advisory Council. I should be happy to try to answer any questions you may have.

REFERENCES:

Advisory Council on Unemployment Compensation, Report and Recommendations, Transmitted to the President and Congress, February 1994.

Unemployment Insurance in the United States: Benefits, Financing, Coverage, A Report to the President and Congress, February 1995.

Defining Federal and State Roles in Unemployment Insurance, A Report to the President and Congress, January 1996.

Collected Findings and Recommendations: 1994–1996.

Chairman SHAW. Thank you, Dr. Norwood.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. This panel is a lot harder than the first panel, and I, frankly, don't have any questions, because I don't know enough yet about what everybody is proposing. So for right now, Mr. Chairman, I beg for more time to study this issue.

But I do appreciate all the contributions of the folks who are here. They're very interesting comments. And I think that I need more time to assimilate all of this.

Thank you.

Chairman SHAW. That is a historic comment, that a Member of Congress doesn't know everything about everything.

Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. What do you do next? I very much, if I might say, sir, respect that approach, and I hope we can look at this issue without kind of automatically choosing up sides.

I think where we can simplify we should do it, and I think we need to look at the administrative problems. I'm no longer on the Budget Committee, but I don't like gimmicks.

I hope we can use, Mr. Chairman, this hearing as an opportunity to take a rather broad and perhaps a fresh look at the unemployment system. Because I think as Dr. Norwood has said, times have changed since it was started.

And also we have, I think, some memories of the last recession. And I hope that no one here, Republican or Democrat, thinks there will never be another one, whatever the assumptions of CBO or anyone else might be.

So let me just ask, for example, I'll ask you, Mr. Wilson, What happens under your proposal if there is no FUTA tax when there is a recession? Where's the supplemental benefit coming from?

Mr. WILSON. I believe the States should have control over establishing their own extended benefits program. They are in the best position to decide the length of the duration, the eligibility for the duration, and the trigger mechanism for the extended benefits.

As you know, in the last recession, in the early nineties, the trigger mechanism at the Federal level kicked in for very few States and forced Congress to establish an emergency employment compensation program.

Mr. LEVIN. Let me just say, myself, I draw the opposite conclusion. And I think Mr. English's testimony, if I might say so, points in the opposite direction from you, from what you say.

Look, we had trouble with the EB Program, so you say don't make it useful. Abolish it.

Mr. WILSON. No. I'm not saying abolish it. I'm saying leave it up to the States.

Mr. LEVIN. Well, that's abolishing a Federal program. And we went through the agony of trying to respond to high unemployment levels in States, and what we're finding is that recessions are not national. They tend to be regional.

So you say leave it up to the States, but the States that are hit are the ones that have the least capacity to respond. Now, you can take 1990 or 1991 if you want. That was difficult enough.

But take 1982, 1983, 1984, and 1985 when we went through the agony of what we were going to do about regional recessions. And it is true, the EB program trigger did not work. We had set up a system we thought might be operable.

But that only showed, I think, the need to have some kind of a national system, partly because the States that are hit are the least able to respond; and second, as we found out in the eighties,

and again to some extent in the nineties, when there's severe unemployment in one State, it affects other States. People go to other States.

Mr. WILSON. But the States are currently responsible for regular benefits. They have been able to manage those benefits, that program, fairly well over the last 60 years.

Mr. LEVIN. Within a Federal structure. But that's assuming no recession. So when you say Governors and State legislators are in the best position to determine the needs of their unemployed workers and establish appropriate wage base and tax rate, even—and I think we need to take a look at that statement honestly. But when there's a recession, even if they look at their needs, and if there isn't a Federal system they can draw upon, so they determine their needs, they don't have the capacity.

Mr. WILSON. I believe the States, the Governors, and the legislatures are in the best position to determine the wage level and the tax rate for their administrative tax.

Mr. LEVIN. Let me ask Dr. Norwood if she would comment.

Ms. NORWOOD. I would just point out that one of the specialists on UI, Wayne Vroman, at the Urban Institute, tells me the State trust funds today are growing at only about one-half the rate of the previous recovery, and the aggregate of State trust funds is now only about three-quarters of the amount of 1989, the last big expansion.

The point that needs to be made is that you cannot raise taxes in a period of recession. That's the worst thing you can possibly do. You're going to hit business when it is down and cause it to go down further. You've got to find the resources in good times to fund those trust funds.

So if the States are determining this completely, and there has been a lot of evidence of reductions in many States now, which do not have very much forward funding—not all States certainly, but in many of them—if there isn't any kind of Federal oversight for that, I think the Congressman is quite right that you will not have those workers served.

Mr. WILSON. There was a lot of money that was sitting in the Federal extended benefit account that went unused in the last recession because of the trigger levels. Devolving that trust fund to the States would increase the solvency of the State benefit trust funds and enable them to establish extended benefit programs with the trigger levels in their individual States. That may be able to help workers.

Ms. NORWOOD. But it would just result in the States reducing the tax further. So you would end up in a situation where you didn't have those resources. That's what has happened if you look at the history. We have studied this since 1947.

Mr. LEVIN. My time is up. I just urge everybody to read the report of the advisory council. Look at the membership which spanned the labor movement to Governor Thompson, and I just think we need to take a hard look at this.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Collins, I see the witness from Georgia would like to be recognized. Perhaps you would recognize him under your time.

Mr. COLLINS. That was my intent, Mr. Chairman.

Chairman SHAW. I knew that.

Mr. COLLINS. I appreciate that very much, because I, too, am very interested in his answer, and I'm sure he's thought this thing through well, because we've talked about it for a number of years. Mr. Oxfeld also wanted to make some comments.

So, Mr. Poythress.

Mr. POYTHRESS. Mr. Chairman, our recommendation is that Federal fiscal accountability standards be established. And that the State trust funds for both benefits and administration be subject to that fiscal responsibility standard, so that you don't have a race to the bottom and empty it out in good times and have no money in bad times.

I would like to go back to another point that was made about the phenomenon of regional State-level recessions, because I think that's what we had in the early nineties. The response, as my friend, Mark, pointed out was not the extended benefit system kicking in. It is so complex and so, in my view, nonresponsive. It didn't kick in.

What happened was a blanket Federal response, which was very generous. And I think, frankly, we, the taxpayers, spent a lot more money in places that we didn't need to spend it then under that approach, whereas if the States had been fiscally responsible and had the money to respond, those States that needed to respond could respond, as a State, and deal with the recession in their locality.

And then as a final matter, our recommendation includes the maintenance of what we call the loan account, or what we call the FUA account, so that if a State hit the wall and there was no way to go, they could come to the Federal Government and borrow at interest.

Mr. COLLINS. Mr. Oxfeld.

Mr. OXFELD. I have a couple of observations pertinent to the discussion. One is I think it's fair to observe, as I have discovered over the many years I've been involved with this program, that no matter what type of extended benefits law there is, the Congress is likely to respond politically with supplemental compensation in order to address the political need, if not the financial need, of people who are unemployed.

The second is the incentives in the unemployment law today for States to maintain fiscally sound and responsible balances in their trust funds are far greater than they were ever in previous history or recessions, because of the requirements that States have to pay market-level interest rates when they borrow.

As a result, States are much more acutely aware of the need to be fiscally responsible in their trust fund balances. That's new. We have not had that in a recession previously.

Finally, I would like to comment on the idea that there is a race to the bottom, which we think is a total myth. In fact, if anything, there is a race to the middle. Some degree of competition among the States, we believe, is healthy.

But if you look at the record, even the advisory council said there is little empirical research to demonstrate any race to the bottom.

Some States have reduced benefits, but other States have expanded benefits.

Today, eligibility is broader than it was just a few years ago. If you're a full-time worker, on minimum wage, in every State you can now qualify for benefits. Some States have raised benefits. Others have reduced them.

But the idea that employers are going to locate in a State that has low benefits, or one that is very parsimonious in its unemployment program, simply isn't borne out by the facts. Otherwise, I think every manufacturing facility in the country after 60 years would be located in Alabama and Mississippi.

Although there are plenty there, there are plenty in other places as well.

Thank you.

Mr. COLLINS. I think you make a good point. I think businesses look more at workman's compensation than they do at unemployment insurance.

Mr. Poythress, you mentioned returning responsibility to the States, lightening the paperwork burden on American business to save millions in wasted tax dollars, laying the foundation for future tax cuts.

But if I just understood your comments, those tax cuts could not come unless there were certain requirements met by those States to ensure those funds were adequate to meet the requirements of the unemployed.

Mr. POYTHRESS. Yes, sir. That's correct.

Mr. COLLINS. Very good.

Thank you.

Chairman SHAW. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Mr. Wilson, why shouldn't we simply make the extended benefit triggers more sensitive, and therefore make the program easier for States to access, just as a followup to Congressman Levin's exchange with Dr. Norwood?

Mr. WILSON. That is an option. I think I would prefer actually that the FUTA tax be—the employer offset credit be raised to 100 percent, and allow the States to establish their own administrative tax rate.

And I think that's a better option, in my personal point of view. You are correct, though. That is a possibility, of changing the Federal trigger level.

Mr. COYNE. Dr. Norwood, did you want to respond to an earlier exchange?

Ms. NORWOOD. Well, I'd like to say first that the council did consider EB at some length, as the law required, and we made some recommendations about the kind of trigger that should be used. There should be an automatic trigger so that you don't have all of the discussion that makes the EB come on late, and sometimes stay on too long.

I think there are ways to handle that by refining and revising the extended benefit program.

Obviously, I disagree with my friend here from UBA about competition among the States. I would just point out that we did a

great deal of research using a good bit of data that had not been used before.

And we did find very real differences, and then we did a complete search of all kinds of records and statements by State officials, and they all were advertising that if a company came to their State, not all of them, but most of them, the entrance of a business to their State would result in lower unemployment taxes.

Mr. WILSON. I would just like to comment that, as Dr. Norwood correctly points out, there are ways to establish a Federal extended benefits trigger level. But for it to be able to adequately handle all of the unique situations for all 50 States, through one trigger formula, I can't imagine that.

I can't imagine that the same trigger formula that would be good and suitable for Georgia would be the same trigger formula that could be found for Nevada or Florida or Michigan. And to be able to come up with a formula, a national, one size fits all formula, would be extremely problematic in my point of view.

Mr. OXFELD. Just a further point on Commissioner Norwood's comment. You would expect that if there was a real race to the bottom, all States would be rushing to have low new employer tax rates.

But in the past 2 years, four States raised their new employer tax rates and four States lowered them. The fact is that employers respond to many, many different issues. Their experience and layoffs have much more to do with their tax rates. And they know that.

They're not looking at the unemployment tax rate. There may be States who tout it, but employers are not responding to that. They're much more likely to be concerned about locating in a State that has a deficit in its unemployment trust fund than they are about a race to the bottom.

Ms. NORWOOD. I'm just very pleased to know that you know what's in the minds of employers. What we did——

Mr. OXFELD. We represent them.

Ms. NORWOOD [continuing]. We tried to do was to look at the data that was available. I would also point out that there has been a significant number of States, particularly southern States, as well as Massachusetts, Kansas, several others, who have reduced their unemployment tax in recent times.

Mr. OXFELD. With very healthy surpluses in their trust funds.

Ms. NORWOOD. Not all of them. That's the issue.

Chairman SHAW. Thank you, Mr. Coyne.

Mr. English may inquire.

Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Chairman, my first job out of school was working as the research director of the Senate Labor and Industry Committee, working on UC, as I noted in my testimony.

My last job in State government was working as staffer for the State Senate Finance Committee. And I have to tell you, Mr. Oxfeld, tax rates matter in locational decisions.

Mr. Wilson from the Heritage Foundation would certainly concede that it is their view that State tax rates have a direct impact on a State business climate.

And certainly in Pennsylvania, UC taxes have been a major part of the business climate, particularly as in the early eighties we came out of a recession, and we had a large deficit—a $1 billion hole in our UC system that hung like a sword of Damocles over the economy.

Now, unless I'm missing something, UC benefits are directly tied to UC taxes, tax rates, and tax levels. And so it strikes me that if States are able to lower their UC taxes through lowering UC benefits, in good times, that will have a very substantial effect on their economic strategy.

I am concerned because in the late seventies, Pennsylvania was running a deficit in a very different climate. In a situation where they didn't have to pay market interest rates, and for strategic reasons, Pennsylvania tried to hold down its taxes in order to remain more attractive to businesses.

I think there is a direct linkage here. I'd welcome your response on this, but my sense is that if States are able to reduce their benefits dramatically and reduce their taxes accordingly, there will be some incentive for them to do that, again, as Dr. Norwood indicated, by tinkering with eligibility.

Why shouldn't there be a race to the bottom when most of the States that I'm aware of, particularly Pennsylvania, are looking for advantages to lower their State tax rates on business in order to attract more jobs?

Mr. OXFELD. Well, I'm familiar with the situation in Pennsylvania. For years, but prior to the requirement that States pay interest when they borrow when their trust accounts run low, Pennsylvania had exceptionally generous benefits compared to most States, and broader eligibility than most States did.

And they knew that if they borrowed, they had interest-free loans, and if they didn't pay it back, it was the Federal tax that would increase through——

Mr. ENGLISH. Mr. Oxfeld, we all know that. I'm speaking to a more general situation. Why wouldn't there be a race to the bottom if you can lower your tax rates by reducing benefits?

Mr. OXFELD. I can appreciate your point, and I hope I don't sound argumentative with you. I would say that the evidence is that very few Members, whether on the congressional level or in State legislatures, are eager to vote for reductions in benefits for people who are out of work.

The fact is I would say the evidence shows that there is a race to the middle. That the States that had more generous duration and higher benefit levels, that had greater than average—easier access to the system——

Mr. ENGLISH. Mr. Oxfeld——

Mr. OXFELD [continuing]. Cut back more toward the center, but not toward the bottom.

Mr. ENGLISH. What evidence? You had cited there were four States that had raised their business taxes, but States are under terrific financial pressure. Others have tried to lower them.

I think given what we know about State finance, isn't it very difficult to draw conclusions from that?

Dr. Norwood, would you like to comment on this?

Ms. NORWOOD. Well, it's quite clear the issue is the funding of the trust funds. States are under pressure, and we found quite a bit of evidence—we'd be glad to send you people papers which used real data.

[The report was sent to all Members of Congress.]

The State has only three options. It can raise the base wage, which, by the way, has not been raised for years, and most States are above it except for a few. We do have a recommendation in our advisory council report on that. That's one way.

The other way is to raise taxes, and the third way, which is really what has been happening, is to restrict eligibility. And I think that's what's happened to the lower wage workers who, I might point out, are the people we most need to protect. It is also possible, of course, to reduce benefit payments.

Mr. ENGLISH. Mr. Chairman, may I ask one more question? My time has expired.

Chairman SHAW. Certainly.

Mr. ENGLISH. Mr. Wilson, on the notion of having the States run extended benefits programs, if you have a regional recession of some duration, won't States be under terrific pressure to dismantle extended benefits for the simple reason that extended benefits are a very substantial expense in an extended recession?

And if a State in that situation, where you have declining revenues coming in because of the recession, is called upon to pay out dramatically more in benefits just because of economic conditions, doesn't that put terrific fiscal pressure on States in a way that welfare doesn't as directly?

Because at least there is a lapse time in a recession when welfare costs increase. There is a direct increase in how quickly unemployment benefit costs go up. So doesn't this hit States when they are at their most vulnerable, if you dismantle the Federal extended benefits program?

Mr. WILSON. I think the bottom line here, Congressman, is the solvency issue. That's what we're all trying to address here. And I think we all agree at this table that there needs to be some solvency standards at the Federal level on States so that States maintain solvent—not only solvent regular benefit trust funds, but also if they are——

Mr. ENGLISH. I quite agree. And that is in my proposal, too.

Mr. WILSON [continuing]. Give them the power to develop and establish their own extended benefit trust funds, that the solvency requirements also carryover into the extended benefits side of it.

I think what we're trying to talk about here is the administrative tax side of the issue. I don't think we have any quarrels here about the benefit side of the program at all. The issue we're trying to address here in these reform proposals relates to the administrative tax, and how the FUTA tax is handled.

Mr. ENGLISH. I understand.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman. I would like to first talk a little bit about the whole, almost from a practical standpoint, but also from a philosophical standpoint, the idea of what Mr. English was talking about.

He proposed a scenario to where States try to attract businesses through lower taxes, and I think that is one of the reasons my State has been so effective in attracting a lot of new businesses, simply because of our low tax base.

I think that that's a good thing. I don't think this is something to be criticized. I think that's a good thing. And he painted the scenario to where if that's done in the manner—if politicians do that in a manner that they allow those trust funds, whatever you would call them, to be depleted, now they get into trouble.

This gets back for me to a question of accountability. If it's the Federal Government that does it, then we can now just borrow. Therefore, we pass this debt on to our children, which is basically what we do. When we get extended benefits, when we get into recession times, the Federal Government just borrows it and goes into debt.

Why shouldn't—and this is where the philosophical point of view comes in—why shouldn't States and State-elected officials be held accountable if they get into that recession and they did not have a rainy day fund—like the Federal Government doesn't have—be held accountable by their local voters?

Yes, Mr. Oxfeld.

Mr. OXFELD. I have to observe, as a matter of Federal law, under the FUTA, States now are required to pay market interest rates if they have to borrow from their trust funds as Congressman English remembers too well.

That is a new provision of the law. It was only enacted in the early eighties as a reaction to the huge deficits many States had, particularly in the Northeast and in the Midwest, and which provide powerful incentives to be responsible in funding their trust accounts that didn't exist before.

We couldn't agree with you more.

Mr. ENSIGN. Would you care to respond, Ms. Norwood?

Ms. NORWOOD. Yes. I disagree with you. It seems to me that every unemployed worker in this country, through no fault of his own, who loses a job needs some temporary help. He's got to get back into work, and there are a whole series of things that need to——

Mr. ENSIGN. Well, I'm not disagreeing with you on that. What I'm talking about is whether it's the States' responsibility or whether it's the Federal Government's responsibility. Because the Government that is closest to the people is the most accountable.

Ms. NORWOOD. Certainly. But there ought to be some very strict and automatic requirements.

Mr. ENSIGN. Why not from the State level and not the Federal level, though?

Ms. NORWOOD. Because every State will have different levels, and we've had a lot of experience that that doesn't——

Mr. ENSIGN. What's wrong with that?

Ms. NORWOOD. What's wrong with it is that you have 17 percent of the workers who are unemployed receiving unemployment compensation in some States, and that's not very much. What happens to the others?

Mr. ENSIGN. What's wrong with a State becoming more efficient, maybe providing, because they're more efficient, providing more

benefits? Another State is not efficient, therefore it can't afford to pay as much benefits. Or another State that chooses not to pay as much benefits. What is wrong with that?

Just like one company pays more money than another company pays.

Ms. NORWOOD. What's wrong with it is that in the past, many of those States, instead of using unemployment benefits have had those workers, particularly the lower paid workers, handled through food stamps, and other Federal programs, and that safety net is being reduced.

Mr. ENSIGN. Well, I would just close with this, as my time is about to expire—I think this gets back to the whole question of whether or not we believe the Federal Government has the answers, whether or not we believe that the Federal Government knows better than people that are more accountable.

I believe the more local the power is, the more it's accountable. I think that that is clearly what our Founders saw as a great vision, because you can hold people more accountable.

Somebody from New York cannot hold me accountable. Somebody from Las Vegas can hold me accountable. And I think that if I'm not meeting the needs, if I'm a local, State elected official, they can hold me accountable. And I think that that is certainly the direction we need to be going.

Maybe not all the answers are there, and maybe it is a slow devolution, but we certainly need to be going in that direction.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Watkins.

Mr. WATKINS. I have no questions, Mr. Chairman.

Mr. LEVIN. Mr. Chairman, could I just——

Chairman SHAW. Certainly, Mr. Levin.

Mr. LEVIN. I think the last discussion with Mr. Ensign has been very useful. And it's hard for me to bite my tongue and say nothing.

But I want to just say to Mr. Oxfeld so you're not under a misimpression about the Congress and our political response to unemployment in the nineties.

True, we fought about extension of benefits. True, it would have been better if there had been a trigger mechanism so extended benefits would not have had to be adopted through specific legislation, three or four times.

But I think you sell short Republicans and Democrats by just saying or implying it was a very political response, because it wasn't. And we spent a lot of time—Mr. English's predecessor, as I remember it, was one of those who was very much involved in this on the Republican side.

We had a disagreement over redoing the EB formula, between the administration and the majority here. And so we acted not mainly because there were votes out there, but because there were hundreds and hundreds of thousands of people who were laid off through no fault of their own.

And we in Michigan and Pennsylvania responded when people were laid off in Texas, and in Oklahoma, and in other places through no fault of their own, and no fault of us in Michigan.

So it was not basically a political response.

Mr. OXFELD. May I respond. I don't mean to suggest that UBA or employers don't believe that it's appropriate to have an extended benefits program at the Federal level. And I think there are honest disagreements over designing the trigger levels, which is a very difficult task to do, given all the differences among the States.

The compromise restructuring plan preserves the extended benefits program. In fact, it relaxes a little bit some of the present restrictions in Federal law on collecting extended benefits, unlike the Heritage plan or the ALEC plan.

We felt it was important in getting more money to have good administration, that we not even deal with that issue. And I respect your opinion. I don't mean to say that Members are only interested in political solutions, but it's been our observation over the years that no matter what type of system has been in place already, there is a degree of political interest among many Members of Congress in doing something additional beyond what is already there.

Mr. LEVIN. Let me just say, the trigger system wasn't working. By the way, I don't think we got very much help from a lot of organizations in redoing it. The trigger system wasn't working. No State was triggering on.

And there were millions of unemployed people in this country.

Chairman SHAW. Before this panel is dismissed, let me just toss another ball in the air and see if somebody wants to jump after it.

In the Green Book, some of the studies that we have, would indicate that people are much more likely to intensify their job search toward the end of their benefit period than they are toward the beginning of the benefit period.

What have any of your studies indicated with regard to that?

Mr. POYTHRESS. Mr. Chairman, let me respond to you in a slightly different way. I have heard that story. I have never seen it documented, but lest it be true, we in Georgia adopted a profiling system at the suggestion of the U.S. Department of Labor some years ago.

We identify, immediately, at the time of filing for a claim, people who we believe are, based on empirical observations, likely to run out their entire period of time of benefits.

And we immediately place them in a reemployment program, providing training and intensive high-touch job placement services. Works great. We get those people hired very quickly.

Chairman SHAW. Dr. Norwood, you're nodding affirmatively.

Ms. NORWOOD. Yes, I would agree with that. There is some evidence in the literature that those who have longer spells of unemployment tend to remain unemployed a little bit longer.

And that's one of the reasons that in Canada and in Western Europe, which have very long spells in which workers receive benefits, we see extended unemployment, much more long duration unemployment.

But I would agree with my colleague that what is really needed is a recognition of the people who really have the need and are going to be there for a longer time, and the pulling together of the resources of the employment security agencies and others to see to it that they get the kind of training and help in applying for jobs that they really need.

The council met with employers and we met with State agency people in all kinds of labor markets, and we also met with unemployed workers and had held a number of public hearings. And we heard a great deal about this.

But mainly about the need to bring all of these kinds of services together.

Chairman SHAW. Yes, sir.

Mr. POYTHRESS. If I could just add one final point about it, because I think we may have come full circle here. We have been doing that, and we do other kinds of employee service activities on a starvation budget for the last 3 years.

And it's been that starvation budget, really, which triggered this entire talk about devolving this system, because the current administrative funding mechanism simply does not work.

As the Doctor pointed out, it is inequitable, it is inadequate. And all the States are really struggling to keep our heads above water, to do the administrative things, the employment service things that we are charged to do.

And it was the inadequacy of those funds that has really triggered this whole discussion.

Mr. WILSON. Mr. Chairman, I'd just like to point out that the former chief economist of the Department of Labor, Larry Katz, published some research for the National Bureau of Economic Research that concluded that extending the duration of unemployment benefits from 6 months to 1 year increases the mean duration of unemployment by 4 to 5 weeks.

So there is, as Ms. Norwood correctly pointed out, a wealth of literature and studies on this that indicate that's the case.

Chairman SHAW. Looks like we have agreement among the panel, and so we will end with that. And I thank all of you for being here. You've given excellent testimony, and I've enjoyed some of the disagreement.

The next panel will be made up of Lynn Doherty, who is the director of the Illinois Department of Employment Security in Chicago, Illinois; Gay Gilbert, deputy administrator of the Ohio Bureau of Employment Services, on behalf of the Interstate Conference of Employment Security Agencies; Jonathan Hiatt who is the general counsel of the AFL–CIO here in Washington, DC; and Albert R. Miller, who is the president and chief operating officer of Phoenix Closures, Inc., in Naperville, Illinois.

The two witnesses from Illinois, I know that Mr. Crane wanted to be here to personally introduce you. He has been summoned by the Speaker which is a higher calling, I believe, and if he comes in during the hearing, I know he would like to make some personal comments about both of you.

Ms. Doherty.

STATEMENT OF LYNN QUIGLEY DOHERTY, DIRECTOR, ILLINOIS DEPARTMENT OF EMPLOYMENT SECURITY, CHICAGO, ILLINOIS; ON BEHALF OF HON. JIM EDGAR, GOVERNOR, STATE OF ILLINOIS

Ms. DOHERTY. Thank you, Mr. Chairman, and Members of the Subcommittee.

Once again the State of Illinois is here asking for your help in passing legislation to overturn the Federal Appellate Court decision in *Pennington* v. *Didrickson.* That decision represents a 180-degree turnaround from how the Federal Government and the States have construed the Social Security Act since that statute's inception more than 60 years ago.

It involves unelected Federal judges in tax and spending policy better suited for Governors and State legislatures. Left standing, it would have a costly impact upon employers and State government in Illinois, and its impact is being compounded across the country.

Pennington is a class action lawsuit brought under the Social Security Act challenging the provision of the Illinois law that establishes the State's base period. The base period is the period of time examined to determine whether an individual is in fact eligible for unemployment benefits, and, if so, the amount of the individual's weekly unemployment check.

The plaintiffs in *Pennington* are demanding an alternate base period for individuals who don't qualify under the State's standard base period. More than 40 States have virtually the same base period system as Illinois.

In *Pennington* v. *Didrickson,* the Federal Appellate Court reversed the ruling of the Federal District judge, and held that individuals could, in fact, sue under the Social Security Act to broaden eligibility for unemployment insurance by requiring States to adopt multiple base periods.

As a consequence of this decision, Illinois and other States may soon be forced to implement multiple base periods.

With all due respect, the Appellate Court was wrong. Its ruling contradicts the legislative history of the Social Security Act, Supreme Court precedent, and the longstanding position of the U.S. Department of Labor.

Beyond all that, however, it has very expensive consequences. The multibase period scheme sought by the plaintiffs would involve millions of dollars in one-time administrative costs, and ongoing costs of $2.5 million a year, with absolutely no identified source of funds to cover those costs.

So far, the courts have limited their analysis to comparing the advantages of multiple base periods against the increases in State government's operating costs.

However, the ramifications extend well beyond that argument. *Pennington* could also raise employer taxes from somewhere between $10 to $40 million per year in Illinois. Alternately, the State could face pressure to offset the increased payouts resulting from *Pennington* by cutting benefits elsewhere.

In either case, determining eligibility based on wages earned during the proposed alternate base period would require additional reporting from employers to verify those earnings.

Beyond all that, the scheme the *Pennington* plaintiffs are after would only be the beginning. A *Pennington*-type lawsuit has now been filed against the State of California as well.

In the California case, however, the plaintiffs are demanding a difficult, even more costly alternate base period scheme than in the *Pennington* case. So consequently, even if Illinois were to adopt what the *Pennington* plaintiffs are after, the State would still be exposed to further lawsuits by different plaintiffs who wanted still another alternate base period to accommodate their particular needs.

Last year the Congressional Budget Office estimated that if implemented nationally, the multiple base period scheme the *Pennington* plaintiffs are seeking could raise outlays from the Federal Treasury by more than $350 million a year.

That figure would rise dramatically as litigants' demands for different base periods multiply.

In a friend of the court brief submitted in *Pennington* v. *Didrickson,* the U.S. Department of Labor said, Given the widespread use of the type of base period employed by Illinois, an order striking down the Illinois law undoubtedly would cause nationwide disruption in the various States' unemployment compensation systems.

The type or number of base periods a State uses is not a litmus test of its fairness to the unemployed. For example, eight States use the alternate base period sought by the *Pennington* plaintiffs. In each of those States, however, the amount necessary to qualify for benefits is substantially higher—up to twice as much.

A State's base period structure is simply a partial reflection of how State policymakers have decided to allocate limited resources to serve best the interests of everybody the unemployment insurance was established to serve.

I am not asking to prohibit the use of multiple base periods, or to take away any rights now enjoyed by any claimant. I am asking that as the decisions to the State's base period scheme are made, all of its ramifications are fully considered and that the people who make the decisions continue to be accountable to the people who will be impacted by the decision.

Thank you very much.

[The prepared statement and attachment follow:]

Statement of Lynn Quigley Doherty, Director, Illinois Department of Employment Security, Chicago, Illinois; On Behalf of Hon. Jim Edgar, Governor, State of Illinois

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to testify before you today. Once again, the State of Illinois is here to ask for your help in passing legislation to overturn the federal appellate court decision in Pennington v. Didrickson. That decision represents a 180-degree departure from the manner in which both the federal government and states have construed the Social Security Act, since that statute's enactment more than 60 years ago. It involves unelected federal judges in tax and spending policy that should be reserved to elected officials. Left standing, it could soon have a costly impact upon employers and state government in Illinois and aggravate the federal deficit by hundred's of million's of dollars. Its impact is already being compounded across the nation.

Background—State Base Period

Pennington is a class action lawsuit, challenging the provision of Illinois law that establishes the state's "base period." As you know, the base period is the period of time examined to determine whether an individual has earned enough wages to be

eligible for unemployment insurance and, if so, the amount of the individual's weekly unemployment check. The base period in Illinois is the first four of the last five completed calendar quarters preceding the individual's filing an initial claim. To qualify for unemployment insurance in Illinois, an individual must have been paid at least $1,600 in wages during his or her base period, with at least $440 having been earned outside the quarter in which the individual's wages were highest.

Forty-nine other jurisdictions use the same base period as Illinois. Of those, eight have adopted alternate base periods for individuals who do not qualify using the standard base period. There are two reasons for the nationwide prevalence of the base period Illinois uses.

First, a base period of the first four of the last five quarters generally ensures that unemployment insurance will be available for workers with a genuine attachment to the labor force, but not necessarily for those with only a marginal connection.

The legislative history of the Social Security Act indicates that unemployment insurance was intended to be limited to individuals with established ties to the workforce. According to a 1935 report by the Committee on Economic Security, which drew the blueprint for today's unemployment insurance system, unemployment insurance was intended for the "ordinarily steadily employed." The Ways and Means Committee's report on the Social Security Act noted the program was not intended to provide relief for everyone who was out of work.

Congress' intent still makes sense today. Unemployment insurance is funded almost exclusively by employers. In Illinois, it is funded 100 percent by employers. Employers alone should not bear the burden for individuals with little or no attachment to the world of work.

Second, a base period like Illinois' streamlines administration and minimizes the risk of fraud. Within a month following the close of each quarter, Illinois employers provide the state with reports on the wages paid to their workers during that quarter. The state uses those reports to verify that claimants are monetarily eligible for unemployment insurance. With Illinois' base period, all reports needed to verify an individual's eligibility should already be in the state's computer system when the initial claim is filed.

Pennington Lawsuit

The plaintiffs in *Pennington* are demanding that the federal court broaden eligibility for unemployment insurance by requiring Illinois to adopt multiple base periods. They argue the Social Security Act grants federal judges the authority to do so. Specifically, they maintain that anyone who has not earned $1,600 over the 12 months included in the base period, or has not earned $440 outside the high quarter, should be able to try to establish eligibility through an alternate base period using the last four quarters.

When the case was first heard in district court, the judge agreed with Illinois that, as part of the state's monetary eligibility requirement, Illinois' base period could not be challenged in litigation under the Social Security Act. However, in Pennington v. Didrickson, the appellate court reversed and remanded the case, to determine whether Illinois had to adopt multiple base periods.

To make that determination, the appellate court instructed the district judge to balance the benefits which some claimants could derive from the alternate base period against the state's interest in holding down administrative costs and minimizing fraud. On remand, the district judge determined the claimants' interests outweighed the state's and, therefore, that Illinois had to adopt the alternate base period. Just recently, the appellate court affirmed the district judge's determination. Illinois will petition the Supreme Court to hear the case. That petition will include the same argument I make to you today.

With all due respect, the appellate court was wrong when it held federal judges could decide the type and number of base periods a state was to have. It was wrong for a number of reasons. The legislative history of the Social Security Act indicates Congress intended states to have broad freedom to set up the types of unemployment insurance systems they considered appropriate.

The United States Supreme Court has held that the Social Security Act was intended to recognize the importance of each state establishing its own eligibility criteria for unemployment insurance.

In addition, since the establishment of the unemployment insurance system, the Labor Department—the federal agency charged with enforcement of the Social Security Act as it pertains to unemployment insurance—as considered a base period of the first four of the last five quarters to be consistent with the Act. As you will recall, the last time this Subcommittee considered the consequences of Pennington,

the Labor Department did not depart from its longstanding position that the type and number of base periods employed by states are matters for state policy makers.

In the 1970's, Congress itself expressly recognized and took no issue with the states' widespread use of base periods consisting of the first four of the last five quarters.

Beyond all that, however, the appellate court was wrong because its decision vests unelected federal judges with the authority to substitute their judgment for governors and state legislatures with regard to tax and spending policy. The balancing test it prescribed is essentially a policy judgment of the type that governors and state legislatures are elected to make and are better-suited to make. The appellate court's ruling has separated the authority to make policy decisions from accountability for those decisions, with potentially expensive consequences.

Potential Illinois Impact of Pennington

In deciding the case on remand, the district judge noted that the administrative costs of the alternate base period sought by the plaintiffs could be substantial—million's of dollars in one-time costs and $2.5 million in additional yearly operating expenses according to the Department of Employment Security. He also acknowledged that additional federal dollars to cover those costs were not likely to be forthcoming. He did not, however, concern himself with where the money to cover those costs would come from or with any of the other significant implications of what the plaintiffs want.

Besides finding the money to implement the plaintiffs' scheme, Illinois would also have to find the time and personnel, inasmuch as the State is already in the middle of two major automation projects for the benefit of claimants: overhauling its extensive mainframe computer system to enable it to continue running in the year 2000 and beyond and implementing a telephone certification system. The telephone certification project is a streamlining initiative that will eliminate the need for claimants to mail paper forms to the State to certify as to their continued eligibility for benefits. As an aside, implementation of the plaintiffs' multiple base period scheme would negate most, if not all, of the cost savings anticipated from telephone certification. The year 2000 project is necessary to ensure the State remains able to pay benefits at all.

In addition to the administrative burden it would impose on state government, Pennington could also substantially raise outlays from Illinois' Unemployment Trust Fund account and impose hefty increases in employer taxes.

The Department of Employment Security estimates the alternate base period the plaintiffs are seeking would increase Illinois' Trust Fund outlays by 1.5 percent. A Labor Department study indicates alternate base periods raise state Trust Fund outlays by four to six percent. A 1.5-percent increase in outlays from Illinois' Trust Fund account would on average amount to around $20 million per year; a six-percent increase would approach $100 million, annually.

As state law is currently written, additional outlays would automatically trigger tax increases for Illinois business. A 1.5-percent increase in outlays would result in an employer tax hike averaging nearly $10 million per year. A six-percent increase in outlays would raise employer taxes by over $40 million each year.

Since state Trust Fund accounts are part of the unified federal budget, the difference between the increased outlays and the higher taxes would translate into an increase in the federal deficit—more than $100-million increase over the next eight years if outlays rose by 1.5 percent; a $400-million increase if outlays rose by six percent..

Alternatively, the State could face pressure to offset the increased payouts resulting from Pennington by cutting benefits elsewhere.

In any case, determining eligibility based on wages earned after the first four of the last five quarters would require additional reporting from employers to verify the earnings, thereby imposing substantial new "paperwork burdens."

Potential National Impact of Pennington

Pennington's impact in Illinois, including its effect on the federal deficit, could presage things to come for nearly every other state. The appellate court's decision is binding in Indiana and Wisconsin, as well as Illinois, and can be used as precedent to attack other states' unemployment insurance laws. As you know, a *Pennington*-type suit has now been brought against the State of California, as well.

The California litigation demonstrates the inherent difficulty of leaving to judicial fiat the type and number of base periods a state is to use. In the California case, the plaintiffs are demanding an alternate base period of the last 52 weeks. Consequently, even if Illinois were to adopt the multiple base period scheme the *Pennington* plaintiffs are after, the State would still be exposed to further lawsuits by

different plaintiffs who wanted still other alternate base periods to accommodate their particular needs.

Moreover, *Pennington's* use as precedent will not necessarily be limited to cases where an alternate base period is the difference between eligibility and ineligibility. States can expect the argument that the Social Security Act requires an alternate base period when an alternate base period would yield a higher weekly benefit check. Pennington has blurred the line between what a state can and cannot be sued for under the Social Security Act.

Last year, as you know, the Congressional Budget Office estimated that, if implemented nationally, the multiple base period scheme the *Pennington* plaintiffs are seeking could raise outlays from the federal treasury by more than $350 million per year. That figure would rise dramatically as litigants' demands for different base periods multiplied.

In the friend-of-the-court brief it submitted to the appellate court, the Labor Department said, "Given the widespread use of the type of base period employed by Illinois, an order striking down the Illinois law undoubtedly would cause nationwide disruption in the various states' unemployment compensation systems."

The case's implications beyond Illinois' borders prompted 23 states to join Illinois in requesting Supreme Court review of the appellate court's decision in *Pennington* v. *Didrickson.*

Conclusion

The type or number of base periods a state uses is not the litmus test of the fairness of that state's unemployment insurance system. For example, in each of the eight states that have adopted the alternate base period sought by the *Pennington* plaintiffs, the amount necessary to qualify for benefits is substantially higher than in Illinois—up to twice as much. A state's base period structure is simply a partial reflection of how that state's policy makers have decided to allocate the system's limited resources to best serve the interests of everyone whom the system was established to serve.

My specific request to you is for legislation to clarify the Social Security Act does not govern state base periods. I am not asking you to prohibit the use of multiple base periods or to take away any rights now enjoyed by any claimant. The legislation I am seeking will simply eliminate the need for further costly litigation. Consistent with the intent of the unemployment insurance system's architects, it will also ensure that requirements as to eligibility remain a decision for state policy makers, who are directly accountable to the people who will be impacted by that decision.

I look forward to working with you toward a speedy resolution of this issue.

Thank you again for your time and consideration.

May 15, 1997

The Honorable Sander M. Levin
United States Representative
2209 Rayburn House Office Building
Washington, DC 20515-2212

Dear Congressman Levin:

At the Human Resources Subcommittee's April 24 discussion of the *Pennington* decision, you asked what the ratio of insured unemployed to total unemployed was in Illinois. That number is 40 percent, compared to 35.8 percent, which is the ratio for all states combined.

As you know, most of the gap between insured and total unemployed is attributable to individuals who have just entered the labor market or entered after extended absences. Neither category would include the plaintiff class in *Pennington*. Other factors contributing to the gap are individuals who have quit their jobs; individuals who have exhausted their benefit claims; individuals who, for whatever reason, were not covered by the unemployment insurance system; individuals who lost their jobs and were ineligible for non-monetary reasons (*e.g.*, someone who has been discharged for misconduct), and persons who lost their jobs but were monetarily ineligible, a portion of whom would be members of the *Pennington* plaintiff class.

I hope you find this useful. If you have any further questions, you or your staff can contact Joe Mueller or me at 217/785-5069. Thank you for your time and consideration of this issue.

Sincerely,

Lynn Quigley Doherty
Director

cc: Matt Weidinger
Deborah Colton

** NOTE: SUBCOMMITTEE INSERT **

JIM EDGAR, GOVERNOR
LYNN QUIGLEY DOHERTY, DIRECTOR

400 W. MONROE
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Mr. COLLINS [presiding]. Thank you.
We'll hear now from Gay Gilbert.

STATEMENT OF GAY GILBERT, DEPUTY ADMINISTRATOR, OHIO BUREAU OF EMPLOYMENT SERVICES; ON BEHALF OF INTERSTATE CONFERENCE OF EMPLOYMENT SECURITY AGENCIES

Ms. GILBERT. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Gay Gilbert. I am deputy administrator of the Ohio Bureau of Employment Services, and I am here today representing the Interstate Conference of Employment Security Agencies, or ICESA.

ICESA is the national organization of State officials who administer the States' public employment service, unemployment insurance laws, the labor market information programs, and in many States, job training programs.

And I would like to thank Chairman Shaw for the invitation to present ICESA's view here today.

As Lynn Doherty has mentioned, the issue in the *Pennington* case has to do with the State's right to determine its own base period as part of the eligibility structure for unemployment compensation.

Just a short review of what a base period is—it's the period of time in which we look at a claimant's wages to determine if they've had some attachment to the labor force. And that becomes part of our eligibility determination.

And as Lynn mentioned, 48 States, including Ohio, use the same period as Illinois. To make this eligibility determination using the base period, almost all States collect wage information from employers on a quarterly basis.

To maintain that data base of information requires a certain amount of technology and a lot of time to do the data entry.

The *Pennington* lawsuit involves the Social Security Act's "when due" clause. The Social Security Act requires that States utilize administrative methods designed to ensure benefits are paid when due; i.e., as quickly as possible.

The issue in *Pennington* is whether or not the base period is a State eligibility requirement or an administrative method that's subject to the "when due" clause. ICESA strongly supports the argument that Illinois has made, that a State's base period is a State eligibility requirement and not an administrative method subject to the "when due" clause.

And there are some fairly persuasive reasons for why we look at it that way. From the very inception of the UI Program, the "when due" clause has been interpreted by the executive branch and the courts to mean that benefits should be paid when due, but under the terms and conditions of the State laws.

And States have been given broad discretion in developing their State UI laws.

One of the indicators that the executive branch has endorsed this position is that when the UI Program first began, the Department of Labor issued some draft bills that were model legislation for States to look at in developing their laws, and one of those draft bills included the base period we all use.

In addition, every year, the Department of Labor is required to certify that each State's law is in conformity with Federal law, and

for 60 plus years they have done that with the base periods we all use.

Some States, like Ohio, have chosen to use an alternative base period. It is ICESA's position that States should continue to have the latitude to use either alternate base periods or whatever base period is appropriate for their State's needs.

I would say that as technology begins to advance, we may have the opportunity to move the base period closer to the time of when the claimant is actually making his/her application. But technology is expensive, as Lynn pointed out, and at this point in time the unemployment insurance system is already underfunded. We are not in a position to spend large amounts of money making huge technological changes.

We are also currently hampered by the fact that we're all having to transition our computer systems to the year 2000 to make our systems compliant.

Lynn mentioned being concerned about additional lawsuits. We believe that this case opens the door not only to lawsuits like *Pennington*, but to other eligibility issues that States determine as part of their unemployment insurance laws.

Policy issues of this kind should be dealt with in the legislative process, and not in the courts. H.R. 125 has been introduced by Congressman Crane, and ICESA supports that legislation and encourages you to do so.

Before concluding I would like to mention two other items very quickly that relate to unemployment insurance. The President's budget for 1998 includes a proposal to double, from roughly $7 to $14 billion, the amount that can be held in the unemployment trust fund account from which loans are available.

There are no projections at this point that States are going to need those loans, and at this point the rules are such, as was mentioned earlier, that there is a great incentive for States to avoid borrowing money. And so we see no policy basis for extending this limit, and we would encourage you to consider possibly not supporting that.

Also, as you develop legislation relative to unemployment insurance, we urge you to look at the national new hire directory which is currently being developed for child support enforcement purposes. States currently have access to this information in their own States, but they do not have access to other States' information. We believe that such access is desirable for our program, and H.R. 125 may provide you with a vehicle to do that.

Again, ICESA would be happy to provide you with more information on that subject.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Gay Gilbert, Deputy Administrator, Ohio Bureau of mployment Services; on Behalf of Interstate Conference of Employment Security Agencies

Mr. Chairman and members of the Subcommittee, my name is Gay Gilbert. I am Deputy Administrator of the Ohio Bureau of Employment Services, and I am here today representing the Interstate Conference of Employment Security Agencies (ICESA). ICESA is the national organization of state officials who administer the nation's public Employment Service, unemployment insurance laws, labor market information programs and, in most states, job training programs.

I would like to thank Chairman Shaw for the invitation to present ICESA's views about the federal court's ruling in the Pennington case.

BACKGROUND

To establish eligibility for unemployment benefits, an individual must have sufficient wages preceding the filing of a claim. The period surveyed for these wages is called the "base period."

Most states use a base period consisting of the first four of the last five completed calendar quarters. For example, if the claim were filed today, April 24, 1997, the base period would be January 1, 1996, through December 31, 1996. Even if the individual had worked during all of the period from January 1, 1997, through April 23, 1997, the wages from this work would not be used to determine eligibility for a claim.

The first four of the last five completed calendar quarters is the most common base period. It reflects the public policy judgement that unemployment benefits should be paid only when the claimant has an established attachment to the labor force. In addition, almost all states determine eligibility for benefits using wage information which is reported by employers on a quarterly basis for all workers. It takes time for these reports to be completed and submitted by employers and for states to enter the information into state computer databases.

OUTLINE AND STATUS OF THE PENNINGTON CASE

As you know, the plaintiffs in *Pennington* are a class of claimants who were not monetarily eligible for unemployment benefits using the standard Illinois base period but would have been eligible had earnings subsequent to the first four of the last five quarters been considered. They contend that the Illinois base period violates the Social Security Act's requirement that administrative methods ensure that UI benefits are paid "when due."

In 1994, the Seventh Circuit Court of Appeals reversed the district court and ruled that individuals could sue under the "when due" clause to challenge a state's base period. The appellate court remanded the case to the district court for a determination as to whether the "when due" clause required Illinois to adopt an alternate base period for the plaintiffs. To make the determination, the district court was instructed to balance the plaintiffs' interest in prompt payment of benefits against the state's interest in minimizing administrative costs. The U.S. Department of Labor submitted an amicus brief to the court supporting the Illinois Department of Employment Security's position.

The Illinois DES appealed the seventh circuit's ruling to the Supreme Court which declined to hear the case in November 1994. Twenty-three states signed an amicus brief supporting Illinois' position.

On remand, the district court weighed four factors: 1) the number of additional eligible claimants there would be under an alternative base period; 2) the amount of additional benefits that would be paid; 3) the increased promptness with which eligible claimants would receive benefits; and, 4) the administrative costs of implementing an alternative base period. There was no consideration of the potential impact on employers in terms of additional costs or administrative burden. With respect to administrative costs, the court found IDES' evidence credible—the agency would incur more than $13 million in one-time costs and additional annual operating expenses of more than $2.5 million. The court also stated it was likely that federal funding to cover the costs would not be forthcoming. Nevertheless, the court concluded that the first three factors inured to the plaintiffs' benefit and outweighed the fourth. Accordingly, the court ruled that Illinois had to adopt an alternate base period for the plaintiffs.

Illinois appealed the district court's ruling; however, just a few weeks ago the U.S. Court of Appeals for the Seventh Circuit affirmed the district court's judgement.

ICESA'S VIEWS

Our nation's unemployment insurance (UI) system is a unique federal-state partnership, grounded in federal law but executed through state law by state officials. The legislative framework created with the Social Security Act in 1935 gives states broad discretion to design their own unemployment insurance programs including determining the terms and conditions under which benefits are payable.

Prior to the court's interpretation in *Pennington,* Section 303 (a) (1) has been interpreted by the Executive Branch and by the courts since 1935 to mean that benefits should be paid as promptly as is feasible administratively under the terms and conditions of state laws.

Throughout the history of the unemployment insurance program, determining the period that constitutes the base period for unemployment insurance claims purposes has been one of many eligibility criteria that federal law has left to the states. For example, each state—through its legislative process—decides the amount of earnings necessary to qualify for benefits, whether various reasons for voluntarily leaving a job constitute "good cause" and when the reasons for discharge from a job are such that an individual is disqualified from benefits.

The legislation establishing the unemployment insurance system in this country makes it clear that Congress intends for the states to have wide latitude in designing their unemployment compensation programs. That being the case, it is remarkable that the structures of state programs are so similar. This phenomenon can most likely be traced back to "draft bills" for state unemployment compensation laws that were provided to the states by the Department of Labor to illustrate legislation that would meet federal requirements. The base period that Illinois and most other states use was included in a draft bill that many states used as a model for their respective state laws. Therefore in establishing a base period consisting of the first four of the last five completed calendar quarters, states were assured that their law conformed to federal requirements. In addition, each year the Secretary of Labor must certify to the Secretary of the Treasury that each state's unemployment compensation law is in conformity with federal law in order for employers doing business in the state to claim the 90% offset credit against federal unemployment tax obligations. The Secretary has certified the Illinois law and the laws of other states with the same base period structure for almost 60 years.

We believe that the court's decision in *Pennington* is an implausible interpretation of the Social Security Act's requirement that administrative methods be designed to ensure the prompt payment of benefits when due and is inconsistent with the intent of Congress that states have wide latitude to design state unemployment insurance programs.

A number of states have put alternative base periods in place to address the circumstances of the plaintiffs in *Pennington*—individuals who would not qualify using the first four of the last five quarters but who would qualify if more recent wages were used. ICESA believes that states should continue to have latitude to establish such alternatives or other standard base periods—that the first four of the last five quarters is only one of a variety of base periods that states might use.

As technology that permits states to collect and process wage information more quickly becomes available, more states may wish to establish alternatives or more recent quarters as their base periods. However, purchasing the latest technology and implementing alternatives to standard practices are expensive. Administrative funding for unemployment insurance has been reduced substantially in recent years, and increases in the future to support practices such as alternative base periods do not appear likely. Right now states are directing scarce resources to making unemployment insurance computer systems Year 2000 compliant. Both UI benefit and tax systems contain numerous date-sensitive calculations which, if not modified to accommodate the century change, will have devastating consequences.

As you know, administrative funding for unemployment insurance is included under domestic discretionary spending caps although the program is an entitlement. There is currently no provision for increases in administrative funding for unemployment insurance under the discretionary caps—even though the number of beneficiaries who would be entitled to be served could increase substantially in an economic downturn.

IMPLICATIONS

Earlier this year, California was sued in a *Pennington*-type suit. Other states may face similar lawsuits very soon. Losing a *Pennington*-type case would mean that if claimants do not qualify for UI benefits under the standard base period, an alternative period, such as the most recent 52 weeks or the most recent 4 quarters, would be used. *Pennington* could also be used as a precedent for lawsuits arguing that the "when due" clause requires an alternative base period whenever inclusion of more recent wages would yield a higher benefit amount. *Pennington* blurs the line between what SESAs can and cannot be sued for, potentially giving rise to further lawsuits against state employment security agencies regarding issues beyond base periods.

We are concerned that *Pennington* could establish a precedent for determination of other qualifying and eligibility requirements for state unemployment benefits by the judicial rather than the legislative process. Expansion of the courts' authority into setting qualifying and eligibility requirements for unemployment benefits pre-

empts the democratic process and, as a result, is likely to erode public support for the program.

In the legislative process, discussions about qualifying and eligibility are not an entirely intellectual exercise. The practical implications, as well as the intellectual basis, of new provisions must be recognized because the legislative body bears responsibility for the outcome. For example, in a state where individuals in the same circumstances as the plaintiffs in *Pennington* are not eligible for benefits, legislators must explain to constituents why they are not eligible; in a state where an alternative base period is put in place, legislators must explain to their employer constituents that their unemployment taxes will be higher. In the legislative process, all interests must be weighed. The courts simply issue an opinion and take no responsibility for implementation.

RECOMMENDATION

In early January, Congressman Phil Crane (R–IL) introduced H.R. 125 which clarifies that individuals cannot file "when due" lawsuits to force changes in state base periods. It does not prohibit a state from adopting an alternate base period and does not take away from any claimant any right now enjoyed with respect to unemployment insurance.

We believe that it is in the best interest of the unemployment insurance system and the workers and employers it serves to maintain the historical interpretation of the Social Security Act's "when due" clause; that interpretation would be changed significantly if the *Pennington* decision stands. ICESA urges you to enact H.R. 125 making clear Congressional intent to leave establishment of base periods to the states.

Chairman SHAW. Thank you very much, Ms. Gilbert.

Mr. Hiatt.

STATEMENT OF JONATHAN HIATT, GENERAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATION

Mr. HIATT. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, I thank you for the opportunity to comment today. I have submitted written testimony for the record, but in the interests of time I'll just highlight some of the points from those remarks.

The *Pennington* case was not brought in a vacuum. Throughout the last 25 years, State and Federal legislators have instituted a distressing array of barriers to access to unemployment benefits: higher earning requirements, tougher disqualification penalties, waiting weeks, artificially high triggers for extended benefits, taxes on benefits, and administrative complications which delay or eliminate access to benefits, the problem that led to the *Pennington* case.

State and Federal legal restrictions on eligibility have reduced the percentage of unemployed receiving benefits from 75 percent in 1975 to only 32 percent for the most recent figures.

Even accounting for changes in the demographics of the unemployed, the Advisory Council on Unemployment Compensation, and numerous independent researchers have noted the important contribution of State legal restrictions in explaining this decline.

The categories of workers affected by enforcing the statutory "when due" standard are precisely those which represent the fastest growing segments of the labor market: contingent workers, lower wage workers, women workers.

Amidst this decline in access to the system, the *Pennington* case highlighted an administrative procedure that has eligibility implications. Legally, the distinction between an administrative issue with eligibility implications and a pure issue of eligibility is pivotal.

The court, in *Pennington,* determined, not surprisingly, and, indeed, most logically, that a procedure which is used to measure eligibility is clearly an administrative procedure, even if it obviously has eligibility ramifications.

The court went on to find that in Illinois an administrative procedure which requires claimants to wait up to 6 months solely so that the State can maintain an outmoded administrative system violated the "when due" clause, the provision which requires the States to pay unemployment benefits as soon as possible once an unemployed claimant is entitled to them.

In Illinois the court found that between 13,800 and 40,000 unemployed workers who were otherwise eligible now lose out or face extreme delay and our impacted in any given year by the failure to consider the lag quarter.

In seeking to reverse the court and alter the Social Security Act, the Crane bill oversteps the boundaries of the Federal/State division of functions. The Supreme Court has twice ruled unanimously on cases where administrative concerns had eligibility implications.

In the *Java* case, they defended the primacy of the "when due" clause against an administrative procedure which existed in 48 States. Most recently, the Supreme Court declined to reconsider the issue in the *Pennington* case.

The Federal Government has a longstanding responsibility to enforce the "when due" clause. In fact, Federal activity, through the unemployment insurance service, has improved the functioning of wage record systems, while simultaneously expanding the range of procedures which are administratively feasible and reducing the time lag which is justifiable under "when due" considerations.

Eight States currently account for the most recent quarter of earnings, the lag quarter, in some way, despite Illinois' protests about the difficulty of achieving this administrative goal. In Maine, Massachusetts, New Jersey, Ohio, Rhode Island, Vermont, Washington, and Michigan, States use a base period which includes earnings of the most recent quarter.

The most common strategy is to use existing wage record data for the first four of the last five quarters to initially determine eligibility, and if a claimant fails the monetary eligibility test, the State issues a wage request to secure the more recent data.

Implementation of a such a movable base system does not require a complete revamping of administrative procedures, nor does it invalidate previous efforts to develop wage record data bases.

The movable base procedure more accurately measures earning history, and more promptly pays benefits to eligibility claimants without imposing undue additional costs.

Technological and history change in administration are essential to the findings in *Pennington.* Many States fear that they will be forced to implement administrative procedures that are defined by courts and rigidly enforced.

That is not our interpretation of what the court in *Pennington* has said. We believe the principle stated in the *Java* Supreme

Court case provides for a balancing act to measure administrative feasibility as against timeliness standards. And that's what the *Pennington* court—all Reagan appointees, incidentally—did in simply applying this balancing test.

States can account for most recent earnings either through existing wage reporting systems or by supplementing those systems through a wage request procedure following initial determinations.

The court, in *Pennington,* specifically did not tell Illinois what system had to be followed, or that any particular system was the only appropriate one. What States cannot do, and what they should not be allowed to do through congressional reversal of *Pennington* is to ignore the national interest in timely benefit payment to individuals who have worked, paid taxes, and earned enough money to be eligible for benefits.

Thank you.

[The prepared statement follows:]

Statement of Jonathan Hiatt, General Counsel, American Federation of Labor and Congress of Industrial Organization

Last year, the AFL–CIO testified before this Subcommittee that the Pennington lawsuit and the proposed legislation to reverse it were vital issues for unemployed workers in the United States. We believe the federal courts have spoken forcefully and correctly in their assessment of Illinois' administrative procedures. They have demanded a reasonable remedy and stayed within the bounds of the current federal-state division of responsibilities under the Social Security Act. It would be misguided and unfair for Congress to reverse the court decision, deny claimants the right to timely benefit payments, alter the Social Security Act, and restrict access for hard-working claimants who happen to work in labor markets or industries which offer only irregular work. We believe the district court and appeals courts in *Pennington*—though, incidentally, were all appointed by President Reagan—have rendered a fair and accurate judgement which should not be overturned through legislative action.

Although we are here to testify on the Pennington panel, we must voice some concerns regarding devolution. The AFL–CIO encourages Congress to fashion a consensus response to UI administrative financing problems. Labor, employers, and federal and state administrators can be brought together around shared principles for administrative financing without fundamentally altering the current federal/state programs. The existing range of devolution proposals, however, has nothing to do with consensus. These proposals only delay the process which should be moving forward to fix administrative problems. We will outline the principles which should guide administrative finance discussion, looking forward to the day when devolution efforts are put aside in favor of more appropriate, consensus-building policies.

The following statement addresses Pennington and devolution, in that order.

Pennington v. *Illinois*

Unemployment Insurance and the New Labor Market

The Pennington case is a pivotal event for unemployed workers because it addresses one aspect of the disjunction between current UI administrative practices and underlying changes in the labor market. At a time when the economy is increasingly creating low-wage and contingent jobs, the UI system has been moving further and further toward serving only higher-wage, more stable employees.

State and federal legal restrictions on eligibility have reduced the percentage of the unemployed receiving benefits from 75 percent in 1975 to only 32 percent for the most recent figures. Even accounting for changes in the demographics of the unemployed, the Advisory Council on Unemployment Compensation and numerous independent researchers have noted the important contribution of state legal restrictions in reducing the percentage of the unemployed who receive benefits.[1]

[1] Bassi, et al. (1996), "The Evolution of Unemployment Insurance," Advisory Council on Unemployment Compensation, Background Papers, Volume III, January; Anderson and Meyer (1994), "Unemployment Insurance Benefits and Takeup Rates," Working Paper 4787, National Bureau of Economic Research; Baldwin (1993), "Benefit Recipiency Rates Under the Federal/State Un-

Amid this national decline in the counter-cyclical and insurance functions of the system, Pennington highlighted the inequitable treatment of claimants subject to the hurdles posed by the Illinois UI system. These administrative hurdles, which the court has strongly rejected, impose a particular burden on workers who are either least able to bear economic uncertainty (due to their low prior earnings) or not responsible for the irregularity of the work patterns (such as construction labor). The overall decline in the effectiveness of the UI system is due in large measure to its insufficient treatment of low-wage and contingent workers.

Unemployment Insurance and Part-Time Work

As discussed below, the Pennington case addresses an administrative procedure issue with eligibility implications. The core issue is whether a state's administrative process, which disadvantages workers with irregular work patterns, can be allowed to stand. Congress must appreciate the full extent to which current UI practice across the country disadvantages low-wage workers in a variety of ways, particularly through monetary eligibility requirements.

Monetary eligibility requirements do not simply set a threshold earnings level for eligibility. Most states require a set amount of earnings for a given 52 week period, but also specify a "high quarter" earning threshold. These high quarter thresholds reduce eligibility on the basis of the distribution of earnings over time, not just the total level of earnings. The non-partisan National Commission for Employment Policy measured the impact of state monetary eligibility requirements—and particularly high quarter requirements—on UI recipiency rates for various population groups.[2] This research duplicated the screening process which unemployed workers face after applying for UI. It compared the earnings history of individuals against the monetary eligibility requirements for the states in which the surveyed individuals lived.

The Commission found that women are twice as likely as men to fail state requirements for high quarter earnings and that only nine percent of all unemployed workers who worked part-time received benefits. State monetary eligibility requirements, particularly high quarter earnings requirements, pose a significant hurdle for the unemployed seeking UI benefits. The impact of high quarter requirements is exacerbated where states delay counting the most recent quarter of earnings, a quarter which may prove essential to eligibility. Thus, by asserting the federal obligation to enforce standards of timeliness, the Pennington case also represents a small, vital step toward reversing years of backsliding under state UI law.

Pennington and HR 125

In Luella Pennington v Lynn Doherty, Director of the Illinois Department of Employment Security, 22 F.3rd 1376 (7th Cir. 1994), the Seventh Circuit court found that federal timeliness requirements (the so-called "when due" clause) of the Social Security Act were violated because Illinois makes eligible workers wait up to six months before they file a claim in order to allow time for processing the most recent quarter of earnings at the time of layoff. The U.S. Supreme Court denied the Illinois appeal. On remand, the U.S. District Court ordered Illinois "to adopt an alternative within a reasonable time" to expedite accounting for a worker's most recent earnings. Illinois filed an appeal. On April 4, 1997, the Republican-appointed United States Court of Appeals for the Seventh Circuit again rejected Illinois' arguments.

Representative Crane has offered HR 125 to remove state base period determination issues from federal scrutiny under the Social Security Act. This action would strip claimants of their right to legal recourse where state accounting procedures neglect to count most recent earnings and, in the process, delay timely payment of benefits. In effect, HR 125 reverses the court decision and implies that a six month delay for benefits is within the bounds of "timely" payments.

Claimants' and States' Rights: HR 125 Reverses Historic Federal Role

Illinois' case against Luella Pennington and Representative Crane's effort through HR 125 assert that the state right to set eligibility is paramount. But for over 60 years, the federal government has had the right to insist that benefits be paid in a timely manner (under the statutory "when due" clause). Indeed, in its most recent decision the Pennington court states that:

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employment Insurance Program: Explaining and Reversing Decline," Ph.D. Dissertation, M.I.T.; Corson and Nicholson (1988), "An Examination of Declining UI Claims During the 1980s," UI Occasional Paper 88–3, US Department of Labor.

[2] Yoon, Spalter-Roth, Baldwin (1995), "Unemployment Insurance: Barriers to Access for Women and Part-Time Workers," National Commission for Employment Policy.

The [U.S. Secretary of Labor's] regulations provide some guidance in this endeavor. But they could provide a great deal more, and perhaps they should.

We believe they should. The federal role in overseeing administrative fairness and efficiency was codified in the Social Security Act. Federal agencies have a unique responsibility to ensure against fraud, to promote timely benefit payments, and to advance system integrity. Congress should resist pressure to alter the federal-state relationship on behalf of the state of Illinois.

The Supreme Court has twice ruled unanimously that state authority over eligibility determination did not have precedence over the federal responsibility to guarantee timely payment of benefits under the "when due" requirement. In perhaps the most important case, California Department of Human Resources Development v. Java, 402 U.S. 121 (1971), the Supreme Court struck down an administrative provision that was in use in 48 states, citing violation of the "when due" clause during pendency of an appeal. This case established the framework for the court's decision in Pennington, namely that "when due" must mean "at the earliest stage of unemployment that payments were administratively feasible."

It is Administratively Feasible to Protect Claimants' Rights

Eight states currently account for the most recent quarter of earnings in some way, despite Illinois' protests about the difficulty of achieving this administrative goal. In Maine, Massachusetts, New Jersey, Ohio, Rhode Island, Vermont, Washington and Michigan, states use a base period which includes earnings in the most recent quarter. The most common state strategy is to use existing wage record data for the first four of the last five quarters to initially determine eligibility. If a claimant fails the monetary eligibility test, the state issues a wage request to secure the most recent data. Alternatively, given current technological advances, many states can easily meet higher timeliness standards by simply speeding their existing wage reporting systems. Thus, implementation of a moveable base does not require a complete revamping of administrative procedures nor does it invalidate previous efforts to develop wage record databases. In fact, efforts to expand wage record reporting systems have laid the groundwork for higher timeliness standards. The moveable base procedure more accurately measures earning history and more promptly pays benefits to eligible claimants without imposing undue additional cost.

The administrative procedures followed in these states show how the cost accounting which Illinois has provided vastly overstates the administrative burden which the state would bear. Loleta Didrickson, Comptroller of the State of Illinois, provided cost estimates that include creating a wage request system and reachback funding to cover previous denials. When these provisions are removed from the cost estimates for alternate base implementation, the additional administrative cost to Illinois drops to just $400,000 per year.[3]

It must be remembered that the Federal government has played an active role in making alternate base procedures administratively feasible. The federal Unemployment Insurance Service has actively promoted technology upgrades which facilitate the timely collection of wage record data and rapid sharing of information. The federal partner in the UI system has a responsibility to demand timely payments and an obligation to make those timeliness standards reachable through system integrity funding and best-practice information. We believe the Department of Labor and state administrators have been working together for years, laying the groundwork for a higher standard of timeliness in benefit payments. Congress should not intervene against claimants to defend outmoded administrative procedures.

Pennington Takes the System Further From Welfare, Not Closer

Last year, opponents of the Pennington decision argued that moveable base provision made UI too much like welfare. This is badly misleading. In fact, by forcing Illinois to accurately account for a worker's earnings, *Pennington* make unemployment insurance a more effective form of social insurance for individuals with work histories. Workers found eligible under a more timely accounting standard have paid in to the UI system through indirect taxes on themselves and direct taxes on their employers. They have worked, paid UI taxes, and lost their jobs. They are guilty only of earning that income during a quarter which the state chooses not to count unless the worker waits and reapplies.

By promoting a more timely and accurate accounting of workers' earnings, moveable base procedures keep workers from slipping into welfare after they lose their jobs. State Senator Patrick Johnston of California recently asked the State of California to provide an estimate of the number of workers who would not slip into wel-

[3] Statement on Behalf of Mrs. Luella Pennington and the Pennington Class Opposing Legislation to Reverse Pennington v. Didrickson.

fare if an alternate base period administrative procedure were enacted. The state made estimates based on the last four completed quarters and on the prior 52 weeks. The state found that 16,357 and 28,200 workers, respectively, would be kept out of welfare because their UI eligibility would be more accurately accounted for and welfare savings of $23.7 million and $40.9 million, respectively, would be realized.[4] Ironically, in the absence of moveable base administrative procedures, states are forcing unemployed workers to reduce their connection to the labor market while awaiting benefit eligibility or, worse, falling into the welfare system.

Summary Arguments: Pennington and HR 125

The Department of Labor is currently sponsoring research into the administrative and eligibility issues relating to moveable base period administration. In an earlier study, Wayne Vroman (1995) found that UI eligibility would increase by six to eight percent and benefit outlays would increase four to six percent under alternate base period programs. Clearly, there are far reaching effects to demanding that states pay benefits in a timely manner.

But these eligibility implications should not cloud Congress' deliberations around HR 125. The Pennington case is first and foremost a case about whether states should be allowed to delay payment of UI benefits, sometimes to the extent that claimants fall out of the system. The courts have emphatically stated that states do not have this right. Congress should not now step in to limit the rights of the unemployed.

DEVOLUTION

In the absence of specific legislative language, we can only speculate about the full effect of the current devolution proposals. However, we have deep concerns about the impact of devolution on vital elements of the current system. Moreover, we fear the attention which is being focused on devolution only serves to delay the development of less fundamental but more practical solutions to administrative financing problems which many constituencies can agree upon.

The AFL–CIO is uniquely representative of various elements of the employment security system in the United States. We represent unemployed union members who remain connected to the labor movement and we try to further the prospects of all unemployed workers as a basic principle of social justice. We also represent employees in human service and unemployment insurance agencies. And representatives of organized labor serve in various capacities on federal, state, and local advisory boards dealing with unemployment insurance related issues. In short, our concern for effective administrative financing runs deep.

We believe administrative financing reform should be guided by basic principles. These shared principles can form the basis for a discussion of alternatives, but devolution efforts fail on virtually all counts.

States Should Receive Adequate Administrative Funds

Current practice starves state agencies of the funds they need to administer programs. Some devolution proposals suggest using general revenue for some functions, a suggestion which imposes a new burden on the tax system without improving the flow of funds. Instead, administrative finance reform should ensure that funds for benefits and funds for administration are more closely linked and made available as needed by state agencies.

Funds Should Go to States on an Equitable Basis

Both the problems with the current system and the virtues of devolution are overstated in this regard. The states which most strongly advocate devolution are also less likely than other states to pay benefits to the unemployed. They receive less in administrative funds because they pay fewer of the unemployed benefits. At the same time, the distributional effects of devolution have yet to be fully explored. We suspect that small states and states with limited tax bases will come up short under devolution. Hold harmless provisions may only forestall the day of reckoning.

Funds Should Account for Fluctuations in Workload

Just as the trust fund for benefits must allow for unpredictable changes in demand, so too should the administrative accounts provide for spikes in administrative requirements. Any proposal which suggests that these peak loads can be covered by borrowing from general revenue should be viewed with great skepticism.

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[4] Letter from Chief Deputy Director of the California Health and Welfare Agency to the Honorable Patrick Johnston, California State Senate.

Tax Reporting Should be Simplified

No one would argue that complex tax procedures should be maintained. As part of any consensus package of administrative financing reforms, employers should expect to see simplified reporting procedures which maintain revenue and still provide necessary information and data. Despite claims to the contrary, we believe devolution may actually increase the complexity of the tax system both for multistate employers and within a given state as new demands result in unique funding mechanisms.

Conclusions

With the effort to reverse Pennington and the effort to devolve UI financing, Congress faces two issues which threaten the social insurance system in the United States. The effort to reverse Pennington would strike down over 60 years of commitment to reducing the anxiety of waiting to receive UI benefits which a worker has earned. The boundaries of what is "administratively feasible" have shifted in favor of claimants; Congress should not resist this important advance.

On devolution, advocates are developing their case as a response to the problems which exist under current financing arrangements. There can be no doubt that such problems exist. There can also be no doubt that solutions short of devolution should be pursued before the current federal/state division of functions is discarded in favor of uncertain, dramatic change.

Thank you for the opportunity to raise these concerns.

Chairman SHAW. Thank you.

Mr. Miller.

STATEMENT OF ALBERT R. MILLER, PRESIDENT AND CHIEF OPERATING OFFICER, PHOENIX CLOSURES, INC., NAPERVILLE, ILLINOIS

Mr. MILLER. Thank you, Mr. Chairman, and Members of the Subcommittee. My name is Bert Miller, and I am president and chief operating officer of Phoenix Closures. My company is located in Naperville, Illinois, and produces container caps for regional and national brand products, both domestic and international.

Our customers cover a wide array of markets, including foods, household chemicals, cosmetics, health care products, industrial products, and pharmaceuticals.

Phoenix Closures presently employs more than 200 workers, and has been an Illinois employer for over 100 years.

I am here today to express my strong support for the legislation Governor Edgar and Director Doherty are seeking in connection with the *Pennington* case. There are problems both with the alternate base period itself, and the manner in which it would be implemented if *Pennington* stands.

The *Pennington* alternate base period would provide for payments of unemployment benefits financed exclusively by employers to individuals with no established connection to the work force. To that extent, it would begin to turn the unemployment insurance system into a 100-percent employer financed welfare program—something well beyond what I understand to have been Congress' intent and something employers cannot afford.

Director Doherty has already discussed the potential impact on employers—annual tax increases of as much as $40 million, and more government imposed paperwork. To put that into context, permit me to discuss briefly my company's situation.

Phoenix Closures is a longtime Illinois business run by a longtime Illinois family. Our success is built on a strong partnership we have with our employees and their union, the textile workers, AFL–CIO.

The company's employees are also its neighbors, and Phoenix Closures intends to remain committed to them in its home in Illinois. However, we face intense competition from businesses whose roots are not firmly fixed.

Many of our competitors have moved to more rural parts of the country to take advantage of low wages. In the past 3 years, four of our competitors have established plants in Mexico.

Phoenix Closures has remained competitive by substantial investments in high-tech equipment, in training our employees to run that equipment, and in doing our level best to keep the line on costs whenever possible.

In that environment, court orders that raise taxes by as much as $40 million per year, and compound government-imposed paperwork, are not just dispiriting. For many businesses like ours, a system that allows things like that will ultimately be deadly.

The alternate base periods costs, however, would not just fall on employers. I am also troubled by the potential impact on government—millions of dollars in startup costs, and $2.5 million in annual costs, according to the Department of Employment Security, with no identifiable source to cover those costs.

I have been a consistent advocate of the idea that government needs to work a lot smarter and cheaper than it does right now. However, no entity can achieve that result if it just keeps taking on more and more things to do.

The alternate base period just gives government one more thing to do, and takes us further in the wrong direction. Besides the problems with the idea of an alternate base period, I am deeply troubled by the fact that, as the *Pennington* case has transpired, employers have been completely shut out of the process. As things stand now, most of my concerns will never enter into the debate. According to both the District and Appellate Courts, the only relevant considerations in deciding whether a State is to be ordered to adopt an alternate base period are how much more would be paid in benefits, and what the impact would be on government's operating expenses. The cost to employers in terms of higher taxes and additional paperwork simply will not count.

Employers will not have the satisfaction of voting against the judge who ordered the alternate base period.

Mr. Chairman, employers are the ones who pay for the system. Our concerns should at least be considered relevant to the discussion.

The legislation Illinois is seeking is simple. It will make sure the decision as to whether or not the benefits of an alternate base period justify its costs remains one for policymakers who will be accountable to the people the decision will affect.

It will also ensure as costs and benefits are weighed, all sides' concerns are given their due. I respectfully ask you to support it.

Thank you for taking the time for having this hearing and considering my views.

[The prepared statement follows:]

Statement of Albert R. Miller, President and Chief Operating Officer, Phoenix Closures, Inc., Naperville, Illinois

Thank you, Mr. Chairman and members of the Subcommittee. My name is Bert Miller. I am the President and chief operating officer of Phoenix Closures. My company is located in Naperville, Illinois and produces container caps for regional and national brand products, both domestic and international. Our customers cover a wide array of markets, including foods, household chemicals, cosmetics, health care products, industrial products and pharmaceuticals. Phoenix Closures presently employs more than 200 workers and has been an Illinois employer for over 100 years.

I am here today to express my strong support for the legislation Governor Edgar and Director Doherty are seeking in connection with the Pennington case.

There are problems both with the alternate base period itself and the manner in which it would be implemented if Pennington stands. The Pennington alternate base period would provide for the payment of unemployment benefits, financed exclusively by employers, to individuals with no established connection to the workforce. To that extent, it would begin to turn the unemployment insurance system into a 100-percent employer-financed welfare program—something well beyond what I understand to have been Congress' intent and something employers cannot afford.

By increasing outlays from Illinois' Trust Fund account, the alternate base period would also raise employer taxes. The greater the rise in outlays was, the higher the tax increase would be. The lowest estimate I have seen is that the alternate base period would increase outlays from Illinois' account by 1.5 percent. An increase of that size would raise employer taxes by around $10 million per year. There is a Labor Department study that estimates an alternate base period can raise a state's Trust Fund outlays by four to six percent. A six-percent increase in outlays from Illinois' account would raise taxes on Illinois business by $40 million each year.

The alternate base period's cost to employers, however, would not be limited to higher taxes. I understand employers would also be faced with additional reporting requirements, with penalties for noncompliance, to verify claimant earnings that had not yet been reported and entered into the state's computers.

To put that into context, permit me to discuss briefly my own company's situation. Phoenix Closures is a longtime Illinois business run by a longtime Illinois family. Our success is built on the strong partnership we have with our employees and their union—the United Needle and Textile Employees Union, AFL–CIO. The company's employees are also its neighbors, and Phoenix Closures intends to remain committed to them and its home in Illinois. However, we face intense competition from businesses whose roots are not as firmly fixed. Many of our competitors have moved to more rural parts of the country, to take advantage of low wages. In the last three years, four of our competitors have established plants in Mexico.

Phoenix Closures has remained competitive by substantial investments in high-tech equipment, in training for our employees to run that equipment and in doing our level best to hold the line on costs whenever possible.

In that environment, court orders that raise taxes by as much as $40 million per year and compound government-imposed paperwork are not just dispiriting. For many businesses like ours, a system that allows things like that will ultimately be deadly.

The alternate base period's costs, however, would not just fall on employers. I am also troubled by the potential impact on government—million's of dollars in start-up costs and $2.5 million in extra annual costs according to the Department of Employment Security, with no identifiable source to cover those costs. I have been a consistent advocate of the idea that government needs to work a whole lot smarter and cheaper than it does right now. However, no entity can achieve that result if it just keeps taking on more and more things to do. The alternate base period just gives government one more thing to do and takes us further in the wrong direction.

Besides the problems with the idea of an alternate base period, I am deeply troubled by the fact that, as the Pennington case has transpired, employers have been completely shut out of the process. As things stand now, most of my concerns will never even enter into the debate. According to both the district and appellate courts, the only relevant considerations in deciding whether a state is to be ordered to adopt an alternate base period are how much more would be paid in benefits and what the impact would be on government's operating expenses. The cost to employers, in terms of higher taxes and additional paperwork, will simply not count. Employers will not even be able to have the satisfaction of voting against the judge who ordered the alternate base period. Mr. Chairman, employers are the ones who pay for the system; our concerns should at least be considered relevant to the discussion.

The legislation Illinois is seeking is simple. It will just make sure that the decision as to whether the benefits of an alternate base period justify its costs remains

one for policy makers who will be accountable to the people the decision will affect and that, as the costs and benefits are weighed, all sides' concerns are given their due. I respectfully ask you to support it.

Thank you for you taking the time to have this hearing today and for considering my views.

Chairman SHAW. Thank you, Mr. Miller.

Mr. Collins may inquire.

Mr. COLLINS. I have no questions, Mr. Chairman.

Chairman SHAW. Mr. Levin.

Mr. LEVIN. I think the panel, Mr. Chairman, has laid out the issue pretty clearly. I just wanted to ask Ms. Gilbert—Ohio now uses a system that's consistent with *Pennington?*

Ms. GILBERT. That's correct.

Mr. LEVIN. Ms. Doherty, do you know what percentage of the workers laid off today in Illinois are covered by unemployment compensation?

Ms. DOHERTY. I can tell you that of the people who apply on a yearly basis with us, 93 percent of them are monetarily eligible. And that's the first thing we look at, is monetary eligibility. Seven percent would apply most likely in this *Pennington* case.

Now, from the 93 percent, though, there are reasons that they may not get unemployment benefits after that. I don't know overall how many workers are not covered in Illinois. No. I can get you that information, though.

Mr. LEVIN. OK. Thank you.

[The information was not available at the time of printing.]

Mr. LEVIN. Yes.

Ms. GILBERT. Congressman Levin, I would like to respond to your issue that Ohio has the *Pennington* base period. Basically, the concern that States have is that States have the right to determine whatever base period that is, and even Ohio would face similar litigation to the *Pennington* litigation potentially for base periods even sooner than what the *Pennington* folks are seeking.

So the concern is that States have the right, that this is a State issue. States have the right to determine their own base period.

Mr. LEVIN. Thank you.

Mr. Hiatt.

Mr. HIATT. Congressman Levin, I believe that in response to your question to Ms. Doherty, the District Court, as upheld by the Appeals Court decision that just came down a couple of weeks ago in the remand in the *Pennington* case, had found that under an alternative base system in Illinois, there would be some 13,800 to 40,000 workers in a given year who would be eligible for benefits if the lag quarter wages were considered.

So other issues of eligibility or ineligibility aside, they found that range would be directly affected by this one change.

Ms. DOHERTY. Congressman, could I also respond? One of the points of interest that we did not bring up here is what it takes for somebody to be eligible. And basically what we look for in a four-quarter period, the first four quarters of the last five completed, is $1,600 in wages.

That's how much they have to make in a year to be eligible for unemployment insurance benefits. That should be noted.

Mr. LEVIN. And how is that responsive to Mr. Hiatt?

Ms. DOHERTY. Well, it's probably a combination of both. Because I think Ohio's monetary eligibility is a bit higher. So we could change our base period, and if we raised monetary eligibility, we could actually cut people out.

You have to look at the whole law, not just one piece, and I think one of the things that happens in Illinois which I think has been fairly effective for us the last 10 years is our law is negotiated between the business and the labor community before it goes in front of our general assembly.

So that both those groups are accountable to the people that they represent. And it's been a fairly effective process for us. We haven't always used that in Illinois, but the last 10 years, with the exception of one or two times, we have stuck with the new agreed bill process, which basically takes both sides of the equation into effect.

Mr. HIATT. If I may, I really think it's apples and oranges to confuse the monetary eligibility requirements, on the one hand, with the "when due" issue, on the other.

As Congressman Ensign pointed out before, ultimately with respect to the eligibility requirements, it's going to be the State officials who are going to be accountable. All that the *Pennington* case addresses is how quickly are unemployed workers who are otherwise eligibility for this unemployment money going to get their money.

And if the State is saying, Well, we'll get it to you when it's owed to you, but as a result we're going to have to raise eligibility requirements, with fewer unemployed workers eligible, well, that's the State's prerogative, and then they'll have to take the heat when the citizens in the State complain about it.

But that shouldn't have an impact on unemployed workers who are eligible by everybody's definition under a given State standard, getting their unemployment check when it's due. That's the only issue that *Pennington* is addressing.

Mr. LEVIN. Thank you.

Chairman SHAW. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

I'm kind of interested in the *Pennington* issue, because Pennsylvania's current UC system, I think, does conform to *Pennington,* as it's structured. So some of these issues are relatively new to me.

Mr. Hiatt, with regard to multiple base periods, and I'd like to move at least my part of this discussion away purely from the cost side of it. Because too much of the debate on UC is cost driven, without fully considering all of the other implications.

In moving toward multiple base periods, what kinds of claimants benefit from that change in the structure of benefits? I know the structure of UC benefits has different effects for different kinds of work patterns.

Can you describe the sorts of workers that you have found would benefit from multiple base periods, as opposed to the system that Illinois has had in place?

Mr. HIATT. Well, a good example that you would find everywhere would be construction workers. Construction workers who are con-

tingent or temporary in the sense that typically their employment on one particular project, with one particular employer, is not going to be of a long-term, ongoing, factory-type pattern.

And so they may not have worked five quarters ago, but they may very well have been working in the quarters two through five. And five is the quarter immediately preceding their unemployment.

As our economy has changed from one where almost everybody worked for one employer for his or her whole working life, to one where an average worker now has, whatever it is, 11 or 12 employers over the course of their lifetime employment, it is not at all atypical that, whether construction workers or other kinds of seasonal or temporary workers who are employed for most of the time, but may have time off in between jobs, many will not be working five quarters ago, but may very well have been working in quarters two through five.

That would be, I think, a typical example.

Mr. ENGLISH. One of the other issues—would you like to speak to that as well?

Ms. DOHERTY. Just that I guarantee you most construction workers, if they worked the second through the fifth quarter, would most definitely be eligible. There are not very many construction workers in Illinois that are not eligible for unemployment insurance.

Mr. ENGLISH. OK. Do you want to comment?

Mr. HIATT. Just that there was a Department of Labor study, the Vroman study, 1½ years ago or so, that found that indeed there is a construction worker impact, that that is one of the groups that would be impacted.

I can't speak to the specific number of construction workers in Illinois who would be affected by this difference, but across the board that was, in fact, cited as a good example in response to exactly the question you're asking.

Mr. ENGLISH. Mr. Chairman, would it be appropriate if the staff of the Subcommittee were to provide the Members with a copy of that study from the Department of Labor?

Chairman SHAW. That certainly can be done.

Mr. ENGLISH. Thank you. Mr. Miller, in your testimony you also focused on the additional reporting requirements that would be imposed on businesses moving toward a *Pennington* implementation.

And I wonder, can you quantify that paperwork burden, and what sorts of businesses would the additional regulations have some impact on?

Mr. MILLER. Well, I think the timeliness issue is such that virtually every employer in Illinois is going to have to come up with a way to accumulate their payroll data radically faster, and move it to the State of Illinois to get on their computers.

And we're going from a situation where we have—and I don't work in my accounting department and so I don't know the exact amount of time that we have to get our numbers into the State of Illinois——

Mr. ENGLISH. Surely.

Mr. MILLER. But from what I understand on *Pennington,* our timeframe is going to be literally several days to get the State computers updated on our payroll, which we don't do.

I have a reasonably good IS department in our company, and we use a payroll service. So it may very well be that my company would be able to respond reasonably well. But I can only imagine that companies that have 50 employees, 75 employees, 100 employees that do their own payroll will absolutely have nuclear meltdown over this kind of thing.

And relative to this whole unemployment issue, there's one company in Illinois that manufactures gowns, graduation gowns. They basically run their business about 90 days a year. If they wind up paying unemployment on all of their employees because of the changes in the base period, the changes that are being discussed, I think it's a safe bet you can expect to see that business move offshore.

And these are the real problems. I am struck by the fact that no one has talked about the costs to manufacturers and employers in the State of Illinois or any other State. I think the numbers that are talked about here are remarkably low compared to what the employers are going to have to do to respond to the more timely reporting requirements.

Mr. ENGLISH. Mr. Chairman, if I could just ask a quick followup. If I am correct, Ms. Gilbert, you had indicated that your State currently is fairly close to being in conformity with *Pennington.*

Ms. GILBERT. We do have an alternate base period.

Mr. ENGLISH. Do you see those additional costs now within your State?

Ms. GILBERT. I don't have them quantified, but it does require employers not only to do their quarterly wage reporting as they do in most States, but at a time when a claimant files for unemployment, if the claimant qualifies under the alternate base period, we must go back to the employer and ask for additional reports at that time.

So it is an additional burden.

Mr. ENGLISH. Thank you. Mr. Chairman, this has been a wonderful panel, and I appreciate their contribution.

Chairman SHAW. Mr. Coyne.

Mr. COYNE. No questions, Mr. Chairman.

Chairman SHAW. Well, I'd like to thank this panel. Thank you very much for being with us.

Mr. COLLINS. Mr. Chairman, I know I passed a minute ago, but I would like to enter something into the record. And I would like to ask Ms. Gilbert a question before she leaves, if you don't mind, sir.

Chairman SHAW. You go right ahead.

Mr. COLLINS. Ms. Gilbert, Members of this Subcommittee received a copy of a letter to the President, dated April 22 of this year, asking his support in fixing the *Pennington* problem. Those States were Illinois, California, Wisconsin, Delaware, Minnesota, Ohio, Georgia, and Iowa.

Can you give us a sense—and Mr. Chairman, I'd like to enter a copy of that letter into the record, please.

Chairman SHAW. Without objection.

[The information follows:]

STATE OF ILLINOIS

OFFICE OF THE GOVERNOR

SPRINGFIELD 62706

JIM EDGAR
GOVERNOR

April 22, 1997

The Honorable William J. Clinton
President of the United States
The White House
Washington, D.C. 20500

Dear President Clinton:

We are writing to ask for your help with a problem that you, as a former Governor, can understand. It is an immediate problem for the states of California and Illinois, and has serious implications for nearly every other state in the nation. The problem is the decision handed down by the Seventh Circuit Appellate Court in *Pennington v. Didrickson.*

The Congressional Budget Office estimates that *Pennington*, if left standing, could raise outlays from the federal treasury by more than $350 million per year. Without any input from state policy makers, it could also force substantial state tax increases on employers and increase government-imposed paperwork for business. The case could, on average, raise employer taxes in Illinois alone by $10 million to $40 million annually. Alternatively, it could lead to overall benefit cuts to offset the additional outlays it would generate. In either event, *Pennington* would also increase state government's cost of doing business by millions of dollars.

The *Pennington* decision allows individuals to sue under the Social Security Act to force state statutory changes with regard to the "base period." The "base period" is the period of time examined to determine whether an individual has earned enough to qualify for unemployment benefits and, if so, the amount of the individual's weekly benefit check. More than 40 states have the same base period as Illinois.

The appellate court's decision marks a fundamental departure from the way states and the federal government have construed the Social Security Act. It blurs the line between what a state can and can not be sued for and involves unelected federal judges in tax and spending decisions. In the friend-of-the-court brief it submitted in *Pennington*, the United States Department of Labor said, "Given the widespread use of the type of base period employed by Illinois, an order striking down the Illinois law undoubtedly would cause nationwide disruption in the various states' unemployment compensation systems." In a July 11, 1996 congressional hearing on the case, the Department of Labor again stated the decision was contrary to its reading of federal law.

Congressman Phil Crane of Illinois has introduced legislation, H.R. 125, that attempts to remedy this situation with bipartisan co-sponorship. H.R. 125 makes clear the decision as to the type or number of base periods a state uses remains in the hands of policy makers who are accountable to the people the decision will affect- not federal judges.

H.R. 125 would not take away from any claimant any rights now available. The amendment would not prohibit states from adopting alternate base periods. It would simply clarify a principle agreed upon by the federal government and states since the unemployment insurance system was established.

Your administration's support on this matter would be greatly appreciated. As always, thank you for taking the time to consider this matter.

Sincerely,

Jim Edgar
Governor of Illinois

Pete Wilson
Governor of California

Tommy Thompson
Governor of Wisconsin

Tom Carper
Governor of Delaware

Arne Carlson
Governor of Minnesota

George Voinovich
Governor of Ohio

Zell Miller
Governor of Georgia

Terry Brandstad
Governor of Iowa

cc: The United States Department of Labor
The Honorable Phil Crane

Mr. COLLINS. Can you give us a sense of how many other States support legislation to clarify the longstanding intent of the Social Security Act that States do have the right to set their own base periods?

Ms. GILBERT. Can you repeat the question one more time?

Mr. COLLINS. Can you give us a sense of how many other States, I named eight, that support legislation to clarify the longstanding intent of the Social Security Act that States have the right to set their own base periods?

Ms. GILBERT. Well, the Interstate Conference of Employment Security Agencies is a consortium of the States. And it is ICESA's position at this point in time to support that legislation.

Mr. COLLINS. How many?

Ms. GILBERT. ICESA currently represents 53 jurisdictions. So all 50 States and the three additional jurisdictions that we serve, the District of Columbia, the Virgin Islands, and Puerto Rico.

Mr. COLLINS. Very good.

Thank you, Mr. Chairman.

Chairman SHAW. Thank you, Mr. Collins.

Our next panel will be made up of Thomas Nagle, undersecretary of health and welfare, the State of California in Sacramento; Hon. Bobby Whitefeather, chairman of the Red Lake Band of Chippewa Indians Tribal Council, Red Lake, Minnesota, and he's accompanied by Mr. Peterson whom I have lately seen on television looking at the devastation. And our concern, sympathy, and prayers go out to you and your constituents for what they're suffering.

William Bentley Ball, Esq., Harrisburg, Pennsylvania, on behalf of the Association of Christian Schools International; and Richard Masur, who is the president of the Screen Actors Guild, Los Angeles, California.

Mr. Peterson, you may have to go. Would you like to go ahead and introduce Mr. Whitefeather? I know you're busy today.

STATEMENT OF HON. COLLIN PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PETERSON. I'd very much appreciate that, Mr. Chairman. I, as you can imagine, am a little busy—the supplemental that is dealing with the flood situation right now, and we're scrambling. So we appreciate those kind words, and my constituents appreciate that.

I'll be very brief. We've been working on this issue for some time—I have and a number of us. And, there's a long history in this country that Indian nations and tribes and bands be treated the same as State governments, and there's been litigation on this. It's been upheld time and time again.

All we're asking for with this bill is that the Indian tribes be treated the same way as States be treated on unemployment. And there's been a dispute here that we've been trying to resolve for some time.

They've been trying to collect, I think, from you a certain amount of money, and Bobby will tell you about that.

But all we're trying to do is just have the tribes be treated the same as the States when it comes to unemployment. That they not have to pay unemployment, that they can take care of it themselves. And apparently there was some discussion earlier about the fact that somebody had said that they would support the tribes activities being exempt, but not the business activities of the tribes.

And I would like to point out that States run a lot of businesses. They run lotteries, other kinds of things that are, in my view, business enterprises, and those are exempt from this unemployment. And there's no difference with what the tribes do when they run a casino or some other operation that basically is the same thing that a State is doing.

So what we're asking for, and we hope that you would consider, is that you treat the tribes appropriately, the same way as we treat State government. And resolve this, and with that I would turn it over to Chairman Whitefeather who has been working long and hard on this, and we really appreciate you taking the time to hear about this today. We very much appreciate it.

Chairman SHAW. Good luck with the emergency supplemental.

Mr. PETERSON. Thank you. We're going to need it. We have a lot of problems. I'll wait for the Chairman to say his word, and then I'll have to leave.

Chairman SHAW. All right. Mr. Whitefeather, and then I'll go back into order.

STATEMENT OF BOBBY WHITEFEATHER, CHAIRMAN, TRIBAL COUNCIL, RED LAKE BAND OF CHIPPEWA INDIANS, RED LAKE, MINNESOTA

Mr. WHITEFEATHER. Thank you, Congressman Peterson.

Good afternoon, Mr. Chairman, and Members of the Subcommittee.

My name is Bobby Whitefeather. I am the tribal chairman of the Red Lake Band of Chippewa Indians, and we are located in northern Minnesota, not quite in the flood plain as some of our neighbors to the west. So we're fortunate in that regard.

Our reservation comprises of 8,000 members, and we are charged with full governmental functions of providing services to those people.

The Red Lake Band of Chippewa Indians is here today in support of H.R. 294, the Indian Tribal Government Unemployment Tax Act Relief Amendment of 1997. I would first of all like to acknowledge again Congressman Peterson for his previous efforts in introducing a similar measure in the 103d Congress. Also Senator McCain, last year, and, of course, Congressman Shadegg with his measure this year.

We support H.R. 294 on the basic premise of establishing fairness and equity to FUTA with respect to treatment, and lack of clear, consistent classification of tribal governments under FUTA.

I think it also should be noted, interestingly, that States, some States treat tribal governments as exempt employers, Minnesota being one of them.

Over the last several years, the Internal Revenue Service has been very inconsistent in the practices and the classification and assessment of the FUTA tax laws.

Reports that the Red Lake Tribe has received from some tribes vary in instances where some tribes were assessed the FUTA taxes, and later, to their surprise they received a refund. There have been also instances such as in Red Lake where we were informed that we were exempt employers, and during the interim of several years, the agents for the Internal Revenue Service changed, and therefore their interpretation of the treatment of tribal governments has changed. And we are under this current dilemma at this point.

Several years ago we were informed that we were exempt, later to find out that a new agent said that was a wrong interpretation, and the typical story is, you should have gotten it in writing.

But be that as it may, I think also it should be noted that the Congressional Research Service has performed various surveys with respect to treatment of Indian tribes with respect to FUTA. And the research and the survey has confirmed that there is inconsistent treatment throughout the country.

The enactment of FUTA over 60 years ago, as in several other pieces of legislation that come up from time to time, does not specifically identify Indian tribes as a unit of government.

Therefore, it results in varied treatments and interpretations, especially in FUTA where even country governments and municipalities are treated as exempt organizations, and, for that matter, charitable organizations as well.

To be fair, tribal employees that are engaged in activities that are similar to State governments, local governments have to be considered. Because we operate a nursing home. We operate a hospital. We provide police protection, fire protection, and all the typical public service functions that any government provides.

In conclusion, I think the application of FUTA to tribal governments as private employers, the government to government principle that we all recognize from nation to nation, is contrary to current understanding of that relationship.

The assessment of FUTA on the Red Lake Band of Chippewa Indians will have a very devastating effect on our tribal economy. We've been informed now that we will be assessed in excess of $2.5 million. In comparison to that assessment, that is about 40 percent of our annual operating budget.

And so I would urge the Subcommittee's support and the Red Lake Band of Chippewa Indians, like I said, we're 8,000 strong. And I am fortunate to have a group of young people with me here today to attend the hearing from the Red Lake High School.

And we stand with you to urge your strong support for the enactment of H.R. 294.

Thank you.

[The prepared statement follows:]

Statement of Hon. Bobby Whitefeather, Chairman, Tribal Council, Red Lake Band of Chippewa Indians, Red Lake, Minnesota

Mr. Chairman, and distinguished members of this Subcommittee, thank you for this opportunity to comment on behalf of the Red Lake Band of Chippewa Indians, a federally-recognized tribal government, in support of the amendments proposed in H.R. 294, the "Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments of 1997."

Since the early 1990s our Tribe has actively sought administrative and legislative relief from a very unfair interpretation and application of the Federal Unemployment Tax Act (FUTA) to tribal governments recently made by the Internal Revenue Service (IRS).

We are indebted to Members like the Honorable Rep. John Shadegg (H.R. 294 in the 105th), the Honorable Rep. Collin Peterson (H.R. 838 in the 104th, H.R. 1382 in the 103rd), and the Honorable Sen. John McCain (S. 1305 in the 104th; S. 391 in the 103rd) who have pressed forward on this issue, year after year. We are now also indebted to you, Mr. Chairman, for including this matter for hearing today.

My Tribe testifies today in strong support of H.R. 294. This bill has the active support of many Indian tribes as well as the National Congress of American Indians. [See attached NCAI Resolution SPK–95–060 on predecessor bill H.R. 838].

We support H.R. 294 because it would foster:

(a) fairness and equity—H.R. 294 would treat tribes like all other governments and non-taxable entities are treated for purposes of unemployment insurance;

(b) orderly and efficient FUTA administration—H.R. 294 would save federal, tribal, and state governments significant sums of governmental revenue by resolving

uncertainties that cause sporadic enforcement, coverage, and expensive disputes; and

(c) government-to-government relations—H.R. 294 would require a consistent application to the FUTA tax laws of the government-to-government relationship that has been recognized by the Federal Courts and by the Congress to exist between the United States and federally-recognized Indian tribal governments.

A. BACKGROUND ON THE RED LAKE TRIBAL GOVERNMENT AND RESERVATION.

Our Tribe's Red Lake Indian Reservation is a relatively large, rural Reservation with over 800,000 acres of tribal trust land and water within the boundaries of the State of Minnesota. Most of our lands are located within the boundaries of our diminished Reservation, which has never been broken into individual allotments and lost to non-Indians. Our Reservation is not governed by Public Law 83–280. This means the Red Lake tribal government and the United States government have full civil and criminal enforcement responsibilities for the Red Lake Reservation. As a consequence, our tribal government provides a full range of governmental services to Reservation residents. We administer police, judicial, penal and fire protection services, natural resource protection and management, social services, health and other emergency services, economic development and planning, and many other governmental activities. Although we are somewhat isolated by our rural location, the Tribe has a variety of economic enterprises which serve the community and provide important governmental revenue to the Tribe. The State of Minnesota has neither civil nor criminal enforcement responsibility or authority over our Reservation.

A December, 1995 study carried out by the Department of Economics, Bemidji (MN) State University found that approximately 6,130 of our tribal members live on the Reservation in 1,560 households. A majority of Reservation households (59%) have incomes below the federal poverty line for a family of four. Forty percent of all Reservation households receive income from employment with our tribal government, making tribal government jobs the single most important source of income on our Reservation. Our Tribe employs approximately 2,400 workers in its governmental programs and enterprises, for a total annual payroll of $17.4 million. In addition, many of our tribal members survive on a traditional subsistence economy of fishing and small-scale timber cutting.

B. FUTA AND TRIBAL GOVERNMENTS.

Introduction. H.R. 294 would correct a serious oversight in the way Indian tribal governments like Red Lake have been treated by the IRS in recent years for unemployment tax purposes under the unique, state-federal unemployment program authorized by FUTA. Red Lake and other Indian tribes are *governments*. We deserve consistent treatment as governments. The changing IRS practice is based on a fundamental disregard for, or lack of knowledge of, what tribes like Red Lake do as governments.

How FUTA Works. FUTA involves a joint federal-state taxation system that levies two taxes on most non-governmental and taxable employers: An 0.8 percent federal unemployment tax (after credit for state taxes that are paid) and a state unemployment tax ranging up to more than 9.0 percent of a portion of an employer's payroll.

Since its enactment in the 1930s, FUTA has treated foreign, federal, state, and local government employers differently from private commercial business employers. FUTA exempts all foreign, federal, state, and local government employers from having to pay the 0.8 percent federal tax that is used to administer the FUTA system nation-wide. It allows state and local government employers, as well as tax-exempt charitable organizations, to contribute into the state unemployment funds on a reimbursable basis, meaning they reimburse the State funds only for those claims actually paid out to former employees. All other private sector employers pay both the federal and state FUTA tax rates in advance without reimbursement. The FUTA statute does not *expressly* mention tribal government employers within the definition of governmental employers.

How the IRS Treatment of Tribes, for FUTA Purposes, Has Changed. In a turnabout from historical practice, but with increasing frequency over the past decade, the IRS has begun to treat tribal governments as if we are private-sector commercial business employers for purposes of determining how we must participate in unemployment insurance programs under FUTA.

The IRS has begun to try to retroactively collect federal and state FUTA taxes from tribal governments, even though, as is the case with Red Lake, to our knowledge all of the employees our tribal government laid off before 1995 were denied unemployment insurance payments from the State fund because the State has treated our Tribe as an exempt governmental employer.

Red Lake's experience is not unusual. At the request of Senator McCain and the Senate Committee on Indian Affairs, the Congressional Research Service (CRS) issued a report on October 1, 1993 of a telephonic survey it conducted of all state unemployment programs. The report concluded that state treatment of tribal governments under FUTA was uneven and varied widely. Some states considered tribal governments exempt. Some treated them as governmental entities and allowed them to reimburse the state fund on a claims-made basis. Some states accepted tribal contributions at commercial rates. The treatment of tribes has lacked any rational consistency.

The Red Lake Tribe conducted its own survey of other tribal governments experience with FUTA. We learned that IRS policy has varied widely from region to region during the 1990s and even up to this day. Some tribes who have paid FUTA taxes have received their tax payments back from the IRS with the message that tribal governments were exempt. Many tribes who have not paid FUTA taxes have contributed to state funds and have not been challenged. Others have not paid either the federal tax or the state contribution and gone unchallenged. Still others, like Red Lake, have been told they are exempt and then have been vigorously pursued by the IRS for huge, retroactive assessments at the full federal FUTA tax rate (there is no credit because no contributions were made to the state fund) for many years into the distant past.

Tribes Like Red Lake Have Suffered Inequitable Treatment At the Hands of the IRS. My Tribe has suffered great legal and programmatic costs as a result of the changing IRS interpretations of FUTA. The IRS has come against us for several million dollars worth of what it calls back taxes, interest and penalties that reach back as far as 1989. Red Lake was completely surprised by this change of position by the IRS in the early 1990s. We had on file two exempt letters from the IRS for several of our Red Lake programs. We had never paid into the State fund. Indeed, the federally-approved Minnesota Unemployment Insurance Plan specifically described Red Lake and other tribal governments as "exempt." The relatively few tribal employees we laid off in prior years were always denied benefits because they worked for what was deemed an "exempt employer." Our Tribe did not cost the FUTA system anything. Suddenly we were ordered to pay huge amounts of money for no benefit.

Faced as we were with the threat of millions of dollars in IRS taxes, penalties and interest continuing to mushroom at an exponential rate, about two years ago our Tribal Council decided under protest to begin to pay into the State unemployment fund in order to contain our costs and at least get something (employee coverage) for our money. We continue to refuse to pay the federal portion of the tax the IRS considers remaining due after a credit is calculated for our contributions to the State fund.

A total in excess of $2.5 million remains at issue for tax years 1989 through 1994, adding up all the tax amounts, penalties and interest that IRS is trying to get from the Red Lake tribal government. Should the IRS succeed, none of these funds will ever return to benefit any former employees of our tribal government. None of these funds will ever return to the State of Minnesota or its unemployment insurance fund.

Analysis of the FUTA Law and Practice. It is well-settled that Indian tribal governments like Red Lake are not taxable entities under the federal tax code because of our status as governments. Until the late 1980s, this same interpretation was applied uniformly by the IRS to its collections under the somewhat ambiguous language of FUTA.

While FUTA expressly exempts all Section 501(c)(3) tax-exempt organizations and all state and local units of government from paying the federal portion of the FUTA tax, the New Deal-era statutory language of FUTA does not expressly mention tribal governments. Based on a re-reading of the statute, the IRS has changed course over the past decade and begun to pursue a number of tribal governments for FUTA taxes as if we are taxable for-profit commercial enterprises rather than governments. This change of interpretation and practice has proven to be quite burdensome to tribal governments like Red Lake who were caught unawares by the change in IRS policy.

The IRS has chosen in recent years to pursue some tribal governments for unpaid FUTA taxes who had proceeded on the good faith assumption that we were immune, as governmental employers, from the federal portion of the tax. Some tribal governments also chose not to participate in the state unemployment programs. Red Lake's experience with the State of Minnesota is not unique. We have learned that other tribes in other states have likewise laid off employees who were subsequently denied benefits by the state unemployment program solely because they had worked for what the states deemed was an "exempt" employer—a tribal government. While this

caused hardship on the former employees of tribal governments, it meant that the state unemployment funds paid out no benefits and experienced no loss.

The change in this IRS interpretation of the FUTA statute has not been uniform. The resulting unevenness has caused additional problems for Red Lake and other tribal governments as we have been subject to differing interpretations over whether and how we are covered under FUTA. Compounding this problem have been the varying views of different state governments and the U.S. Department of Labor. As a result, different tribes have been treated differently in different periods of time. This has led to considerable confusion among tribal governments about whether they are covered and how much they are supposed to pay.

Tribal Experience With the Changing IRS Practice. In the past decade, some tribes have paid the federal FUTA tax and then enjoyed the unusual experience of having the IRS return their payments to them with the notation that the IRS considered them to be exempt employers. Other tribal governments have not paid any FUTA contributions in a good faith and reasonable belief that they were exempt. For example, two employer subdivisions of our Red Lake tribal government, the Red Lake Tribal Job Training Partnership Act Program and the Red Lake Tribal Comprehensive Health Services Program, received written communications from the IRS treating them as if they were tax exempt.

IRS Collection of Unpaid FUTA Contributions is Punitive. The IRS effort to collect unpaid FUTA assessments is the equivalent of a punitive tax under FUTA's unique enforcement mechanisms. The statute permits the IRS to collect the full tax from a non-paying commercial business regardless of its experience rating. These provisions act as "teeth" designed to encourage private sector businesses to pay the tax in advance.

However, now that the IRS interpretation of the law has changed, the IRS effort to collect back taxes from Indian tribal governments like Red Lake means that none of the funds assessed and collected by the IRS will ever be paid out as unemployment benefits to former employees of a tribal government like Red Lake that has not participated under FUTA. Nor will these dollars return to the state funds in which Red Lake and other tribal governments did not participate. Instead, the federal IRS will collect the highest possible state and federal unemployment taxes and place all of these funds directly into the U.S. Treasury without credit or benefit to any workers, tribal employees or otherwise, in Minnesota. The IRS approach would result in a windfall for the United States Treasury, and break the back of our Tribe's government and Reservation economy.

How can it be fair to impose this kind of taxation without benefit on the meager funds of an Indian tribal government like Red Lake simply because we have followed an interpretation of FUTA that some regional offices of the IRS and the states previously followed but now have abandoned?

H.R. 294 Would Fairly Resolve the Problem. H.R. 294 would amend existing FUTA tax statutes to clarify expressly that tribal governments should be treated just as state and local units of government are treated for FUTA unemployment tax purposes.

Under H.R. 294, the IRS would have no authority to assess federal FUTA taxes against tribal governments, just as it cannot do so against like state and local governments and tax-exempt organizations. In addition, H.R. 294 would expressly authorize tribal governments, like state and local governments and tax-exempt organizations, to contribute to a state unemployment insurance fund on a reimbursable basis for unemployment benefits actually paid out to former employees.

If a tribal employer does not lay off employees, under H.R. 294 there would be no reimbursements owed because no benefits have been paid out. If a tribe does lay off someone for whom benefits are paid, the tribe pays the benefits, dollar for dollar. In contrast, private sector employers typically must pay an advance unemployment tax. The FUTA law spreads the insurance costs across the private sector, with commercial employers paying flat rates only partially adjusted by their experience rating. The public policy underlying this approach seems to be that the burden of unemployment insurance should be borne somewhat evenly by all private sector interests.

The rationale for public sector employers having a reimburser status is that governmental employers, such as Indian tribes and states, have a far more stable employment environment than that of the private sector. Equally important is the rationale that governmental revenue, whether it be federal, state or tribal, should not be "spent" in advance of when an obligation to pay actually arises.

Finally, H.R. 294 would also remove a theoretical unemployment tax liability of tribal governments like Red Lake who did not pay unemployment compensation taxes in the past in the good faith and reasonable belief that we were exempt, provided that no benefits were paid to their former employees. If former employees

were paid benefits by a state fund, the tribal government would be obliged to reimburse the state for those benefits actually paid out.

This last point is very important to Red Lake and to other tribes who have been caught in the net cast by the changes in IRS policy and practice. It is our understanding that Section 2(e) of H.R. 294 (transition rule) would assure that federal and state portions of the FUTA tax for years prior to the effective date of H.R. 294 could not be asserted or collected except to the extent that benefits have been paid out by a state fund for service attributable to the tribe for such period. If this is not your reading of this language, we would want to work closely with your staff to amend the language to ensure that IRS is prohibited from collecting the unfair windfall it is seeking to gain from our Tribe and others similarly situated for past years.

Questions That Have Been Raised on H.R. 294. Three years ago, the U.S. Department of Labor raised a concern that, because tribal governments, like all governments, are immune from suit by virtue of their sovereignty, a state fund may not be able to force a participating tribal government to reimburse the state fund for money it has paid out to a former tribal employee. There do exist several ways by which a state in such a situation could collect the necessary reimbursements from a tribe (for example, it could reduce other funds going to a tribe for other state-funded services administered by the tribe). However, a provision was added to the bill that would allow a state to insist that any tribe wanting to have "reimburser" status post a payment bond to assure that reimbursements will be made. Section 2(c) of H.R. 294 contains this provision and of course has our support.

A second question has been raised about whether H.R. 294 should be amended to address only those tribal government employees who carry out what are seen as "traditional" governmental activities like law enforcement, judicial services, social services, or natural resource protection, removing from H.R. 294 those tribal government employees of tribal enterprises wholly-owned and controlled by an Indian tribal government. Tribal governments and their employees *do* engage in business-type activities in order to generate governmental revenue and provide jobs and services in what are, more often than not, rural and isolated economies. But it should be noted that State governments do the same thing. Any effort to exclude certain tribal government employees in this way would be patently unfair. State and local government employees throughout America are engaged in a wide variety of business-type activities that are wholly-owned and controlled by state and local governments. A recent CRS survey preliminarily concluded that state governments annually raise $46.5 billion from business-type activities. That is $46.5 billion, not million, in revenues from the direct operation of business-type activities by State government employees. All of these state government employees, from the liquor store stock clerks in Pennsylvania to the massage therapists in the State park resorts of West Virginia to the lottery gambling clerks in dozens of states, are treated as governmental employees for purposes of FUTA. To be fair, our tribal government employees who are engaged in business-type activities run by the tribal governments should be treated no differently than these State and local government employees. Like states, Indian tribal governments dedicate the revenues from these business-type activities to governmental purposes. This is consistent with the longstanding Federal policy that encourages tribal government self-determination and self-sufficiency. It would be the height of unfairness for the United States to discriminate against Indian tribes who do the same thing that state governments are doing.

C. Conclusion.

The Red Lake Band of Chippewa Indians, along with other federally-recognized Indian tribal governments, seeks prompt enactment of H.R. 294. H.R. 294 would restore fairness to the administration of the FUTA program and tax structure, because it proposes to once again have the United States uniformly treat each Indian tribal government the same as it treats state and local governments and tax exempt organizations for purposes of FUTA. Our participation as tribal governments in the FUTA program under H.R. 294 would be on the same terms that all other governments and non-taxable organizations participate. There is no special favor or special treatment involved. H.R. 294 would simply clarify that tribal governments like Red Lake should be treated for what we are—governmental employers.

My Tribe stands ready to assist the Subcommittee in refining and securing passage of H.R. 294. Thank you for this opportunity to be heard.

Attachment

Resolution SPK–95–060

TITLE: SUPPORTING LEGISLATION DESIGNED TO EXCLUDE TRIBES FROM BEING ASSESSED UNDER "FUTA"

WHEREAS, we, the members of the national Congress of American Indians of the United States, invoking the divine blessing of the Creator upon our efforts and purposes, in order to preserve for ourselves and our descendants rights secured under Indian treaties and agreements with the United States, and all other rights and benefits to which we are entitled under the laws and Constitution of the United States to enlighten the public toward a better understanding of the Indian people, to preserve Indian cultural values, and otherwise promote the welfare of the Indian people, do hereby establish and submit the following resolution; and

WHEREAS, the National Congress of the American Indians (NCAI) is the oldest and largest national organization established in 1944 and comprised of representatives of and advocates for national, regional, and local Tribal concerns; and

WHEREAS, the health, safety, welfare, education, economic and employment opportunity, and preservation of cultural and natural resources are primary goals and objectives of NCAI; and

WHEREAS, the Internal Revenue Service has taken the position that federal unemployment tax act assessments will be applied to tribes; and

WHEREAS, other governmental units and non-profits are specifically exempted from such assessments; and

WHEREAS, member tribes view their resulting treatment as a "private employer" as an infringement upon tribal sovereignty; and

WHEREAS, legislation entitled "Indian Tribal Government Unemployment Compensation Act Amendments of 1995" has been introduced in Congress as H.R. 838; and

WHEREAS, the legislation, if passed, would include "an Indian tribe" along with other governmental and political subdivisions now specifically exempt from the assessment.

NOW THEREFORE BE IT RESOLVED, that the NCAI go on record as supporting legislation designed to exclude tribes from being assessed under "FUTA" and thereby retain for tribes their status of being exempt from such federal taxation.

CERTIFICATION

The foregoing resolution was adopted at the 1995 Mid-Year Conference of the National Congress of American Indians, held at the Sheraton Spokane in Spokane, Washington, on June 6–8, 1995 with a quorum present.

gaiashkibos, President

ATTEST:

S. Diane Kelley, Recording Secretary

Adopted by the General Assembly during the 1995 Mid-Year Conference of the National Congress of American Indians, held at the Sheraton Spokane in Spokane, Washington, on June 6–8, 1995.

Chairman SHAW. Thank you.

Mr. Nagle.

STATEMENT OF THOMAS P. NAGLE, UNDERSECRETARY, HEALTH AND WELFARE AGENCY, STATE OF CALIFORNIA, SACRAMENTO, CALIFORNIA

Mr. NAGLE. Thank you, Mr. Chairman, and Members of the Subcommittee. Thank you for the opportunity to appear before you today. I shall be brief. I have two issues. The primary issue is the one referred to by Congressman Thomas earlier this morning, involving the payment of unemployment benefits to inmates upon release from prison.

In 1990 California voters passed a ballot initiative which required the State to establish the joint ventures program in the State prison system. Under this program, private businesses may contract with the California Department of Corrections to hire inmates to produce on the grounds of State prisons various goods and services for sale.

In terms of the inmate income, part of the income goes for Federal, State, and local income taxes, for support of the prisoner's family, a restitution for the crime victims, reimbursement to the State for the cost of room and board, and approximately 20 percent is held in an escrow account and made available to the individual upon release.

An unintended consequence of this employer participation in the joint ventures is that employers are required to pay unemployment taxes for the inmates they hire for employment. Consequently, inmates are eligible for unemployment benefits when they are paroled or released from prison.

We believe this distorts the intention of both programs. Unemployment insurance was not intended to be a support program for inmates.

The California legislature, to correct the situation, passed a bill, S.B. 103, which placed a second initiative on the ballot that would specifically deny unemployment benefits to inmates upon their release from prison.

The ballot initiative, which was Proposition 194, was overwhelmingly passed by the California voters in March 1996.

The U.S. Department of Labor has threatened to deny California companies $1.7 billion in unemployment insurance tax credits as a result of Proposition 194.

We basically support the legislation introduced by Congressman Thomas, H.R. 562. This bill would exempt services performed by inmates who participate in the joint ventures programs, and similar programs in other States from unemployment taxes and the resulting benefits.

Inmates who provide services currently and historically in the prison system, such as doing work in the prison laundry or kitchen or cabinet shops, make furniture that's used by State offices. This program has been in existence for at least 20 or 30 years, and they have been exempt from unemployment taxes under the current law.

Congressman Thomas' bill merely extends that exemption to inmates to work in these relatively new private sector agreements.

The other issue is that we are in support of the ICESA position on the *Pennington* situation. We feel the issue is one of State discretion. We've been legally challenged in the courts. The *AFL–CIO* v. *Lee* in California. And so we're intimately involved in this.

We believe it should be resolved through legislative process in the Congress, and not by the courts. Our preliminary estimate is that it will cost California businesses, employers, approximately $93 million annually.

The increasing cost to administer the program in California alone, if it's court mandated, we establish to be approximately $12 million.

So we do support the legislation introduced by Congressman Crane, H.R. 125. This bill would affirm that the base period determination should be decided by the States and not as an administrative consideration.

Thank you, sir.

[The prepared statement follows:]

Statement of Thomas P. Nagle, Undersecretary, Health and Welfare Agency, State of California, Sacramento, California

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today to bring to your attention two very important unemployment insurance issues which are of great concern to the State of California.

The first issue concerns a situation that has arisen in California involving the payment of unemployment benefits to inmates upon release from prison. We believe immediate action is required by Congress to prevent the misuse of taxpayer dollars for that purpose.

In 1990, California voters passed a ballot initiative which required the State to establish the Joint Venture Program in the State prison system. Under this program, private businesses may contract with the California Department of Corrections to hire inmates to produce, on the grounds of state prisons, various goods and services for sale. Similar programs have been established in several other states.

The Joint Venture Program provides an opportunity for inmates to learn important work skills and also generates revenues for crime victims and savings for federal, state and local governments. Up to eighty percent of an inmate's income is withheld to pay for federal, state and local income taxes; support of the prisoner's family; restitution to crime victims; and reimbursement to the state for the cost of room and board.

The Joint Venture Program has been very successful. However, this partnership with the private sector has created an unintended consequence. Employers participating in the Joint Venture Program are required to pay unemployment taxes for the inmates they hire for employment. Consequently, inmates are now eligible for unemployment benefits when they are paroled or released from prison. Governor Wilson believes that employers and taxpayers never intended the unemployment insurance program to be an ex-inmate support program.

In an attempt to resolve this issue, the California Legislature passed, and the Governor singed a bill, S.B. 103, which placed on the ballot an initiative to deny unemployment benefits to inmates upon their release from prison. The ballot initiative, Proposition 194, was overwhelmingly passed by California voters in March 1996. This should have been the end of the story, but, unfortunately, it was not.

Recently, the U.S. Department of Labor (DOL) has threatened to deny California companies $1.7 billion in unemployment insurance tax credits as a result of Proposition 194. One option offered by the DOL to avoid this action is to make the inmates employees of the State, and then exempt them from benefits. Not only is this option an insult to the hardworking California correctional staff, it is unacceptable to California employers and taxpayers and inconsistent with the intended purpose of the unemployment insurance program.

To prevent DOL sanctions and to ensure that inmates do not qualify for unemployment benefits upon release from prison, Governor Wilson supports legislation introduced by Congressman Bill Thomas, H.R. 562. This bill would exempt services performed by inmates who participate in the Joint Venture Program, and similar programs in other states, from unemployment taxes and the resulting benefits.

Such an exemption is not unprecedented. Inmates who provide services directly to the prison by work in the prison laundry or kitchen or cabinet shop are already exempt from unemployment taxes under current law. Congressman Thomas' bill merely extends that exemption to inmates who work in these relatively new private sector arrangements.

California voters have already made a clear statement that they do not want their tax dollars used to pay unemployment benefits to inmates released from prison. Governor Wilson urges the Subcommittee to act quickly to resolve this issue by passing Congressman Thomas' bill when it considers unemployment insurance reforms.

The other important issue I would like to bring to your attention today is the impact on California and other states of the Pennington v. Doherty case out of Illinois. That case interpreted existing federal law to substantially change the manner in which most states have calculated the base period for the award of unemployment benefits since the beginning of the program in 1935.

From the inception of the Unemployment Insurance Program the base period for the purposes of determining monetary eligibility for unemployment benefits has been determined by each state, most of which have opted for a base period similar to that chosen by California. The unemployment compensation program is a federal-state partnership, with certain basic requirements imposed by federal law as a condition of participation. The specific eligibility standards and amount of benefits payable have generally been considered to be within the discretion of the individual states.

California considers the choice of base period to be an eligibility criteria solely within each state's discretion. This is the central issue in a lawsuit currently pending in California, AFL–CIO v. Lee. The plaintiffs in that lawsuit are asking the federal courts to follow the Pennington decision and to order California to adopt a specific base period, one that would impose a very significant administrative and monetary burden upon both the state and employers.

The Department of Labor (DOL) participated in the Pennington case in Illinois by filing a brief in support of the State of Illinois. DOL's position agreed that the base period is a matter of a state's rights. The most recent decision in that case was unfavorable to the State of Illinois and Illinois has stated that it will be filing a petition in the U.S. Supreme Court. To date, DOL has not taken a position in California's pending lawsuit.

Congress can and must resolve this issue because the consequences of a court-imposed base period are severe. The cost to California employers alone will be $93 million annually. The cost to Illinois employers will be from $30 to $40 million annually. This, ultimately, will translate into increased employer taxes.

The increased costs of administration to implement a court-mandated alternative base period in Illinois includes an annual administrative cost of $2.6 million. In California, the annual administrative cost alone would be $12 million.

If California and Illinois are required by these lawsuits to implement a new base period, the other states won't be far behind. When the costs experienced by California and Illinois are extrapolated to all of the other states, it's apparent that an alternative base period requirement is going to impose a very significant fiscal burden upon employment security agencies and employers nationwide.

The additional administrative costs of an alternative base period will have to be absorbed within existing budgets, which can only mean services in other areas will have to be cut. The unemployment compensation system has worked well for 60 years with the existing base period. There is no valid reason to remove this eligibility determination from the state domain.

Governor Wilson believes that Congress must act to take this issue out of the court system and reaffirm that this is a matter for each state to decide through open debated and the legislative process. In this regard, the Governor supports H.R. 125, the legislation introduced by Congressman Phil Crane that would affirm that the base period determination is a matter that should be decided by each state. Governor Wilson strongly urges Congress to pass H.R.125 quickly and relieve states of the potential administrative and fiscal burden that would be imposed upon them if they are mandated to adopt a specific base period.

Mr. Chairman, this concludes my prepared statement. At this time, I would be pleased to answer any questions that you or other Subcommittee Members may have.

Chairman SHAW. Thank you, Mr. Nagle. The next witness will be introduced by our colleague, Mr. Crane, who is back from the Speaker's office. Congratulations on your escape.

Mr. CRANE. The beginning, not the end.

Mr. Chairman, I want to thank you for including in this hearing another bill I introduced, H.R. 124, which would exempt religious schools operated by lay board of believers from the Federal Unemployment Tax Act, FUTA.

Currently, the exemption extends only to schools directly operated by churches. It's estimated that 20 percent of Protestant evangelical schools in our country fall in this nonexempt category, as well as many Catholic and Jewish schools.

Yet such schools would not even exist if they didn't have a strong religious mission. Therefore, it's only fair these schools be allowed to decide whether or not they'll participate in the unemployment system.

Today the Subcommittee will hear from William Ball, representing the Association of Christian Schools International. Although I've worked in support of this effort for a number of years, Mr. Ball has devoted his career to being an advocate for religious freedom.

He has argued some of the landmark religious freedom cases before the U.S. Supreme Court, and many State supreme courts around the country. He has defended those who because of religious beliefs cannot defend themselves from the intrusion of government in their religion and in their daily lives.

Because he has tirelessly fought in the name of religious freedom for students, parents, schools, or entire religious communities, Mr. Ball is uniquely qualified to speak to the issue raised by H.R. 124, and I commend his testimony to my colleagues on the Subcommittee, and again thank you, Mr. Chairman.

Chairman SHAW. Mr. Ball.

STATEMENT OF WILLIAM BENTLEY BALL, ESQ., HARRISBURG, PENNSYLVANIA; ON BEHALF OF ASSOCIATION OF CHRISTIAN SCHOOLS INTERNATIONAL

Mr. BALL. Mr. Chairman, Members of the Subcommittee, I want to thank you very much for having me appear here today. As Congressman Crane said, I represent the Association of Christian Schools International, which is a nonprofit organization representing some 3,000 nonprofit, nonracially discriminatory evangelical Christian schools in our country, serving some 570,000 students.

Parents, who are the main supporters of these schools, and the school administrators are deeply interested in H.R. 124. And why? Well, the answer is simple. Congressman Crane has just expressed it.

Section 3309(b)(1) of the Internal Revenue Code says that schools controlled by churches and are operated primarily for religious purposes are exempt.

I think the Congress did not intend at that time to exclude religious schools run by lay board. They focused on church schools, and they said, Well, it's obvious that we're covering the religious schools of the country when we speak of church-controlled schools.

Now, in the Association of Christian Schools International, there are quite a number of church-controlled schools. But there are also a significant number of schools not operated by churches but which are governed by dedicated evangelical Christian boards of laypeople.

If you would permit me to just take you in your imagination to a town somewhere in the country where you see Grace Academy, which is controlled by Grace Church. A couple of miles down the street, another school called Lake View Christian School is operated by a lay board of evangelical Christians.

As you go into each of these schools, you'll find a religiously oriented curriculum. You'll find teachers of evangelical faith imparting the evangelical faith to their children. You'll see prayer, a strong spiritual atmosphere. You'll find the same moral training.

You'll see religious symbols in each. And when you leave, you won't be able to tell which was which. They are indistinguishable.

As Congressman Crane mentioned, too, there are Orthodox Jewish schools which—and I don't speak for them—but which I understand to be in the same category as maintaining lay board religious schools.

It's obvious then that there is a need here for this measure, H.R. 124, and the exemption it would then extend to the remaining number of religious schools.

I want to conclude by drawing to your attention something I think would be significant to you, if not critical, which is the question of tax impact.

There are three impacts of this measure. First of all, it is virtually revenue neutral. This same measure, in the form of amendment 3443, came before the 100th Congress, and the Joint Committee on Taxation said that the net budget gain would be less than $5 million in that fiscal year, and negligible in the years thereafter.

The second impact which I would refer to, tax impact, is that it will help the parents who are supporting these lay board religious schools. And the third impact relates to what you stated in your advisory statement, that you're interested in increasing employment and interested in business growth.

The ACSI schools produce highly literate graduates, who are trained in civic responsibility. And that, I think, in this day, is a boon to the country, and these schools, therefore, should be encouraged in their efforts and not penalized.

Thank you.

[The prepared statement follows:]

Statement of William Bentley Ball, Esq., Harrisburg, Pennsylvania; on Behalf of Association of Christian Schools International

I speak for the Association of Christian Schools International (ACSI), which thanks you for this opportunity to address the important measure which is H.R. 124. The Association is the largest organization of evangelical Christian schools in the nation, with more than 3000 schools and colleges. It now serves about 570,000 students.

The sponsors of H.R. 124 are to be congratulated because your bill will, if enacted, correct a serious defect in our tax laws. Let me spell out that defect. The Federal Unemployment Tax Act (FUTA) provides exemption for services performed by employees

in the employ of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled or principally supported by a church or convention or association of churches.

A religious school controlled by a church is not covered by the Act, and the school is not required to pay the FUTA tax.

But many religious schools are not such schools. Fifteen percent of ACSI schools are not. Indeed one out of five religious schools in the USA are not. They are indeed operated (by lay boards) "primarily for religious purposes" but are not controlled, or principally supported, by a church or association of churches. Under the present law, those schools are liable for the tax. Yet they are absolutely indistinguishable from church-operated schools. You could readily find this out by visiting both types of school. They are equally religious in curriculum, program and spiritual life. So it is seriously discriminatory to say that one shall be taxed but the other not taxed.

It is clear, from examining the history of FUTA, that the Congress intended no such discrimination but simply was unaware of the relatively small number of non-church, religious schools. The Congress readily concluded that it had exempted all religious schools when it exempted the church schools. That oversight was understandable. But no longer is it reasonable to maintain that unfortunate mistake. Let me conclude by pointing out three important facts:

First, *no* non-church school would be exempt unless it would have proven to IRS that it is "operated primarily for religious purposes." Our non-church religious schools do not seek any open-ended exemptions.

Second, the change effected by H.R. 124 will be revenue-neutral. The previous effort to remove the present inequity (Amendment 3443 (100th Congress)) was held by the Joint Committee on Taxation to be so, stating that the "net budget effect of this bill would be a gain of less than $5 million in the fiscal year and a negligible effect each year thereafter." (Congressional Record, 100th Congress, S14861–2).

Third, ACSI's plea is on behalf of the parents who sacrifice to afford the education which ACSI's schools provide. This plea is also on behalf of our society, because ACSI knows that its schools are providing excellent education and moral training for young Americans in a caring environment. Schools which do that should be encouraged in their efforts, not penalized under our tax laws.

Thank you for hearing this testimony. It is to be hoped that you will now see fit to move decisively to remove a serious inequity by voting favorably on H.R. 124.

Chairman SHAW. Thank you, Mr. Ball. Our last witness is Richard Masur of the Screen Actors Guild.

STATEMENT OF RICHARD MASUR, PRESIDENT, SCREEN ACTORS GUILD, LOS ANGELES, CALIFORNIA

Mr. MASUR. Good afternoon. My name is Richard Masur, and I am the president of the Screen Actors Guild.

Mr. Chairman, I would like to thank you and the Members and the staff of this Subcommittee for giving me the opportunity to testify in support of Congressman English's bill, H.R. 841.

Today I am speaking on behalf of my colleagues in the entertainment industry, in particular, the senior performers represented by the Screen Actors Guild, the American Federation of Television and Radio Artists, and our colleagues in the Directors Guild of America.

By way of brief introduction, please allow me to explain the predicament that is faced by seniors in our industry as a result of section 3304 of FUTA. While some actors are financially well off, most are not. Entertainment professionals work many short-term jobs and face prolonged periods of unemployment.

But like many other hardworking Americans, some senior members of the entertainment community manage to earn a modest pension after working 20 or more years. Still, they have years of productive work ahead of them, and often seek roles, which we encourage them to take, portraying senior citizens in a positive, active, and vigorous light.

Actors, writers, and other workers in the entertainment industry are participants in various multiemployer pension plans which were established through collective bargaining.

Under the terms of those plans, a worker who has met the minimum requirements to qualify for benefits can take normal retirement at age 65, or an early retirement option with reduced benefits as early as age 55. It is very common for an actor, once he or she has begun to receive a modest monthly pension, to continue to seek work in motion pictures or television to supplement that fixed income.

When such work is obtained, the actor's employer will, in compliance with the collective bargaining agreement, contribute to the pension plan. Now, under the plan's rules, such contributions will result in an increase in the actor's monthly pension check.

Subsequently, while the actor has otherwise met the qualifications for unemployment benefits, section 3304 of FUTA requires that an individual's unemployment insurance benefit be offset by the pension benefit when, one, that person works for any employer member of a multiemployer unit which contributed to the pension; and, two, where that work results in an increase in benefits.

Section 3304, as currently written and interpreted, requires the unemployment benefit be offset not simply by the amount of the benefit increase, but by the total amount of the pension.

In this way, senior actors and other industry professionals are being penalized for remaining active workers simply because they have accepted a short-term job to supplement their fixed incomes.

For example, assume that as a result of a short-term acting job a worker's monthly pension benefit increases by $7, from $400 to $407 per month. Also assume that the unemployment insurance benefit is determined to be $450 per month.

Under current law, the monthly unemployment benefit of $450 would be reduced by $407, leaving a net benefit of only $43 per month. Now, it would be reasonable, or certainly more reasonable, if the unemployment benefit offset were limited to the amount of the pension increase.

H.R. 841 does just that. Using my example, the change encompassed in the bill would reduce the monthly unemployment by $7, leaving a net benefit of $443 a month.

This change to FUTA is noncontroversial, and it enjoys bipartisan support. We have also been told that it is supported by the AMPTP, that is, the Alliance of Motion Picture and Television Producers, and the Motion Picture Association of America, which represent many of our employers.

As you may recall, this bill was first introduced in the last Congress as H.R. 3677 by Congressman English, and at that time my colleague and former Guild President Charlton Heston testified before the Subcommittee on its behalf.

The Congressional Budget Office estimates the enactment of H.R. 841 would result in an increase in benefit outlays of $2 million, as well as an eventual increase in revenues to pay for those outlays. Therefore, this legislation would meet the pay-as-you-go criteria.

All of our investigation indicates this problem is unique to the entertainment industry, so with the Chairman's permission, I would also like to submit a package of correspondence between our attorneys, the California Employment Development Department and the U.S. Department of Labor, which shows that attempts were made to correct this problem at the State level through administrative means.

This correspondence supports the need for congressional action at the Federal level.

The pension offset rule was designed to prevent abuses such as when a person who is retired attempts to collect unemployment benefits by returning to their original employer for enough time to qualify for those new benefits.

The current law does, however, allow a person collecting a pension to work for a different employer without losing subsequent unemployment benefits if laid off.

The law did not contemplate an adverse effect on people such as actors who receive a pension increase from the same pension plan, not the same company. In the entertainment industry, workers who become eligible for a pension under the industry's multi-employer plans have subsequently returned to work under the same multi-employer plan.

In the eyes of the law, these actors are returning to the same company, when in fact they are merely doing short-term work in a diverse industry with many employers.

At a time when we are encouraging older people to work and asking experienced actors and actresses to project positive role models on television and film, the current pension offset provision acts as a discouragement to those seeking employment.

Passage of H.R. 841 would restore the integrity of the unemployment law to its original intent. It would protect the well-being of senior workers, while also encouraging them to continue contributing to the entertainment industry and American culture.

On behalf of all of the senior workers in the entertainment industry, I would especially like to thank Representative English for authoring this bill, and Representatives Matsui and Royce for being the chief cosponsors.

We appreciate the Subcommittee's consideration of this legislation, and stand prepared to assist you as your deliberations move forward.

Thank you very much, Mr. Chairman.

[The prepared statement and attachments follow:]

Statement of Richard Masur, President, Screen Actors Guild, Los Angeles, California

Good day. My name is Richard Masur, and I am President of the Screen Actors Guild.

Mr. Chairman, I would like to thank you and the members and staff of this Subcommittee for giving me the opportunity to testify in support of H.R. 841. Today, I am speaking on behalf of my colleagues in the entertainment industry, in particular the senior performers represented by the Screen Actors Guild, the American Federation of Television and Radio Artists and the Directors Guild of America.

Your actions affecting unemployment insurance policy have a direct impact on many people's lives. I am here today to speak to you about some of them—senior members of the entertainment community who have been affected adversely, and we believe unintentionally, by Section 3304 of the Federal Unemployment Tax Act. As currently written and interpreted by the Department of Labor and state employment offices, that Section deprives senior workers of unemployment insurance benefits for which they have otherwise qualified.

By way of brief introduction, please allow me to explain this predicament—which is caused by a combination of the unique nature of entertainment work, the rules of the pension plan under which we operate, and the current interpretation of federal law.

While some actors are financially well off, most are not. Entertainment professionals work many short-term jobs and face prolonged periods of unemployment. But like many other hard-working Americans, some senior members of the entertainment community have earned a modest pension after working 20 or more years. Still, they have years of productive work ahead of them and often seek roles we encourage them to take—portraying senior citizens in a positive, active and vigorous light.

Actors, writers and other workers in the entertainment industry are participants in various multi-employer pension plans which were established through collective bargaining.

Under the terms of those plans, a worker who has met the minimum requirements to qualify for benefits can take normal retirement at age 65, or an early retirement options with reduced benefits as early as age 55. It is very common for an actor, once he or she has begun to receive a modest monthly pension, to continue

to seek work in motion pictures or television to supplement that fixed income. When such work is obtained, the actor's employer will, in compliance with the collective bargaining agreement, contribute to the Pension Plan. Under the plan's rules, such contributions will result in an increase in the actor's monthly pension check. Subsequently, while the actor has otherwise met the qualifications for unemployment benefits, Section 3304 of the FUTA requires that an individual's unemployment insurance benefit be offset by the pension benefit when:

(1) that person works for any employer-member of a multi-employer unit which contributed to the pension, and

(2) where that work results in an increase in benefits.

Section 3304, as currently written and interpreted, requires that the unemployment benefit be offset—not simply by the amount of the benefit increase—but by the total amount of the Pension. In this way, senior actors and other industry professional are being penalized for accepting a short-term job to supplement their fixed incomes.

For example, assume that as a result of a short-term acting job, a worker's monthly pension benefit increases by $7, from $400 to $407 per month. Also assume that the determined unemployment insurance benefit is equal to $450 per month. Under current law, the monthly unemployment benefit of $450 would be reduced by $407, leaving a net benefit of only $43 per month.

It would be reasonable if the unemployment benefit offset were limited to the amount of the pension increase. H.R. 841 does just that. Using my example, the change encompassed in the bill would reduce the monthly unemployment benefit by $7, leaving a net benefit of $443 per month. This more-reasonable offset in benefits would be accomplished by amending Section 3304 of the FUTA to simply limit the unemployment benefit offset to the amount of the pension increase for workers in the entertainment industry.

This change to the FUTA is non-controversial and enjoys bi-partisan support. As you may recall, this bill was first introduced last Congress as H.R. 3677 by Congressman English, and my colleague Charlton Heston testified before this subcommittee on its behalf. The Congressional Budget Office estimates the enactment of H.R. 841 would result in an increase in benefit outlays of $2 million, as well as an eventual increase in revenues to pay for those outlays. Therefore, this legislation would meet "pay-as-you-go" criteria.

All of our investigation indicates this problem is unique to the entertainment industry. With the Chair's permission, I would also like to submit a package of correspondence among our attorneys, the California Employment Development Department and the U.S. Department of Labor, which shows that attempts were made to correct this problem at the state level through administrative means. These correspondence essentially support the need for Congressional action at the federal level.

The pension offset rule was designed to prevent abuses, such as when a person who is legitimately retired attempts to collect unemployment benefits by returning to their original employer for enough time to qualify for unemployment benefits. The law does, however, allow a person collecting a pension to work for a different employer without losing subsequent unemployment benefits if laid off. The law did not contemplate an adverse affect on people such as actors who receive a pension increase from the same pension plan—not the same company. In the entertainment industry, workers who become eligible for a pension under the industry's multi-employer plan have subsequently returned to work under the same multi-employer plan.

In the eyes of the law, these actors are returning to the same company, when in fact they are merely seeking short-term work in a diverse industry with many employers.

At a time when we are encouraging older people to work—and asking experienced actors and actresses to project positive role models on TV and film—the current pension offset provision discourages them from seeking employment. Passage of H.R. 841 would restore the integrity of unemployment law to its original intent. It would protect the well-being of senior workers while also encouraging them to continue contributing to the entertainment industry and American culture.

We appreciate your consideration of this legislation and stand prepared to assist you as your deliberations move forward. Thank you.

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VIA UPS NEXT DAY AIR

File No.:
11640-0041

December 22, 1992

Rec'd 12-23-92

Thomas P. Nagle
Director
Employment Development Department
800 Capital Mall
Sacramento, California 95814

RE: Unemployment offset

Dear Mr. Nagle:

This office represents the Screen Actors Guild (SAG), the American Federation of Television and Radio Artists (AFTRA) and the Writers Guild of America, west (WGA west) jointly referred to as the "Unions." Please accept the thanks of the Unions for arranging for our meeting with your representative, Marie Lopez, on October 15, 1992 in Los Angeles. The meeting proved to be worthwhile and informative. Indeed, it is partly at her suggestion that we now address our concerns directly to you, and request a meeting with you in an effort to obtain relief from a serious problem the senior members of the Unions are experiencing.

As I am sure you are aware, in this era of dual income households and high unemployment (especially in California), it is difficult for most retirees to make ends meet just with income from social security and their pensions. For this reason many retiree members of the Unions are compelled to supplement their fixed pension incomes through post-retirement employment. Unfortunately, the inherent nature of virtually all the work in the entertainment industry is seasonal, and sporadic. The competition for the few employment openings made available to performers and writers of retirement age is intense. The inevitable result of the combination of all these economic realities is that many retirees find themselves relying substantially on unemployment benefits to cover their living costs in the interim periods between what little employment they are able to find.

As if these circumstances were not difficult enough, the retiree members must overcome an additional burden in their struggle to maintain solvency and a decent living standard: in accordance with the EDD's current interpretation of applicable tax law, members' unemployment benefits will be offset by their pension benefits where they work for any employer-member of a multi-employer unit which contributed to their pension and where that work results in pension eligibility or an increase in benefits. This severely restricts the ability of many retirees to find work that will not, ironically, cause them financial hardship, and arbitrarily punishes employees who happen to work in an industry dominated by multi-employer entities. Since, as will be demonstrated below, California law requires that the pension offset be minimized to the greatest possible extent, and federal law does not require such an offset in this instance, the unions urge that the EDD adopt and apply an interpretation, consistent with the applicable statutes, that requires pension offset only where the pension employer and the base period employer are the identical, single employer.

THE APPLICABLE LAW

In 1980 Congress amended 26 U.S.C. §3304(a)(15), to read in pertinent part:

> "(A) the [pension offset] requirements of this paragraph shall apply to any pension . . . only if -
>
> (i) such pension . . . or similar payment is under a plan maintained or (contributed to) by a base period employer or chargeable employer (as determined under applicable law), and
>
> (ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 . . ., services performed for such employer by the individual after the beginning of the base period (or remuneration for such services) affect eligibility for, or increase, the amount of, such pension, . . . and
>
> (B) the State law may provide for limitations on the amount of any such a reduction to take into account contributions made by the individual for the pension, . . . or other similar periodic payment. . . " (emphasis added).

The state of California is required to conform its unemployment benefits policy to federal strictures such as the pension offset

provision to maintain its federal certification, but the state legislature has left no doubt that EDD is to comply "with the letter of the federal law, and nothing more," in light of the "self-destruct" clause of Unemployment Insurance Code §1255.3(b), and the legislature's view that

> the pension offset provision was both unfair and misguided, . . . that . . . many workers pushed into early retirement actively seek() new employment . . . (and) a pension offset unfairly discriminates against workers wholly dependent upon income from pensions and unemployment compensation. . . .

Evans v. Unemployment Ins. Appeals Bd., 39 Cal.3d 398, 409, 410 (1985). The EDD is therefore under legislative and judicial mandate to maximize unemployment benefits and minimize the impact of the pension offset, as long as such policy is not inconsistent with clear federal law.

ANALYSIS OF THE PENSION OFFSET

Abiding by the legislative command to accord the federal law no more than its most restrictive, literal meaning, requires the pension offset to be operative only when the pension plan has been contributed to by the base period employer, and the work performed for "such" employer results in pension eligibility or an increase in the amount of the pension.

Thus, the offset applies where an employee works for employer A, retires with a pension, then returns to A, and as a result of the second stint, his/her pension amount increases. By the same token, if the employee worked for and retired from employer A, and then went to work for employer B, any unemployment benefits resulting from an eventual layoff from B would not be offset. Why should that result change if B happens to be in a multi-employer unit which also contains A? Given that the legislature and the Supreme Court authorize only the narrowest, leanest application of the offset, and that nothing in the federal law requires a different result in the multi-employer context, the EDD must not extend the offset to that situation.[1]

---

[1] At our October 15, 1992 meeting, Ms. Lopez stated that she was unaware of any federal law or regulation that required the EDD to maintain its current interpretation, and our research has revealed no such federal law.

The EDD's interpretation of the offset statute is broader than is required by its literal language, in fact, erases a key word, and furthermore injects ambiguity and uncertainty, all of which can and should be avoided by a narrower reading.

Under the EDD's interpretation, Congress meant to apply the offset to any employment which results in pension eligibility or increase. If Congress intended that result, it could have stated so with fewer words and greater clarity. The EDD's interpretation thus lends a gloss of ambiguity that clouds the meaning of "employer" for no discernible reason.

More fundamentally, the EDD's interpretation renders the word "such" in subparagraph (A)(ii) superfluous. If the only criteria for applying the offset were that the base period employment result in pension eligibility or increase, (as the EDD's interpretation demands), there would be no need for the words "for such employer" to appear in (A)(ii) In order to instill meaning in that phrase and the remainder of (A)(ii) as well, "for such employer" must be understood to mean the same employer as the base period employer. Thus, subparagraph (A)(ii) is comprised of two separate components: (a) a requirement that the base period employer be the same employer as that with which the employee became pension eligible, and (b) a requirement that the base period employment result in pension eligibility or increase.[2] In other words, (A)(ii) requires both a match between pension and base period employer, and in addition, a change in pension status resulting from that last employment.

Congress was certainly aware of the existence of multi-employer pension plans, and could easily have provided for the broad reading of §3304(a)(15) adopted by the EDD if it intended to do so. In fact, it has chosen in analogous contexts in the Internal Revenue Code (§§415 and 401(a)(17)) to apply the statute on an employer-by-employer rather than on a plan-wide basis. Again,

---

[2] At the October 15, 1992 meeting, Ms. Lopez cited Rivera v. Becerra, 714 F.2d 887 (9th Cir. 1983), a social security case, as a possible analog in support of EDD's position. However, subparagraph (A)(ii) expressly does not apply at all to social security, and does apply to private pensions such as those covering SAG, AFTRA and WGA members. The Ninth Circuit recognized and articulated that distinction in its discussion of the legislative history, 714 F.2d at 893. Indeed, the Seventh Circuit Court of Appeals recognized that in the private pension context, the limitation of offset applicability to a return to work with the same employer would apply. Peare v. McFarland, 778 F.2d 354, 356-357 (7th Cir. 1985).

EDD Serving the People of California
State of California / Health and Welfare Agency

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SCREEN ACTORS GUILD
LEONARD CHASSMAN

Pete Wilson, C...no

May 4, 1993
REFER TO: 40:10:93.0241:arm
(916) 654-8210

Mr. John Humphrey
Regional Director
for Unemployment Insurance Services
Employment and Training Administration
U. S. Department of Labor
P. O. Box 193767
San Francisco, CA 94119-3767

Dear Mr. Humphrey:

In December 1992, we received a letter from the law firm which represents the Screen Actors Guild (SAG), the American Federation of Television and Radio Artists (AFTRA) and The Writers Guild of America, west (WGA, west), hereafter referred to as the "Unions." The letter requested that we reconsider our Department's position with respect to when a pension from a multi-employer pension plan is deductible from unemployment insurance (UI) benefits. Enclosed for your information is a copy of the letter dated December 22, 1992.

California law requiring the offset of pension benefits from UI benefits conforms with federal law, 26 U.S.C., Section 3304(a) (15). Based on our interpretation of both state and federal law, a pension which is based on an individual's own work is deductible from UI benefits if:

1. A base period employer on the UI claim maintained or contributed to the fund from which the pension is paid, <u>and</u>

2. The work performed by the individual <u>after</u> the beginning of the base period affected the individual's eligibility to receive the pension or increased the award of the pension.

The Unions agree with the Department that a pension received by one of their members would be deductible under the following circumstances:

> An individual worked for 30 years for employer A and employer B, both of whom had contracts with SAG and so contributed to the pension fund provided for in the collective bargaining

given the legislative admonition enunciated in §1255.3(b) and Evans, if there is any room for discretion in interpreting the federal law, the EDD must opt for the position that most severely confines the offset burden. The above discussion demonstrates that such a limiting construction is dictated by the statute.

In sum, the interpretation of the federal offset adopted by the EDD, rather than being required, is in fact not justified by its literal language. A more sound interpretation, and one in keeping with state policy, would apply the offset only where the same employer provided both the pension and the base period work resulting in pension eligibility or increase.

We hope the above persuades you to reconsider and revise the EDD's position consistent therewith. We request the opportunity to meet with you to further explicate our position and address any questions you may have, sometime in mid to late January. Please contact the undersigned so we may arrange for such a meeting. Thank you for your cooperation.

Very truly yours,

TAYLOR, ROTH, BUSH & GEFFNER
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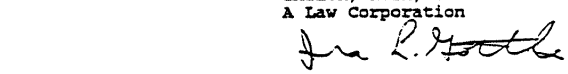

IRA L. GOTTLIEB

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Leonard Chassman
Vicki Shapiro
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Warren Kimmerling
Mark Farber
Pamm Fair
Brian Walton

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> agreement. The individual filed for UI benefits and both employer A and employer B were base period employers on the UI claim. The work performed by the individual after the beginning of the base period increased the individual's pension award.

The Unions and their attorneys urge that a pension received from a multi-employer pension plan should be deductible "only where the pension employer and the base period employer are the identical, single employer" as in the example shown above.

In those instances where the base period employer is not an employer for whom the individual worked while earning his or her initial entitlement to the pension, the Unions argue that the pension should not be deductible from the UI benefits. For example:

> The same individual mentioned above secured work with employer C some two years after applying for his SAG pension which was based on employment with employers A and B. Employer C also had a collective bargaining agreement with SAG and contributed to the pension fund on the individual's behalf while he worked. After being laid off by employer C, the individual filed a valid claim for UI benefits. The only base period employer was employer C.
>
> The Department determined that the work the individual performed for employer C after the beginning of the base period did result in an increase in the pension award. Thus, the entire pension (and not merely the increase) will be deductible from the UI benefits.

The Department's position is that employer C contributes to the same multi-employer pension fund from which the individual's pension is paid. Employer C is a base period employer and the work the individual performed after the beginning of the base period did result in an increase of the pension award.

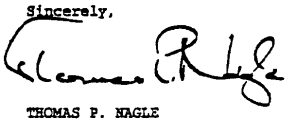
The Unions and their attorneys disagree with this interpretation. Their position is that the individual earned his initial eligibility for the SAG pension based on his work with employer A and employer B, neither of whom were base period employers in the second example. Thus, employer C is not the "pension" employer and the pension benefits should not be deducted from the UI benefits.

While the Department feels that its interpretation of state and federal law with respect to the offset of pension payments from UI benefits is correct, we agreed to request an opinion from the Department of Labor (DOL) as to whether there would be a conformity issue should our Department change its interpretation of how the pension offset law applies to pensions paid from a multi-employer pension fund and adopt the interpretation urged by the Unions.

We request an opinion as to whether the DOL would consider that the Department was exempting retirement income which meets the requirements of subparagraph (A) of Section 3304(a) (15) from deduction and whether this would result in a conformity issue.

Thank you for your assistance in this matter.

Sincerely,



THOMAS P. NAGLE
Director

Enclosure

cc: Screen Actors Guild
Ira L. Gottlieb

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SCREEN ACTORS GUILD
LEONARD CHASSMAN

File No.:
11640-0041

VIA EXPRESS MAIL

May 17, 1993

Mr. John Humphrey
Regional Director for the
Unemployment Insurance Services
Employment and Training Administration
U.S. Department of Labor
Post Office Box 193767
San Francisco, California 94119-3767

RE: Unemployment Benefit Offset by Pension

Dear Mr. Humphrey:

This is to supplement the position taken by SAG, AFTRA and the WGA, west which was set forth in my December 22, 1992 letter to Thomas Nagle, and enclosed with Mr. Nagle's May 4, 1993 letter to you.

As you are aware, it is the policy of the State of California to maximize the availability of unemployment benefits to employees in this state, and concomitantly to encourage people to seek and obtain gainful employment. The current position of the EDD does not fulfill those goals to the greatest extent consistant with applicable law, and as will be explained in this letter, in fact inhibits the search for employment among retirees. We are confident that the EDD would reconsider its policy if the Department of Labor provides it with assurances that it will not be considered out of conformity with federal law in doing so. Since there is no federal law expressly prohibiting the adoption of the Unions' position in the multiemployer context, there is no reason for the DOL to intervene in this matter. The Unions therefore urge the Department to give the EDD approval to reconsider its policy on this point.

THE PROBLEM

As noted in our December 1992 letter, especially in the current economy, the Unions' retirees find it necessary to supplement their base retirement income with earnings from new employment. Retirees already encounter severe difficulties in this endeavor because of the tendency of employers not to hire older workers, the intermittent character of the work they perform, and generally because of the dismal economic conditions that currently prevail in California.

The difficulties faced by the retirees are compounded by the problem the Unions seek to address in this letter. The industry in which the Unions' members work is dominated by a multi-employer unit consisting of individual employers who contribute to a collectively-bargained pension plan. The EDD's treatment of the unit as one large employer for offset purposes is neither mandated by federal law, nor serves the legislative purpose of avoiding having an employer pay twice to benefit an unemployed retiree. Under the current EDD regime, if a retiree works for an employer who contributes to the multiemployer pension, and as a result of that work, her pension increases, then the entire amount of her pension (not just the amount of the increase) is applied to offset any claim for unemployment benefits. The EDD applies this rule even to base period employers who did not contribute to the original pension of the employee. The deterrent effect of this rule is clear: why perform intermittent work for relatively little income and a minute increase in pension, if that increase will erase the unemployment benefits needed to tide oneself over between jobs? At least where the pension employer and base period employer are not the same, there is no rule or reason to justify that result.

LEGISLATIVE HISTORY

Our December 1992 letter provides the textual analysis supporting the desired change in the EDD's policy. Enclosed with this letter are excerpts from the legislative history demonstrating that the amendments to the federal law relating to pension offset were designed to limit that offset to "only those unemployed workers who were collecting unemployment benefits and retirement payments from the same employer" (Tab A, p.23048 (highlighted portion)). Senator Bradley's remarks

included in the booklet are to the same effect: if an employee works for an employer who is "separate and apart" from the employer paying his pension, and is laid off, he is entitled to unemployment benefits (Tab B, pp. 26040-26041). There is no reason to expand the narrow legislative focus, trained on avoiding an employer "double" payment, in the context of multi-employer-dominated industries.

That Congress was aware of the existence of such industries and nevertheless chose not to broaden the scope of the pension offset as the EDD has done is evidenced by the portion of legislative history at Tab C. Congress was addressing changes in ERISA specifically with respect to multiemployer pension plans at the very time it was enacting the pension offset amendments that are found at 26 U.S.C. §3304(a)(15) Congress recognized certain advantages to the utilization of such plans, and found them "particularly but not exclusively important in industries such as . . . the performing arts, which (is) charactarized by mobility of employees, or employers, or rapid turnover of both" (Tab C, p.2921). If Congress had wished to require expansion of the pension offset in the multiemployer context in the manner of the EDD's policy, given its consciousness of the prevalence of such plans in certain prominent industries, it would have done so. In the absence of such a clear federal requirement, the DOL need not impose one on the state of California.

CONCLUSION

In our telephone conversation last week, you mentioned that your initial response to the EDD's correspondence was to avoid intervention in the absence of a federal mandate contrary to any suggested EDD action. Acknowledging that that response was neither final nor the official DOL position at this time, the Unions urge the DOL to follow that initial impulse, and allow the EDD the latitude necessary to modify its policy in the manner advocated herein. That modification would be consistent with federal law and Congressional intent, and would effectuate California policy to the benefit of employees in this state.

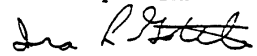
Once you have had an opportunity to consider this matter, we

would request a meeting with you to discuss the DOL's response and the steps to be taken thereafter.

Thank you for your consideration.

Very truly yours,

TAYLOR, ROTH, BUSH & GEFFNER
A Law Corporation



IRA L. GOTTLIEB

ILG:pjw

Enclosure(s)

cc: Ken Orsatti
Leonard Chassman
Vicki Shapiro
Bert Freed
Warren Kimmerling
Mark Farber
Pamm Fair
Brian Walton
Thomas Nagle (Director, EDD)

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U.S. Department of Labor

Employment and Training Administration
P.O. Box 193767
San Francisco, California 94119-3767

Reply to the Attention of: 9TGU

June 9, 1993

Mr. Thomas P. Nagle
Director
Employment Development Department
P.O. Box 826880 (Attn: MIC 40)
Sacramento, CA 94280-0001

Dear Mr. Nagle:

I am writing in reply to your May 4, 1993, request for an opinion on the issue of pension offset. In particular, you asked whether altering the Employment Development Department's interpretation of the pension offset provision as requested by attorneys for several entertainment industry unions, would raise an issue of conformity with Federal statute.

The law corporation of Taylor, Roth, Bush & Geffner, as representatives for the Screen Actors Guild, the American Federation of Television and Radio Artists and the Writers' Guild of America, hereafter referred to as the "unions", argue that by incorporating a broader than necessary interpretation of Federal pension offset provisions, California policy needlessly penalizes individuals in the entertainment industry who are covered under a multi-employer pension plan. States may, of course, choose to broaden the application of the offset provision beyond the minimum Federal requirement. However, a State may not consistently with Federal law exempt any pension income from offset if offset is required by application of the minimum Federal requirements. Although we are sympathetic to the difficulties faced by retirees, it is our opinion that adoption of the policy suggested by the unions and their attorneys would exempt from offset pensions which are subject to offset under the minimum Federal requirement.

The provisions of Federal law relevant to pension offset of unemployment insurance benefits are found at Section 3304 (a)(15)(A)(i & ii) of the Federal Unemployment Tax Act (FUTA) which states:

> "(15) the amount of compensation payable to an individual . . . which begins in a period with respect to which such individual is receiving a governmental or other pension, retirement pay, annuity, or any other similar periodic payment which is based on the previous work of such individual shall be reduced (but not below zero) *by an amount equal to the amount of such pension, retirement or retired pay, annuity or other payment which is reasonably attributable to such week* except that -

(A)the requirements of this paragraph shall apply to any pension, retirement or retired pay, annuity, or other similar periodic payment only if-

(i) such pension, retirement or retired pay, annuity, or similar payment is under a plan maintained *(or contributed to)* by a base period employer or chargeable employer . . . , and

(ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 . . . services performed for such employer by the individual after the beginning of the base period . . . affect eligibility for, or increase the amount of, such retirement or retired pay, annuity or other similar periodic payment, and" [Emphasis added.]

In letters dated December 22, 1992, (to T. Nagle) and May 17, 1993, (to J. Humphrey), Ira Gottlieb, a member of the law corporation representing the unions, has proposed that pension offset is only required when the base period employer is the same employer as that with which the employee became pension eligible and that such base period employment resulted in pension eligibility or a pension increase. Mr. Gottlieb further argues that each employer member of a multi-employer unit should be considered as a separate and distinct employer. The following example illustrates the issue.

> An individual works for employer A and employer B, for 20 years, both of whom are members of a multi-employer unit and contributed to the same pension plan. The individual establishes pension eligibility based on employment with A and B.
>
> Some years later, while drawing the pension based on employment with A and B, the same individual secures work with employer C, a member of and contributor to the same multi-employer unit/pension plan to which A and B belong. After being laid off by employer C, the sole base period employer, the individual files a valid claim for unemployment insurance benefits. Contributions by employer C to the pension plan for services performed after the beginning of the base period result in an increase in the individual's pension. Consequently, the entire pension is deducted from the individual's UI benefits.

Mr. Gottlieb contends that because the individual's initial pension eligibility was established by employment with employers A and B, neither of whom are base period employers, UI benefits following separation from employer C are not subject to any offset.

Plaintiffs in several circuit court cases[1] have raised the same argument unsuccessfully and like Mr. Gottliab, have cited the legislative history to support their argument.

The case Rivera v. Becerra(9th Circuit 1983), discusses in detail the meaning of the 3304(a)(15)(A)(i), and the appropriateness of reverting to legislative history to determine that meaning. On the issue of reverting to legislative history, the court ruled that the meaning of the statute is clear on the face and hence resort to the legislative history is not necessary. The court did not agree with the plaintiff's argument that pension offset was only required when the pension eligible employer and the base period employer are one and the same. Although the pension plan in question in Rivera was a Social Security pension, the court's determination was based on its interpretation of 3304(a)(15)(A)(i), which is applicable to both private and government pensions. The offset applies under section 3304(a)(15)(A)(i) if the base period employer "contributed" to the plan from which the pension benefits are derived. Section 3304(a)(15)(A)(ii) makes a further stipulation for offset of private pension plans that services performed "for such employer by the individual after the beginning of the base period . . . affect eligibility for, or increase the amount of such pension." This requirement is applied equally to both single employer units and multi-employer units.

Clearly in the above example, employer C is a base period employer who had contributed to the plan from which pension benefits are derived and services for such employer (employer C), have resulted in an increase in the pension amount. The 1980 amendments to the federal offset provisions lowered the minimum requirement to require offset for "only those unemployed workers who were collecting unemployment benefits and retirement payments from the same employer." In the above example, offset is required to preclude the individual from drawing UI benefits and the pension (amount of the increase) from employer C. Conversely, if the services performed for employer C did not affect the individual's eligibility for or cause an increase in the amount of the pension, no offset of UI benefits would be required under FUTA.

Offset of only the amount of pension increase based on employment with employer C would appear to be a more equitable alternative to offset of the total amount of the pension. However, as ruled in the Ninth Circuit, by which this office and EDD is bound, the language of the statute does not permit proportional offset. When the conditions of 3304(a)(15)(A)(i & ii) are satisfied the amount of compensation payable to an individual shall be reduced (but not below zero) by an amount equal to the amount of the pension.

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[1] Rivera v. Becerra, (9th Circuit 1983); Peare v. McFarland, (7th Circuit 1984); and Walker v. Donovan, (Eastern District Michigan, Southern Division, 1986)

In summary, it is our opinion that amending EDD policy to discontinue pension offset when the pension amount has been increased based on services performed in the base period, and the base period employer has contributed to a multi-employer pension plan, would raise an issue of conformity with the minimum requirements of Section 3304(a)(15), FUTA.

Questions concerning this information should be referred to Jamie Bachinski at (415) 744-6648.

Sincerely,

Don A. Balcar
Regional Administrator

cc: Ira Gottlieb, TAYLOR, ROTH, BUSH & GEFFNER, A law Corporation

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VIA FACSIMILE

January 22, 1997

Leonard Chassman
Hollywood Executive Director
Screen Actors Guild, Inc.
5757 Wilshire Boulevard
Los Angeles, California 90036

RE: Unemployment Insurance/Pension Offset

Dear Leonard:

You have asked that we research and respond to the question of what problem or abuse was sought to be remedied by the original federal legislation authorizing offset of unemployment benefits by pension payments. The answer to that question calls for a discussion of the historical development of the law, because it started with a stark rule that disqualified all recipients of pension from receiving any unemployment benefits, but was quickly moderated to avoid the harshest results of that rule, enabling those who had not left the work force to still collect benefits, with certain exceptions and limitations. It is our position in seeking this legislation that further refining is necessary and appropriate to effectuate the Congressionally-stated purpose of the offset, while focusing in on the specific abuses that Congress originally wished to address.

The offset provision was first enacted in 1976. It originally called for the subtraction of all pension benefits from unemployment benefits, without regard to identity that might exist between the pension employer(s) and base period employer. The rationale was articulated by the Senate Committee on Finance, as follows:

> It was brought to the attention of the committee that in a number of states retired people who are receiving public and private pensions, railroad retirement annuities, social security retirement benefits, military retirement pay, etc., and who have actually withdrawn from the labor force are being paid unemployment compensation. In other States, various rules are used to disqualify some or all of these people. The committee believes that a uniform rule is required and has added to the bill a new provision requiring each State to prohibit the payment of unemployment compensation to any individual who is entitled to any government or private retirement pay, retirement pension to [sic] retirement annuity based on previous employment.

Senate Report No. 94-1265, 94th Cong., 2d Sess. 21-22, reprinted in 1976 U.S. Code Cong. & Ad. News 5997 at 6015-6016.

Thus, as noted above, and in the statements of lawmakers explaining the amendment that took effect in 1980, Congress expressed concern with the problems of undeserving people who were not actively looking for work receiving unemployment compensation, and that of variance among the states in their interpretation and application of this law.

Directly after the (1979) effective date of the original offset law, Congress amended it to ameliorate some of the harsh results that were engendered by its broad, literal application. Congress added the provision that offsets would only occur where the pension employer and the base period employer (or more specifically, where the retirement plan of the pension and base period employers) were the same. That amendment significantly narrowed the impact of the offset, more justly and appropriately limiting it in most non-Social Security cases to situations in which the retired employee went back to work for the pension employer and that work caused an increase in, or eligibility for, the pension amount, thus arguably "abusing" the system, or double-dipping, which appears to be one of the concerns expressed by the Finance Committee in the passage quoted above.

The 1980 amendment attempted to "fine-tune" the statute to continue to address perceived abuses, consistent with the original intent of the first enacted legislation, while avoiding some of the punitive, overbroad applications to circumstances that were not condemned by the Finance Committee. See, e.g., Peare v. McFarland, 778 F.2d 354, 355

(7th Cir. 1985); Rivera v. Becerra, 714 F.2d 887, 893 (9th Cir. 1983); Evans v. Unemployment Ins. App. Bd., 39 Cal. 3d 398, 408 (1985). Thus, Senator Dole remarked that the amendment was appropriate because --

> The offset provision was too broadly drafted in the original legislation and would penalize many legitimately unemployed individuals simply because they had earned pension benefits from a previous employer. Under the bill, only the portion of a pension contributed by the employer to whom the unemployment is attributable is required to be offset. This should assure that individuals who are actually unemployed rather than retired will not be penalized while conversely assuring that individuals who are, in fact, retired are not drawing unemployment benefits.

126 Cong. Rec. S.2096 (March 4, 1980).

Similarly, Senator Javits noted that

> (i)f a claimant has retired from an employer with a pension and has then taken another job, he or she has certainly demonstrated current labor market attachment and an intent to work. So application of the pension offset in these circumstances is unfair and unnecessary to prevent the abuse of the UI system by retirees that has been alleged.

126 Cong. Rec. S. 2101 (March 4, 1980).

The California Supreme Court articulated several of the pungent criticisms pointed out by the National Commission on Unemployment Compensation, which reported to Congress during the legislated hiatus between enactment and the effective date of the original legislation:

> . . . the Commission stated that the pension offset provision was both unfair and misguided. In the Commission's view, this was a matter best left to the several states in their administration of unemployment compensation. The Commission condemned the amendment[1] for introducing an

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[1] The "amendment" referred to in this passage is the original pension offset statute, which itself was an amendment to the Internal Revenue Code.

> inappropriate "needs test" into unemployment compensation, an approach fundamentally incompatible with the social insurance philosophy underlying the basic program. In addition, the Commission noted that, in the present economy, many workers are pushed into early retirement by industry-wide layoffs and that, while these workers may qualify for an early retirement pension, they are also still in the labor force, actively seeking new employment. What is more, a pension offset unfairly discriminates against workers wholly dependent upon income from pensions and unemployment compensation, while workers with other sources of income, from rental property, for example, or investments, are not penalized.
>
> Finally, the Commission observed that the pension offset provision as enacted was ill-suited to solving the problem of double payments by a single employer to the same retiree. In many cases the base-period employer, who bears a portion of the cost of unemployment compensation, is not the same employer who contributed to the retiree's pension.

Evans, supra, 39 Cal. 3d at 409.

As the newly amended legislation was written, it was attacked in the Courts by people who sought further judicially-crafted limitations on its applicability. Litigants argued that the offset should be limited in amount to the increase in retirement benefits caused by the post-retirement return to work, not the entire amount, where an employee goes back to work for the social security employer; and, some argued that the offset should not apply at all where the social security employer and base period employer were the same, see, e.g., Rivera v. Becerra, 714 F.2d 887 (9th Cir. 1983); Bowman v. Stumbo, 735 F.2d 192 (6th Cir. 1984); Watkins v. Cantrell, 736 F.2d 933 (4th Cir. 1984); Edwards v. Valdez, (10th Cir. 1986). Those arguments were uniformly rejected by the Courts, because they determined that the language of the statute was clear, even though there was some legislative history that supported the more generous view.

Thus, we repair to Congress to seek further amelioration of the language of the statute, fully consistent with and in the spirit of the moderating intent of the 1980 amendments. Our proposed amendment seeks to avoid economic harm to those who Congress evidently did not mean to catch in the offset net: those who are genuinely back in the labor market after

Leonard Chassman
January 22, 1997
Page 5

retirement, and are not both out of the labor force yet collecting unemployment. If the entertainment industry employees we seek to assist were not often employed by one multiemployer group contributing to one virtually all-encompassing retirement plan, then they would probably already have relief from the offset, which they should receive consistent with the intent of the 1980 ameliorative amendments. Since it so happens that they are part of a multiemployer-dominated industry, they are entangled in a net from which this limited proposed legislation seeks to free them.

In addition, the proposed legislation seeks a further equity by limiting the offset, where otherwise applicable, to the increase in the amount of pension due to the new work performed. That avoids much of the deterrent that otherwise is confronted by workers seeking to rejoin the workforce, while still drawing the line at any abuse that might come into play with an employee receiving both unemployment and an increased pension from the same employer.

For your information, I am enclosing with this letter a booklet we put together to submit to the California Employment Development Department entitled, "Legislative History of Pension Offset", which contains highlights of some of the Congressional discussions of the 1980 amendments.

I hope the above proves informative and helpful. Please feel free to call to discuss it; while you may wish to pass this letter along to Mr. Brandon or other interested people as it is, I would be happy to edit, condense or expand it to suit your purposes.

Very truly yours,

GEFFNER & BUSH
A Law Corporation

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Chairman SHAW. Thank you. Mr. English, your name was mentioned. Why don't you inquire?

Mr. ENGLISH. Thank you. Mr. Masur, I very much appreciate your testimony here today, because I think you brought before the Subcommittee in fairly vivid and specific terms how this perverse pension offset which was put in with perhaps the right intentions particularly affects some people involved in your profession.

The only question I have, and this is something I've been trying to puzzle through the last few days, is how this pension offset would also potentially interact with the Social Security earnings limitation, which is an offset in part.

It seems to me there might be some people in the age bracket of 65 to 69 who would be hit with two offsets at the same time, and, in effect, would be invited to go to work, take a substantial cut in the Social Security benefits, and after work, qualifying for unemployment benefits, would in effect lose the bulk of those as well.

So this would be a huge disincentive for people to work. Have you run into instances where actually for this reason motion pic-

ture association members are unable to attract as many actors as they would like for these sorts of roles?

Mr. MASUR. Well, actors, as I'm fond of telling people, never retire. They don't fade away. They just work until they drop or can't do the work anymore.

So it takes a lot of discouragement to keep our senior performers from going to work.

Mr. ENGLISH. I understand.

Mr. MASUR. But I don't know that there have been any cases where they haven't been able to attract the appropriate people for the work.

I do know there has been extreme concern about this new burden caused by a thoughtful action by our pension plan which didn't use to credit current work in terms of increased benefits, but now senior actors fall under this harsh offset.

So when the plan changed the way we did our business, unfortunately it put all of our members in a situation where suddenly they lost nearly all their unemployment benefits.

So they've been very upset about this for about 8 or 9 years now.

Mr. ENGLISH. Well, we appreciate your coming before the Subcommittee again following up on Mr. Heston's testimony last year. This is something, Mr. Chairman, I'd very much like to see addressed this year, if we have the opportunity.

And again, I yield back the balance of my time. And I also want to thank the other panelists, because this is a very good panel.

Chairman SHAW. Mr. Levin.

Mr. LEVIN. No questions. I think everybody has presented their case very well, Mr. Chairman.

Chairman SHAW. Thank you. Mr. Whitefeather, I want to also point out that Mr. Ramstad also encouraged your appearance here today. I'd like to also note the appearance of our former colleague, Mr. Sikorski. Welcome back. Nice to see you.

Then I'd thank all the members of this panel for being with us this afternoon. I think it has been a very enlightening few hours here.

Thank you very much, and the hearing is concluded.

[Whereupon, at 1:12 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Duane Parde, Executive Director, American Legislative Exchange Council

I. BACKGROUND

The employment security system, created in the 1930s, consists of three programs, unemployment insurance, labor exchange (employment service), and labor market information. Unemployment insurance is designed to alleviate hardship with temporary benefits for workers who have lost jobs without fault on their part. The labor exchange (available to benefit recipients as well as others looking for work) seeks to match job seekers with openings listed by employers. Labor market information programs provide useful labor statistics, including data on unemployment levels.

These services are provided through state employment security agencies (SESAs), staffed by state employees, who take and pay unemployment claims, run the labor exchange, and collect and disseminate labor market statistics. Unlike the typical state agency, which is supported by state general revenue, SESAs rely for their administrative funding primarily on federal grants received from the U.S. Department of Labor (DOL).[1] As with most federal grants, many conditions are attached and regulatory oversight from DOL is intense.

These administrative grants are funded by a federal employer payroll tax, collected by the IRS, under the Federal Unemployment Tax Act (FUTA). The tax is levied at a rate of 0.8% on the first $7,000 of each worker's wages. Included in the present 0.8% rate is a 0.2% surtax scheduled to expire December 31, 1998. Some of the FUTA funds are deposited into separate federal trust accounts to pay for extended benefits ("EB"),[2] the "EUCA" account, and to make loans to insolvent state jobless trust funds, the "FUA" account.

II. PROBLEMS

The present bifurcated employment security system has created serious problems in the eyes of ALEC's public and private sector members:

Overtaxation. The main purpose of the FUTA tax is to finance salary and overhead expenses for the SESAs. But in FY 1996, only $3.38 billion, or 58 percent, of $5.85 billion collected under FUTA was returned to the States to run their agencies. The rest was not appropriated by Congress (to offset the federal deficit); spent on IRS and DOL bureaucracy; or deposited in the rarely used EUCA and FUA accounts. The federal government thus removed $2.5 billion from the private sector, which could have put those dollars to work—in capital reinvestment, in hiring more workers, in increasing employee pay or benefits, or in dividend distribution.

Unnecessary Tax Paperwork. The IRS spends $70 million each year in collecting the FUTA tax, and business spends more than $290 million annually in filling out FUTA forms. This is because employers must complete both a federal unemployment tax return (to pay for SESA administrative costs), and a state return (to finance jobless benefits), rather than using a single form.

Shortchanging of States. Not only is less than 60% of FUTA revenue given back to the States, but esoteric allocation formulas devised by DOL compound the problem. All but five States and the Virgin Islands received less money in FY 1995 (the most recent information available) than their employers paid in FUTA taxes. And 20 States got back 50 percent or less of the FUTA tax money they sent to Washington.

For example, Tennessee, which paid in $120.8 million and received grants worth just $43.6 million, or 36.1 percent. Other States with eye opening grant-to-tax ratios are North Carolina, 36.6 percent; Florida, 36.7 percent; Indiana, 37 percent; Georgia, 38.9 percent; Virginia, also 38.9 percent; and Ohio, 39.2 percent.

Unproductive Federal Trust Accounts. At the end of FY 1997, the EUCA account, which pays for EB benefits, will contain $9.43 billion; the FUA account's balance, from which loans to state trust funds are made, will be $6.72 billion. The EB program has rarely been used, even during the early 1990s recession, resulting in large balances. The loan program has seen little activity since the early 1980s, when the federal government began charging interest for loans not repaid within the same fiscal year.

The effect of these large balances is to conceal the true size of the federal deficit, since the trust fund accounts exist within the unified budget, and, in essence, to fi-

[1] A separate state tax finances actual benefit payments to the unemployed.

[2] Under the EB program, individuals who have exhausted their benefit eligibility may receive an additional 13 weeks in payments, but only when the unemployment level in their State reaches a "trigger point."

nance other government spending—which the FUTA tax was never intended to cover.

Inefficient Service Delivery. The present employment security system promotes inefficient service delivery by SESAs in several ways:

• distinct federal funding streams for different activities (unemployment insurance, labor exchange, labor market information) inhibit economies of scale by making it difficult or impossible to pool monies for personnel and overhead expenses.

• burdensome DOL rules, restrictions, and requirements result in "bean counting" and paperwork proliferation. This has been estimated to consume not less than four percent of a SESA's personnel resources.

• states receive grant amounts based on archaic DOL formulas; there is no incentive for economy or better performance since these do not affect funding levels.

Most important, however, America's state legislatures have no role in the employment security system. This is because the federal government sets both the administrative tax rate and the grant amounts which state agencies receive to run their programs. SESA program priorities thus are set on a "one-size-fits-all" basis in Washington, rather than by legislators who know the most about designing an employment security system that meets local needs. Likewise, employers and citizens are denied an effective voice in the system, because their local elected representatives lack any real authority.

III. The ALEC Reform Plan

The ALEC plan for employment security system reform embraces three simple but essential elements captured by the words "replacement," "repeal," and "redistribution."

Replacement of FUTA with State-set administrative taxes.[3] Most of the problems in the present system can be erased by this single reform. If state legislators were permitted to set an administrative tax rate to finance their SESAs, the following beneficial changes would occur.

• Overtaxation of employers, caused by the federal government's failure to return to the States more than two-fifths of the FUTA revenue collected each year, would end. Most States would be able to set an administrative tax rate far lower than the current FUTA level without reducing agency operating budgets. Annual savings: $2.5 billion.

• Unnecessary paperwork for employers would be done away with, since they could file a single state return for both administrative and benefit taxes. Annual savings: $290 million.

• States would no longer be shortchanged by DOL administrative grants, since each State would set a tax rate commensurate with the funds it wants to spend on its agency.

• State agencies would be able more efficiently to allocate resources with the disappearance of separate funding streams.

• Budget, taxing authority, and program oversight responsibility would be lodged in a single level of government closer to the citizens. This would encourage more efficient operation, and enable States to set agency priorities and performance standards consistent with the needs of their employers and workforce.

Repeal of burdensome DOL grant conditions. The DOL rules, restrictions, and requirements that currently accompany federal grants and hinder effective agency operations would be replaced with substantive oversight from state legislators. Of course, some basic federal protections would remain, like uniform minimum employer coverage standards and due process safeguards for persons whose claims are denied.

Redistribution of EUCA and FUA funds. By terminating the unnecessary federal EB program (and letting States enact their own), and using general revenue to back the current loan program for state trust funds, more than $16 billion could be redistributed to state jobless trust accounts. With vastly increased trust assets, States would have a menu of attractive options: cutting benefit taxes (or in some cases even enacting moratoria), improving benefits, or just bolstering trust fund solvency.

ALEC also advocates using $2.7 billion in unappropriated administrative revenues to hold harmless for five years those few States that now receive more in federal grant money than is attributed to employment in their States; to provide a one-time enhancement of administrative revenue for other states; and to pay for necessary transition costs. Also, to limit any impact on the national deficit, state administra-

[3] This would be accomplished by permitting the 0.2% surtax to expire, and raising from 90% to 100%, the credit received against the actual 6.0% tax rate by employers in States with programs conforming to remaining federal standards.

tive funds would continue to be deposited in Washington-based accounts, except that each State would have its own dedicated account into which to deposit tax revenue and make withdrawals to pay for SESA salaries and overhead costs.

IV. The "UBA–ES Administrators" Plan

At ALEC, we have also had an opportunity to review the draft of another plan calling for changes in the employment security system. This plan is supported by UBA, Inc., and several state employment security administrators.

On the whole, the "UBA–ES" proposal offers only minor improvement in some parts of the system; in other respects, it actually makes things worse. Unless the Subcommittee is willing to make changes going beyond those recommended by "UBA," we would urge retention of the status quo.

This statement is not the place for a detailed analysis of the "UBA–ES" plan, but ALEC does wish to draw the Subcommittee's attention to fundamental differences that separate the two plans.

Unlike the ALEC plan, the "UBA–ES" approach maintains the FUTA tax, rather than effectively eliminating it. As a result, employers would be denied more than $1 billion in tax relief available only under the ALEC plan.[4] Although UBA would permit States to keep most of the revenue raised by the FUTA tax in their States, this money would go straight to expansion of state agency budgets. Many agencies would receive windfall increases of more than 50%.

State legislators would still have no effective control over the rate of tax and agency . budgets. As a result, legislatures would be deprived of the ability to establish priorities and design employment security systems responsive to the needs of their employers and their workforces. State agencies would have no incentive to become more efficient, since their funding would be guaranteed.

The "UBA–ES" plan increases DOL regulation by requiring state agencies to make new reports to Washington on such matters as the proportion of claimants using re-employment services and the proportion of employers using employment services.

The "UBA–ES" proposal continues to mandate the federal EB program on the States, even while redistributing to them funds in the EUCA account. The ALEC plan permits states full freedom to determine the conditions, if any, under which benefits should be extended.

The "UBA–ES" plan fails to redistribute $6.7 billion in assets located in the FUA account to state jobless funds, limiting States' ability to provide benefit tax relief, to increase benefit payments, or to raise trust fund solvency levels.

V. Conclusion

In considering changes to the Nation's employment security system, ALEC observes that a sharp contrast exists between its approach and that of UBA and the ES Administrators.

The "UBA–ES" idea is that state agency bureaucracies should be arbitrarily inflated without oversight or interference from state legislators or taxpaying employers, and that Washington regulation must be intensified.

The ALEC concept promotes maximum employer tax relief, substantial deregulation and paperwork reduction, and handing back real taxing and decision-making power to state legislators who, after all, are closest to the people the employment security program is intended to serve.

We hope the Subcommittee will cut taxes and bureaucracy and reinvigorate our federal system by writing legislation consistent with the principles I have described here.

Attachment: "Resolution To Transfer the Employment Security System to the States," American Legislative Exchange Council.

[The attachment is being retained in the Committees files.]

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[4] Both plans contemplate some tax relief when the 0.2% FUTA surtax expires at the end of 1998.

Statement of American Society for Payroll Management, New York, New York

ASPM is a professional association of the senior managers who control the preparation of payroll and employment taxes for large employers in the United States. We represent large employers, systems vendors and tax service providers. As a group, we collect and account for a major proportion of the income and employment taxes the Internal Revenue Service receives.

ASPM wishes to submit this statement for inclusion in the printed record of the of the hearing, although ASPM will not be testifying in person. FUTA reform efforts greatly affect the work of our members and we believe that comments from the payroll professional community should be heard.

We are writing to express our concern about the proposal under active consideration for inclusion in the FY98 budget to mandate monthly collection of both federal and state unemployment insurance taxes. This proposal makes little economic sense and would impose unnecessary burdens on both employers and program administrators. We find it quite inconsistent with government initiatives such the Simplified Tax and Wage Reporting System ("STAWRS") that was created to focus specifically on ways to reduce tax and wage reporting burdens

Companies represented by our organization withhold, report, and deposit a large proportion of all taxes paid to the Treasury each year. For years, we have worked closely with the IRS and other government agencies to simplify the tax and wage reporting process. Recently, we met with officials at the Treasury, the Department of Labor and program officials within OMB in an attempt to understand a policy rationale that would justify the burdens imposed by this proposal. The only justification that we heard was that, even though most of the UI taxes collected are state revenues, the change can be "scored" as a one-time federal revenue raiser in the year of implementation. This budget justification ignores the real cost of the increased financial and administrative burden imposed on both federal and state tax administrators—and on our nation's employers.

It was most troubling to learn from these meetings that little consideration had been given to the additional compliance burden imposed on employers. In light of the Administration's commitment to both paperwork reduction and STAWRS, we find this to be quite disappointing. Furthermore, from these sessions it became clear that this concept was developed without significant evaluation of its potential impact on the unemployment insurance ("UI") program. It appears to have been developed exclusively as a "revenue raiser" without meaningful input from the federal agency responsible for UI program policy.

The current two-track federal/state system for collection of FUTA/SUI taxes has been estimated by state government and employer groups to cost employers somewhere between $290 to $500 million a year in processing costs. Increasing employers' UI filing obligations from 8 to 24 times annually will only exacerbate the problem. It would increase payroll processing costs by an amount that in the aggregate will be measured in the hundreds of million dollars every year—all to achieve a one-time technical accounting speed-up in the year 2002. We believe the long-term burden far outweighs the short-term benefit. The burden would be especially onerous for small business and would be inconsistent with the purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, which is intended to lessen legal, administrative and reporting requirements imposed on small businesses by the federal government.

In measuring the overall impact of this proposal, it is important to remember that the increased state administrative cost is in reality a federal outlay, since such expenses must be appropriated from the Unemployment Trust Fund. To the extend that the federal government chooses not to appropriate additional funding to cover the states' increased administrative burden, the states will be confronting yet another form of unfunded mandate coming to them from Washington. Moreover, any reduction in available funds for administration of employment services would further increase outlays reflected in the federal budget, by reducing employment services to unemployment compensation claimants, who in turn would draw additional benefit payments.

As you work to complete preparation of the FY98 budget submission, we would ask you to give most serious consideration to the overall implications of this proposal. When evaluated with a full appreciation of (I) its impact on both federal and state UI tax administration and (ii) its significant new administrative burden on employers, we do not believe that it can be defended from a either a policy or budget perspective.

When enacted, the surtax was to be a temporary surtax to help keep the FUTA trust funds solvent. The trust funds now have substantial surplus balances. The

funds collected in this trust fund may not be used for any other purpose, so the surtax does not really help reduce the deficit in overall spending, except on paper.

The acceleration of payments is a budget gimmick to show a first year only increase from collecting taxes two months earlier. This funding would also go into the trust fund and would do nothing to relieve the overall deficit. More importantly, this proposal has a very significant cost burden to both employers and to the state and federal agencies that collect and account for these taxes. The proposal would triple the cost of paying and collecting these taxes in exchange for a one-time paper benefit to the revenue budget. The current system could be more meaningfully reformed by having the states collect all unemployment taxes under their own rules and forward the federal portion to the IRS

This would produce real, on-going budget savings by eliminating federal salaries and administrative expenses presently used for collection efforts. There are opportunities for real reform of the UI system, but the budget proposals only create further unnecessary burdens on employers. ASPM, the employer community and the state unemployment agencies strongly oppose this proposal.

Respectfully submitted,

Clark G. Case
Vice President of The American Society For Payroll Management
Government Relations Committee Chair
Financial Systems and Employee Accounting Manager
City of Winston-Salem, NC
cc: Dan Glum, ASPM President
ASPM Board Members
ASPM Government Relations Committee Members

Statement of Don Novey, President, California Correctional Peace Officers Association, West Sacramento, California

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to submit testimony before you regarding a serious problem with the Federal Employment Tax Act. Under this law, states are prevented from denying unemployment insurance for private sector employment during an inmate's incarceration when an inmate is released from prison. Failure for a state to conform with the federal statute would result in the loss of federal tax credits to all businesses in that state.

The California Correctional Peace Officers Association (CCPOA) represents over 25,000 correctional and parole officers in the State of California. CCPOA strongly supports passage of H.R. 562, introduced by Congressman Bill Thomas. H.R. 562 would correct this flawed law by denying unemployment benefits for hours worked for a private sector employer when incarcerated. Since inmates are not eligible for unemployment benefits for working for a non-profit or public sector employer while in prison, this bill would provide this same exemption to private sector employment.

In a nut shell, prisoners should not be entitled to unemployment benefits simply because they released from prison and therefore out of a job. These men and women are not being laid off from a job. If prisoners are able to work while in prison, it is a privilege he or she is being granted. Inmates are in prison to serve a debt to society. Taxpayers already pay a high cost for their crimes—from the victims themselves who pay the ultimate price to the taxpayers who must pay for the inmate's incarceration. H.R. 562 needs to be enacted into law so that inmates are not entitled to the same unemployment benefits provided to law-abiding and hard working men and women who lose a job through no fault of their own.

In 1990, voters in California approved proposition 139, which established a joint venture program between the private sector and the state Department of Corrections. Businesses were provided the opportunity to set up operations inside prisons. This program generates savings and revenue for the state. Wages to an inmate are subject to local, state and federal taxes. Twenty percent of the inmate's salary is used to pay restitution to victims. An inmate's salary is also used to offset the costs of incarceration and to support his or her family. The inmate benefits from the program by learning skills and twenty percent of his or her salary goes into a savings account which is available to the inmate upon release.

There was a loophole in the California law that was subsequently corrected. Existing state law provided that inmates would be eligible for unemployment benefits on the basis of his or her employment in a joint venture program once released from prison. CCPOA was a leader in the state effort to correct this serious problem. On

March 26, 1996, voters in California overwhelmingly passed Proposition 194, which prevented prisoners from collecting unemployment benefits for employment in a joint venture program once paroled.

The United States Department of Labor, however, has determined that California's new law (Section 2717.9 of the State Penal Code) raises a conformity issue under federal law (Section 3304(a)(10) of the Federal Unemployment Tax Act). Lack of conformity with federal law would result in a loss to all Californian businesses of a federal tax credit, which lowers their federal unemployment tax payments. The Department has advised the State of California that there are various ways to get around the conformity problem, such as making inmates participating in the program employees of the state. We find this suggestion nothing short of outrageous. Taxpayers already pay for an inmate's room, board, education, exercise facilities, medical and dental expenses, and more. To make these inmates employees of the state is a serious insult to correctional officers who are responsible for ensuring the public is safe from this criminal element.

The Department's response—here's how to get around the problem—is completely unacceptable. The issue clearly needs to be addressed and corrected by Congress. Unemployment insurance is meant to provide assistance to working men and women who lose their jobs through no fault of their own. It is not meant for a convicted criminal who is paroled out of a job. The prisoner was granted the job as a privilege while serving time for breaking the law.

For these reasons, CCPOA strongly urges this Subcommittee to pass H.R. 562 and move this bill to the floor of the House in the very near future. We commend Congressman Thomas for his leadership and the Chairman of the Subcommittee for addressing this issue at today's hearing. Thank you again for the opportunity to present testimony on this important issue.

Statement of Jennifer A. Vasiloff, Executive Director, Coalition on Human Needs

The Coalition on Human Needs opposes the legislation (H.R. 125) introduced by Representative Phillip Crane (R–IL) which would overturn a key court case protecting the rights of unemployed workers to collect unemployment insurance benefits due them in a timely manner. The Coalition on Human Needs is concerned that enactment of H.R. 125 would have a particularly harmful effect on low wage workers and former welfare recipients making the transition to paid employment. Given the extensive changes enacted last year as part of welfare reform, efforts to delay access to unemployment compensation could have particularly grave consequences on vulnerable workers and their families.

H.R. 125 is an attempt to reverse the US Court of Appeals, 7th Circuit, decision in the Luella Pennington vs. Lynn Dohorty, Director of the Illinois Department of Employment Securitycase. In the 1994 Pennington decision, the court ruled that the state must count an applicant's most recent earnings information in determining an applicant's eligibility for unemployment insurance compensation. In its decision, the court affirmed the federal requirement that states must pay benefits in a timely manner. The court rejected the state's claim that counting the most recent earnings was administratively infeasible.

H.R. 125 would reverse this court decision and allow Illinois to continue the administrative shell game of delaying the payment of benefits to workers that they have already earned and are entitled to receive. Therefore, H.R. 125 must be rejected.

Current attempts to limit access to the unemployment insurance compensation system must be considered in the context of the historic drop in the number of people able to access the unemployment system at all. In 1975, seventy five percent of the unemployed received benefits. Today, only about a third of all unemployed workers receive unemployment compensation. The unemployment compensation system should be reformed to cover more unemployed individuals not to impose new barriers to accessing earned benefits.

The Department of Labor has estimated that if states used the most recent earnings information available to calculate eligibility, an additional six to eight percent of the unemployed would receive benefits. The study also estimated that paying these individuals the unemployment compensation they are due would only increase the cost to states by four to six percent. This discrepancy is due to the fact that many individuals who would qualify for benefits if their most recent earnings information were counted have below-average earnings levels and therefore would qualify for only minimal benefits.

The group of low wage workers who would benefit from a state using their most recent earnings information to calculate eligibility includes higher proportions of women, minorities, younger workers and workers with limited education. This is exactly the population that the welfare reform law, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PL 104–193), targets to move into work. Workers fitting this profile already face unemployment and underpayment rates between four and five times the national average. Furthermore, they are more likely to be required to leave a job due to disruptions in child care or the illness of a family member.

The Personal Responsibility and Work Opportunity Reconciliation Act imposes on poor individuals strict new work requirements and lifetime limits on the receipt of cash assistance. Welfare recipients are being pushed to enter a low wage labor market characterized by high levels of volatility and contingent work in addition to low wages and a general lack of benefits. Thus, individuals, such as former welfare recipients, working in low wage jobs are likely to face periods of unemployment through no fault of their own.

Delaying payment of unemployment benefits these individuals have already earned is not only unjust, but also could result in extreme economic hardship. For example, if an individual who loses her job has worked long enough and earned enough to qualify for unemployment benefits—but only if the state counts her most recent quarter of earnings—she and her family could be left with no benefits for up to six months if Pennington is reversed. If this same individual, despite having demonstrated a strong work effort, had previously exhausted her time limit of assistance under the Temporary Assistance for Needy Families (TANF) block grant, it would be even more important that she have prompt access to any unemployment benefits she had earned. If these individuals cannot access their unemployment benefits promptly, there may be no other income support available to them.

It is indefensible to refuse to pay earned unemployment benefits in a timely fashion. Significant delays in access to such benefits are very likely to force some low wage workers onto welfare, or—if they have exhausted their TANF benefits—into even more desperate poverty from which they may never escape. This would be a devastating blow to poor workers who have made every effort to play by the rules and achieve work-based self-sufficiency for their families.

In conclusion, enactment of H.R. 125 would cause grave injustices to be committed against our nation's most vulnerable workers. It would place additional barriers in the way of individuals moving off of welfare and into jobs. The unemployment compensation system should be reformed to cover more workers who are clearly attached to the labor force, not to impose new barriers to accessing earned benefits. The Coalition on Human Needs urges Congress to reject H.R. 125.

The Coalition on Human Needs is an alliance of over 170 national organizations working together to promote public policies which address the needs of low-income and other vulnerable Americans. The Coalition's members include civil rights, religious, labor and professional organizations and those concerned with the well-being of children, women, the elderly and people with disabilities. The Coalition on Human Needs also works with grassroots groups across the country that share an interest in the human needs agenda.

Statement of Eastern Band of Cherokee Indians, Cherokee, New York

The Eastern Band of Cherokee Indians, located in western North Carolina, is pleased to have an opportunity to submit written testimony to the Human Resources Subcommittee regarding the Subcommittee's consideration of Congressman John Shadegg's bill, HR 294, the Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments. We were particularly pleased to learn that the Subcommittee heard testimony from Congressman Shadegg and Bobby Whitefeather, the Chairman of the Red Lake Band of Chippewa Indians. The Eastern Band strongly supports this legislation, and respectfully urges the Subcommittee to include it within any legislation the Ways and Means Committee reports the House amending the Federal Unemployment Tax Act (FUTA).

Congressman Shadegg's bill would simply amend the tax code to clarify that Indian tribal governments are to be treated in the same manner as state governments and local governments. This bill would ensure equity, but it would not give tribal governments any greater privileges than all other forms of government now receive. Furthermore, HR 294 would not have any negative impact on state coffers, and would save federal, tribal, and state government funds which are currently lost be-

cause of sporadic and uncertain enforcement, coverage, and expensive dispute resolution efforts.

The Constitution, the Congress, the Supreme Court, and all Administrations since President Richard Nixon have long recognized that Indian tribes are sovereign governing entities. However, under FUTA as it now stands, "Indian tribal government employers" are not expressly included within the definition of "government employers." This ambiguity has been the subject of differing interpretations by the U.S. Internal Revenue Service, the U.S. Department of Labor and by state governments. Even within the same federal agency the interpretations have differed from region to region and state to state. Furthermore, the interpretation has varied over time. Clearly this is not a workable situation.

In April of 1996, the Department of Labor sent out an Unemployment Insurance Program Letter to all state employment security agencies prohibiting states from treating the Indian tribal governments, located within their borders, as governments for the purposes of FUTA. The IRS has not taken a consistent position, but certain regions have indicated that, for the purposes of FUTA, they will consider tribal governments to be mandatorily covered as "private employers." For the federal government to prohibit state governments from treating tribal governments as governments violates Congressional intent, and it could unnecessarily strain and confuse state-tribal relations.

The practical consequences of the treatment of tribal governments under FUTA are substantial. FUTA is a joint federal-state taxation system that levies two taxes on private sector employers: a 0.8% federal unemployment tax and a state unemployment tax ranging from near zero percent to more than 9.0% of the payroll wages. Since the 1930s FUTA has exempted all federal, state and local government employers from the 0.8% federal FUTA tax. Additionally, it allows government employers to contribute into the state unemployment funds on a reimbursable basis. That is, government employers only reimburse the unemployment insurance system for claims that are actually paid out to former employees. Whereas, private employers pay FUTA taxes in advance through a flat tax rate which runs up to 9% in some states. Congressman Shadegg's bill would simply extend the same status to tribal government employers that is enjoyed by these other government employers. This bill is all the more important, as tribal governments continue to take over more and more of the functions that used to be provided by the federal government. As Tribes take over these federal functions, they are being required to absorb high FUTA taxes from which the federal government was exempt when it carried out those functions. The bill would correct this injustice.

Just as with state and local governments, all employees of the tribal government should be treated as government employees for the purpose of FUTA. Neither FUTA nor the IRS distinguish between state or local government employees who carry out "traditional" government functions and those state or local employees who work in business-type activities that are wholly-owned and controlled by state and local governments. Such activities provide substantial revenues to state and local governments. In fact, in November of 1995, the Congressional Research Service conducted a survey and determined that state governments currently generate $46.5 billion in revenues from the direct operation of business-type activities by state government employees. As Chairman Whitefeather said in his testimony, "All of these state government employees, from the liquor store stock clerks in Pennsylvania to the massage therapists in the State park resorts of West Virginia to the lottery gambling clerks in dozens of states, are treated as governmental employees for the purposes of FUTA." As a matter of equity, HR 294 treats all tribal government employees as government employees, regardless of whether or not they work in tribal business-type activities, so long as the tribal enterprise is wholly owned and controlled by the Indian tribal government. Certainly, tribal governments should have the same opportunities to engage in revenue generating activities as state and local governments.

The Eastern Band of Chorokee Indians provides all of the governmental services which most major municipalities, and even some states, provide to their citizens, including law enforcement, fire department services, and utilities. Despite the fact that the governing body of the Eastern Band of Cherokee Indians provides these many government functions, our tribal government has paid over $131,000.00 in "private employer" FUTA taxes just since 1995. These monies could have been used to fund any of the myriad of social programs which the Tribe is obligated to provide for its members. I hope that you will give strong consideration to the information contained within this testimony and support Congressman John Shadegg's bill, HR 294.

Statement of Robert B. Peacock, Fond du Lac Band of Lake Superior Chippewa Indians, Cloquet, Minnesota

On behalf of the Fond du Lac Band of Lake Superior Chippewa Indians, I appreciate the opportunity to submit testimony in support of H.R. 294, a bill to amend the Federal Unemployment Tax Act to clarify that Indian tribes are to be treated like state and local governments with regard to this tax.

The Fond du Lac Band is a federally recognized Indian Tribe with a reservation in northeastern Minnesota. The Band is responsible for providing a wide range of governmental services and programs to Band members—many of whom still live far below standards of living enjoyed by the majority of Americans. Among the governmental services provided by the Band are health care, social services, education, job training, and housing assistance. The Band is responsible for Reservation infrastructure—schools, clinics, government offices, community centers, as well as roads, water and sewer systems. The Band's governmental functions also include protection and management of natural resources, planning for land use and economic development, general civil regulation and law enforcement. Income from recently established Band enterprises is being used to supplement federal funds to provide these essential services. The Band currently has approximately 1,500 employees working in a variety of government programs and enterprises on the Reservation.

The Federal Unemployment Tax Act imposes an excise tax on the employer-employee relationship. As a general rule, the private employers who are subject to the Act must pay a tax equal to 6.2% of the first $7,000 in wages paid to each employee for a calendar year. The Act gives a credit against the amount of federal tax due for unemployment taxes paid into a state unemployment system. As a result of the credit, most employers are effectively taxed by the IRS at 0.8%.

The Federal Unemployment Tax Act specifically provides that employment services performed for states and their political subdivisions or for the United States government or an instrumentality of the United States are *not* considered employment for purposes of the FUTA. Thus, these governmental employers are not subject to the tax. In 1978, the Act was amended to provide that a state as an employer could either participate in the state unemployment compensation program as a private employer or reimburse the state for benefits paid to its unemployed workers. But while it clearly exempts federal, state and local governmental employers, the Act is silent with regard to its applicability to Indian tribes.

For many years, the Act's silence regarding tribes was not a problem. In 1987, the IRS took the position that Indian tribes were exempt from FUTA. The IRS specifically advised the Fond du Lac Band that the Band was not subject to FUTA and was therefore not required to pay the Federal Unemployment Tax. The IRS refunded federal taxes that the Band had previously paid. A copy the IRS letter to the Band is attached for the record.

While there has been no relevant change in the Act, the IRS has since completely reversed its position. In fact, the IRS has initiated an action against the Band which is now being litigated before an Administrative Law Judge. In these proceedings, the IRS seeks over $2 million in back taxes and penalties from the Band—even though the Band in good faith merely complied with the written position of the IRS itself. The government's change of position on the issue is grossly unfair to Fond du Lac and similarly situated tribes, and has generated litigation that is burdensome and inefficient for both the tribes and the federal government.

Moreover, the IRS is pursuing this matter in a punitive way even though the Fond du Lac Band has voluntarily participated in the State's unemployment compensation plan. The Band has done so because the welfare of our employees and our former employees is of the utmost importance to us. The IRS' position has nothing to do with protecting Band employees, who are in fact already protected by the Band's voluntary action.

Congress must address the unfair and inconsistent treatment of tribes at the hands of the IRS regarding FUTA. The pending legislation, H.R. 294, as introduced by Representative Shadegg, would do just that. The measure would codify the position—previously espoused by the IRS—that tribes, like other governmental entities, are not subject to the Federal Unemployment Tax. This resolution is supported by established federal Indian policy which for more than two decades, under Republican and Democratic Administrations alike, has been directed toward encouraging tribal self-determination, and economic self-sufficiency. Numerous federal statutes—enacted to further these ends—recognize and confirm the status of the tribes as governments. Among other things, the IRS has never considered tribes to be taxable entities, and Congress has expressly provided that tribes be treated like states for

many tax purposes. *See* 26 U.S.C. 2871. H.R. 294 merely makes federal policy regarding FUTA—which is now unclear—consistent with federal Indian policy generally.

H.R. 294 would give Indian tribes as employers the option of either participating in the state unemployment compensation program as a private employer or reimbursing the state for benefits paid to the tribe's former employees. Thus, under the measure Indian tribes would have the same options as states and their political subdivisions. The bill also provides that states may require payment bonds to assure payment by tribes opting to reimburse states. We support this provision as well.

Finally, we understand that section 2(e) of H.R. 294 is intended to prevent the IRS from seeking to collect FUTA taxes against any tribe for employment services arising before the date of enactment, provided that the tribe has reimbursed the state for benefits provided regarding employment with the tribe. In other words, it is our understanding that under H.R. 294, the IRS would be required to discontinue its unfair FUTA collection proceedings against the Fond du Lac Band and other tribes.

The Band urges the Committee to act favorably on H.R. 294 to ensure that tribes are treated equitably under FUTA.

Respectfully submitted,
Robert B. Peacock, Chairman
Fond du Lac Band of Lake Superior Chippewa

Department of the Treasury
Internal Revenue Service
ANDOVER, MA 05501

In reply refer to: 08012634
FEB. 02, 1987 LTR 858C
41-1561549 8612 10 000
02395

FOND DU LAC MGMT INC
105 UNIVERSITY RD
CLOQUET MN 55720-9595

Employer Identification Number: 41-1561549

Dear Sirs:

We received your Form 940, Employer's Annual Federal Unemployment Tax Return. You are not required to file Form 940 because Federal, State, and local government agencies are exempt from Federal unemployment tax. You may discard any Form 940 returns or Federal Tax Deposit cards you receive.

Even though you are not liable for the Federal tax, you could be liable for the State tax. States can establish and operate their own systems without direction from the Federal government. Therefore, you may wish to contact your State to find out whether you are required to make contributions under the State unemployment compensation law.

We hope this information is helpful to you.

Sincerely yours,

Gerald W. Dinan

Gerald W. Dinan
Chief, Tax Assistance Section

ATTACHMENT 5

Department of the Treasury
Internal Revenue Service

ANDOVER, MA 05501

In reply refer to: 08401505
JULY 25, 1988 LTR OC
41-1561549 8612 10 000
00134

FOND DU LAC MGMT INC
105 UNIVERSITY RD
CLOQUET MN 55720-9595

Taxpayer Identification Number: 41-1561549
Your Inquiry Dated: May 23, 1988

Dear Sirs:

We received your request of refund of the payments of $938.28 and $2,494.71. Your payment of $938.28 has been released for refund and should be issued in four to six weeks.

Your payment of $2,494.71 was credited to your Form 941 account for March 1987. $300.14 was used to pay the Deposit Penalty charged to this account. The balance was refunded on Feb. 22, 1988. The refund check of $2,349.53 included $154.96 interest.

Thank you for your cooperation.

Sincerely yours,

Cecile Potvin
Chief, BMF Section, Adj. Branch

United States Treasury 15-51/000 P 307,322,195

Check No.

02 23 88 64 PHILADELPHIA, PA 3068 48553352

41-1561549 11 3P 8 FOND ANDOVER 41 F-941 REF

Pay to the order of FOND DU LAC MGMT INC
105 UNIVERSITY RD
CLOQUET MN 55720

03/87
52 $***2349-53

INT 154.96

ROD GRAMS
MINNESOTA

COMMITTEES:

BANKING, HOUSING, AND URBAN AFFAIRS

ENERGY AND NATURAL RESOURCES

FOREIGN RELATIONS

JOINT ECONOMIC

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June 5, 1996

William Roth, Chairman
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Roth:

I am concerned about the legal uncertainty regarding the applicability of the Federal Unemployment Tax Act (FUTA) to tribal governments. In particular, in the State of Minnesota, the Fond du Lac Band of Lake Superior Chippewa has been the victim of the IRS' inconsistent position on that question. Previously, the IRS had determined that tribal governments, along with state and local units of government, were exempt from FUTA taxes. However, the IRS has reversed its original position and decided that tribal governments must now pay FUTA taxes.

In 1987, the IRS advised the Fond du Lac Band that the Band was not subject to FUTA and was therefore not required to pay the federal unemployment tax. The IRS actually refunded federal taxes that the Band had paid. The IRS has since changed its mind, and has litigated before an administrative law judge of the IRS. By those proceedings, the IRS seeks over $2 million in back taxes and penalties from the Band. The government's change of position on the issue is not only unfair to tribes, but generated litigation -- a result that is expensive and inefficient for both the tribes and the federal government to pursue.

There is a bill now pending before your Committee which seeks to resolve this. The bill, S.1305, would ensure that tribes are treated the same as State and local units of government for unemployment tax purposes. This legislation would also ensure that tribal employees are provided unemployment benefits, by requiring tribes to either voluntarily participate in state plans, as Fond du Lac is now doing, or to reimburse the state plans for any payment made to tribal employees.

I request that your Committee act favorably on S.1305, to remove the inconsistency of the current IRS position and allow tribal governments to receive the same exemption from the FUTA tax as state and local governments now have.

Sincerely,

Senator Rod Grams
United States Senate

PRINTED ON RECYCLED PAPER

Statement of Marge Anderson, Chief Executive, Mille Lacs Band of Ojibwe Indians, Onamia, Minnesota

Mr. Chairman and Members of the Committee, I am very pleased to submit the written comments of the Mille Lacs Band of Ojibwe Indians for the Committee's review in consideration of H.R.294, the Indian Tribal Government Unemployment Compensation Tax Relief Amendments of 1997. I respectfully request that my full statement be entered into the official hearing record.

The Mille Lacs Experience:

The Mille Lacs Band of Ojibwe Indians is located on a small reservation in east-central Minnesota. We are a federally recognized American Indian tribal government, and our tribal membership approximates 3,000, the majority of whom reside and work on the Mille Lacs Reservation. We are pleased very pleased to lend our strong support to enactment of H.R.294, and urge the Committee to act as swiftly as is possible.

H.R.294 would resolve a long-standing and very serious problem which tribal governments have been experiencing with regard to IRS policy dealing with administration of the Federal Unemployment Tax (FUTA). Until recent years, the Mille Lacs Band believed that it was exempt from paying into the federal system which administers the FUTA tax. Since we had never paid into the State system, we had no reason to believe that we were responsible for making federal payments to the IRS for FUTA administration. In fact, the State of Minnesota had delineated the Band and other Minnesota tribes as being exempt within the Minnesota Unemployment Insurance Plan, a plan approved by the federal government. When this issue was questioned in the late 1980's, the IRS confirmed that we were in fact exempt. In essence, the Mille Lacs Band did not pay the federal FUTA share of 0.8%, nor did we pay into state funds, nor did we have any reason to believe that we must.

In the early 1990's, the Band was stunned to learn that the IRS had reversed its policy toward the Mille Lacs Band of Ojibwe and some of the other Minnesota tribes. You can imagine our reaction when the IRS began seeking immediate FUTA payments into the federal system, along with retroactive payments for the previous years during which time we were believed to be exempt.

Thus began a lengthy series of negotiations between the Band and the IRS, which concluded with a final settlement agreed to by both parties, at great expense and financial hardship to the Band. Not only are we still aggrieved today at the injustice which we experienced at the hands of the IRS during this period, but our employees also suffered directly. In spite of the fact that we retroactively paid the full rate for unemployment insurance, not one former employee received any benefits. All of our former employees who attempted to collect on unemployment insurance claims during this period were denied their claims. In essence, the IRS got what it was after, but our employees were left out in the cold, and the Band effectively financed a federal system which would never benefit any tribal employees.

At the conclusion of our negotiations, the Band agreed to begin paying the federal share for FUTA contributions. To this day, however, the Band does not make any payments into the State system. The Band took the position long ago that inclusion within the state unemployment system was a violation of tribal sovereignty and self-governance. As a result, we are not credited for any state contributions, and our entire contribution goes to the IRS. This inevitably means that when tribal employees are terminated or laid off, they are still denied unemployment insurance payments by the State, in spite of the fact that the Band is paying the full FUTA tax rate for all employees. Today, we pay 6.2% to the IRS on the first $7,000 in wages earned by all employees, even though our employees never get one dime of benefit.

The Position of the Mille Lacs Band of Ojibwe:

1. The Band will continue to forego employee benefits and await fair treatment under FUTA as a government:While the Band could ensure that former employees do receive unemployment insurance payments by simply abandoning our resolve and paying into the state unemployment system, it has been our experience that if one tribe holds out long enough, it can eventually bring a better day for itself and other tribal governments and Indian people. The Mille Lacs Band is known for such tenacity. For many years during the 1980's, the Mille Lacs Band was the only tribal government in Minnesota to routinely turn down State funds for energy assistance and weatherization for tribal members. We did so because of a condition within the state contracts requiring the Band to waive its tribal sovereign immunity. At Mille Lacs, our sovereignty is our very identity as a tribal government, and so we refused to waive our sovereign immunity and instead went without state funds. This policy, of course, created some hardship for all of us during those Minnesota winter months. Yet in 1989, our efforts paid off. After an intense campaign by the Mille Lacs Band, the State Legislature finally dropped the requirement that tribes waive sovereign immunity prior to entering into state contracts, and all tribes in the State continue to benefit today from our perseverance on this matter.

2. The Band views advance payment into the State system as a violation of sovereignty: We are aware that some tribes in other regions have been forced to make advance payments into their state system, as if they were non-governmental commercial enterprises. The Mille Lacs Band does not believe that it is appropriate for

the Band to pay into the state system in the same way that commercial businesses do, since we are an independent, self-governing and self-determined tribal government. The State of Minnesota does not exercise regulatory or civil jurisdiction within the reservation: these government functions are reserved for tribal government. Therefore, the Band views participation in the state system as a commercial enterprise as a violation of our self-determination and self-governing, autonomous authority. The State apparently agreed, given that it deemed tribal governments as exempt in its Minnesota Unemployment Insurance Plan.

3. The Band would prefer to self-insure and run its own Unemployment Insurance Program: We firmly believe that we have the internal financial and administrative controls to run our own unemployment insurance program, and we know that we can do so more effectively and efficiently than can the state or federal government. As an example, only a very few tribal government programmatic employees were laid off or terminated in 1996. However, the Band's contribution into the federal system approximated $140,000, a complete windfall for the U.S. government, since no claims were paid for former tribal employees. We clearly could have provided fair unemployment benefits to our former employees at a fraction of that cost, and at the same time our integrity as a sovereign government would have remained intact, at no cost to the federal or state governments.

4. If federal law precludes the Band from adminstering a self-insured program, then we are supportive of paying the state on a reimbursable basis for claims paid, as is provided by H.R.294: If it is not possible for the Band to be considered wholly exempt or to run its own self-insured program, we are supportive of being treated in the same "reimburser" status as are other local governments, and as is provided by H.R.294. The Mille Lacs Band would agree to reimburse state coffers for claims actually paid out to former tribal employees, but would not agree to make advance payments into the state system. H.R.294 would amend the existing statute to clarify expressly that tribal governments should be treated just as state and local units of government are treated for FUTA unemployment tax purposes. Further, we would be exempt from having to make federal FUTA payments, just as state and local governments as well as tax-exempt organizations are.

5. The Band urges the Committee to ensure that the provisions of H.R.294 are extended to all branches of tribal government, just as the provisions of FUTA are extended to all branches of state government Most states and many municipalities run some form of business activity. These activities include liquor stores, resorts, race tracks, lotteries, and casinos, just to name a few, and are done in the name of generating governmental revenue, to ease the tax burden for state citizens. Indian tribes are no different. We are governmental units, just like states, and many of us operate various forms of business enterprises for the purpose of generating governmental revenue to pay for our tribal programs. Because most of our population are in the midst of recovering from a lifetime of poverty, we do not yet have a dependable citizen tax base from which we can generate government revenues. Therefore, these enterprises are critical to our ability to run our government. Today, the Mille Lacs Band of Ojibwe operates a gas station, a bakery, and two casinos for the purpose of creating governmental revenue to pay for our new schools, clinic, human service programs, roads, public works, and other governmental programs.

In the same way that the federal government does not distinguish between state service programs and state business activities with regard to administering FUTA, we would ask that the Congress not distinguish between service and business activities for Indian Tribes within H.R.294. To exclude some tribal activities from the FUTA exemption provisions within H.R.294 while allowing the exemptions for the exact same state and municipal activities would be tremendously unfair.

CONCLUSION:

In closing, we would like to extend our appreciation to the Chairman and the Committee for taking time to study this very important matter. Further, we are very grateful to the Honorable Rep. John Shadegg, the Honorable Rep. Collin Peterson, and the Honorable Senator John McCain, who have been staunch supporters of tribal governments on this issue for several years.

Mr. Chairman, we also thank you for allowing the hearing record to remain open, so that you could receive the comments of the Mille Lacs Band of Ojibwe Indians and other tribal Nations for whom this issue is so critically important. It is our greatest hope that H.R.294 can move ahead as expeditiously as possible. Thank you for your consideration.

STATEMENT OF
THE NATIONAL CONGRESS
OF AMERICAN INDIANS
TO THE HUMAN RESOURCES SUBCOMMITTEE
OF THE COMMITTEE ON WAYS AND MEANS

Submitted by W. Ron Allen, President
National Congress of American Indians
2010 Massachusetts Avenue, NW
Second Floor
Washington, D.C. 20036

The National Congress of American Indians (NCAI) appreciates the opportunity to submit this testimony in connection with the Subcommittee's April 24, 1997 hearing on unemployment insurance issues. The appropriate reform and restructuring of our country's unemployment insurance (UI) system is of utmost importance and interest to our members. This testimony is submitted to emphasize our support for H.R. 294, legislation designed to fix the inequitable treatment of tribal governments and tribal employees under the Federal Unemployment Tax Act (FUTA).

NCAI is the oldest, largest, and most representative national Indian organization in the United States, representing over 200 tribal government members on a variety of federal and state issues. Since 1944, NCAI has served to promote unity and cooperation among tribal governments for the protection of tribal sovereignty and self-determination.

I. FEDERAL TAX STATUS OF INDIAN TRIBES AND TRIBAL ENTITIES

Indian tribes are unique, sovereign governments with inherent powers and attributes of sovereignty.[1] Like other sovereigns in our constitutional system, Indian tribal governments enjoy immunity from suit and protection against the levying of taxes by other sovereigns. Like state governments, tribes are charged with governmental duties and responsibilities. In addition, tribal governments have a special role in fostering tribal economic development.

The IRS has consistently ruled that Indian tribes are not "taxable entities" and are, therefore, immune from the federal income tax.[2] Congress explicitly reaffirmed its intent to preserve the tax immune status of tribes when it enacted the Indian Tribal Governmental Tax Status Act in 1982. See S. Rep. No. 646, 97th Cong., 2d. Sess. 8,12. The IRS also treats certain wholly-owned tribal entities as nontaxable for federal income tax purposes.[3] Such treatment is based on the nature of the entity and not on the type of activities the entity undertakes.[4] The economic development and revenue-raising activities of tribal governments, like that of states, have never been subject to the unrelated business income tax.

II. TAX TREATMENT OF TRIBES UNDER FUTA

FUTA was enacted in 1935. It is a joint federal-state taxation system that results in the levy of two taxes on private sector employment: a federal unemployment tax of up to 6.2 percent and a state unemployment tax which ranges from nearly zero percent to more than 9.0 percent of payroll wages. If an employer makes UI tax payments to a properly structured state unemployment fund, the 6.2 percent federal rate is reduced down to 0.8 percent through a credit mechanism.

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[1] See United States v. Mazurie, 419 U.S. 544 (1974), stating "Indian tribes are unique aggregations possessing attributes of sovereignty over both their members and their territory."

[2] See Rev. Rul. 67-284, 1967-2 C.B. 55: Rev. Rul. 81-295, 1981-2 C.B. 15; see also B. Bittker and L. Lokken, Federal Taxation of Income, Estates, and Gifts, 2d ed. 1989, stating that "[a]s quasi-sovereign bodies, Indian tribes are not taxable entities."

[3] See Rev. Rul. 94-16, 1994-1 C.B. -19; and Rev. Rul. 94-65, 1994-2 C.B. 14.

[4] As a preeminent legal scholar has noted with regard to this issue: "[t]ribal corporations formed under the Indian Reorganization Act, 25 U.S.C. Sec 477 or chartered by a tribe and wholly-owned by it have been deemed equivalent to the tribe and not taxable." F. Cohen, Handbook of Federal Indian Law, 390, 11 (1982 ed.).

FUTA exempts all federal, state and local government employers from the federal FUTA tax. It also requires the states, as a condition of qualifying for the federal tax credit, to allow governmental entities to elect between two methods of satisfying their state UI tax obligations: (1) by paying UI contributions under the state law's regular tax provisions (the "contribution method"); or (2) by reimbursing the state for actual benefits paid to separated employees (the "reimbursement method"). Further, FUTA requires states, in order to receive the federal tax credit, to cover all state and local government employees.

FUTA does not expressly include tribal government employers within the definition of governmental employers. Moreover, Code Section 7871, which treats Indian tribal governments as states governments for specified Code purposes, fails to reference the FUTA provisions (Code Sections 3301 through 3311). This failure to include tribal governments within FUTA's definition of government employers has led to differing interpretations as to whether and how tribal governmental employees and employers are covered under FUTA. For several years, the IRS has informally taken the position that Indian tribal governments are to be treated as private employers under FUTA.[5] However, the lack of precedential guidance, the inconsistency between state and federal agencies, as well as selective IRS enforcement, led many tribes to question their FUTA obligations.[6] In addition, tribes view their treatment as "private employers" to be an infringement on tribal sovereignty.

For tribal governments, the greatest inequity arises if a state chooses not to cover tribal government employees at all. If a tribal government is not covered by a state, the IRS position would still obligate the tribe to pay UI taxes at a 6.2 percent rate to the Federal Government, but it would have no mechanism by which employees may collect UI benefits.

III. ANALYSIS OF H.R. 294

H.R. 294 would amend the Federal Unemployment Tax Act ("FUTA") as follows:

1. Section 2(b) of H.R. 294 would clarify that separated employees of Indian tribes qualify for **unemployment benefits to the same degree** as employees of state and local governments. This provision is necessary to correct variation among states as to whether former employees of Indian tribes are entitled to unemployment benefits.

2. Section 2(a) of H.R. 294 would exempt Indian tribes from having to pay **the *federal* portion of the FUTA tax** (0.8% of wages paid). This provision is simply a matter of equity. It will apply to Indian tribes the same rules that currently apply to state and local governments.

3. Section 2(c) of H.R. 294 would allow Indian tribes to elect between (1) paying the ***state* portion of the FUTA tax**; or (2) reimbursing the state unemployment fund for benefits paid to former employees of Indian tribes. Like the other provisions of H.R. 294, this provision would apply to Indian tribes the same rules that currently apply to state and local governments.

Under Section 2(d), the definition of an Indian tribe, like that of a state government under the existing FUTA provisions, includes wholly-owned instrumentalities.

In addition, Section 2(e) of H.R. 294 would require the IRS to hold harmless Indian tribes that have not paid **past FUTA taxes**, so long as the tribes reimburse a state unemployment fund for any benefits that have been paid to their former employees. As noted above, some tribal governments have not paid FUTA taxes because they believed that the tax did not apply to them. H.R. 294 would remove any federal unemployment tax liability incurred by such tribes. Instead of having to pay back taxes, the tribes would be required only to reimburse the state unemployment fund for any benefits

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[5] See, e.g., Priv. Ltr. Rul. 8748004 (Aug. 27, 1987).

[6] State government, IRS, and U.S. Department of Labor interpretations have varied from state to state and from region to region, resulting in differential treatment of Indian tribal governments. See Congressional Research Service, "Indian Tribal Government Treatment by State Unemployment Insurance Programs" (Feb. 16, 1989 memorandum by Roger Walke) and Congressional Research Service, "Indian Tribal Government Treatment by State Unemployment Insurance Programs: A Re-survey of State Practices" (Oct. 1, 1993).

paid to their former employees.

NCAI has twice adopted formal resolutions supporting legislation similar to H.R. 294. Attached hereto is a copy of Resolution 96-107, adopted by the General Assembly of NCAI at its 1996 Annual Meeting in Phoenix, Arizona.

IV. WHY H.R. 294 SHOULD NOT BE AMENDED TO DISTINGUISH BETWEEN TYPES OF EMPLOYMENT

It was tentatively suggested at the Committee's hearing on April 24, 1997 that tribal governments should have the same FUTA treatment as states, but only to the extent that their employees are performing an "essential governmental" function. For the reasons set forth below, NCAI would strongly oppose any such amendment.

First, an "essential governmental function" rule that applied to tribal governments, but not state or local governments, would perpetuate the inequity of the current situation. The FUTA provisions make no attempt to distinguish between governmental employees engaged in so-called "traditional governmental functions" and those who perform more business-like functions, such as workers in state lotteries, state-owned liquor stores and state-owned business ventures.[7] To impose a different rule for tribes is neither justifiable nor desirable.[8]

Second, adding an "essential governmental function" gloss to the already complex FUTA provisions would create a tax administrative morass for both tax administrators and affected governmental employers. Although such a concept has been applied under the tax Code to specific purchases (for excise tax purposes) and facilities (for tax-exempt financing purposes), it has never been introduced into the context of governmental employment.

Although some types of governmental employment would easily fall into one category or another, many jobs would not. Thus, the IRS or Department of Labor would have to promulgate and continually update guidance on the different classifications. Governmental employers, in turn, would have to institute two systems of payroll withholding for their governmental employees, thus adding to the burden of paperwork and complexity. Undoubtedly, the two-track system would spawn costly and inefficient controversies and litigation over appropriate worker classification.

In contrast, H.R. 294 proposes a fair and administratable rule. Employees of tribal governments and wholly-owned tribal instrumentalities would be treated in a uniform fashion -- just like employees of states and state-owned instrumentalities. If a tribe entered into a joint venture with a taxable entity or formed a corporation that was not 100-percent owned by the tribe, the employees of such a venture would be treated like private business employees. However, if the employer is a tribal government or a wholly-owned tribal entity, the rules generally applicable to governmental employment would apply. The lines drawn by this rule are clear and easy to follow.

* * * * * * * * * *

In order to resolve the FUTA tax treatment of tribal governmental employees in an equitable way, NCAI urges the swift adoption of H.R. 294 as introduced by Congressman Shadegg.

7/ A recent CRS survey found that state and local governments are actively involved in numerous business-type activities that produce approximately $46 billion in revenues for state treasuries. See Congressional Research Service, Memorandum to the Senate Committee on Indian Affairs (Nov. 6, 1995).

8 The FUTA provisions, which give section 501(c)(3) organizations the same favorable treatment as governments, also make no attempt to distinguish between employees that perform charitable functions for the organization, and those engaged in a non-exempt function or unrelated business. Both types of employees are treated the same. Thus, the charitable employer's FUTA status is not jeopardized by any unrelated business activity. Again, the FUTA treatment is determined at the entity level, and not on an activity-by-activity basis.

National Congress of American Indians

Executive Committee

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Resolution PHX-96-107

TITLE: FUTA

WHEREAS, we, the members of the National Congress of American Indians of the United States, invoking the divine blessing of the Creator upon our efforts and purposes, in order to preserve for ourselves and our descendants rights secured under Indian treaties and agreements with the United States, and all other rights and benefits to which we are entitled under the laws and Constitution of the United States to enlighten the public toward a better understanding of the Indian people, to preserve Indian cultural values, and otherwise promote the welfare of the Indian people, do hereby establish and submit the following resolution; and

WHEREAS, the National Congress of American Indians (NCAI) is the oldest and largest national organization established in 1944 and comprised of representatives of and advocates for national, regional, and local Tribal concerns; and

WHEREAS, the health, safety, welfare, education, economic and employment opportunity, and preservation of cultural and natural resources are primary goals and objectives of NCAI; and

WHEREAS, this exemption is based on the fact that states and their political subdivisions are immune from such taxation under the Constitution of the United States, Id., and immunity which federally recognized Indian tribes share; and

WHEREAS, prior to the UIPL, states could consider Tribes and their various wholly owned entities as "political subdivisions" of their state for purposes of exempting Tribes from the FUTA tax, thereby making Tribes eligible for favorable governmental unemployment tax rates as well as reimbursement status (where a Tribe would only pay for those unemployment benefits paid out) if desired; and

WHEREAS, if member Tribes allow the UIPL to stand and not seek to change the law to rightfully exempt them from this federal tax, they will not only be subject to a higher state program tax rate (provided they can still even participate in the program), Tribes will also be subject to an unacceptable *and possibly illegal* federal tax; and

WHEREAS, the two Colorado Ute Tribes are already faced with a seven - fold increase in their state unemployment insurance tax rate due directly to Labor's UIPL (reference attached letter from the Colorado Department of Labor); and

WHEREAS, it is settled law that the FUTA tax is an excise tax and this is acknowledged in Labor's own UIPL; and

WHEREAS, Tribes should be exempt from the FUTA tax and be allowed to participate in a state's unemployment insurance program on the same level as any political subdivision therein; and

WHEREAS, this exemption and fair treatment could be guaranteed by amending 26 USC* 7871(a)(2) (which treats Tribes as states for purposes of several federal taxes, including many excise taxes) to add FUTA to that list of excise taxes for which Tribes are considered as states and therefore exempt.

NOW THEREFORE BE IT RESOLVED that the National Congress of American Indians does hereby acknowledge this as a serious issue affecting nearly all member Tribes and shall immediately begin a member-wide survey to coordinate among its members the effort to amend the above-mentioned law in as timely a fashion as possible.

CERTIFICATION

The foregoing resolution was adopted at the 1996 Annual Convention of the National Congress of American Indians, held at the Phoenix Civic Plaza in Phoenix, Arizona, on October 20-25,1996 with a quorum present.

W. Ron Allen

W. Ron Allen, President

ATTEST:

S. Diane Kelley, Recording Secretary

Adopted by the General Assembly during the 1996 Annual Convention held at the Phoenix Civic Plaza in Phoenix, Arizona on October 20-25, 1996.

Statement of the Navajo Nation

INTRODUCTION

Mr. Chairman and members of the Subcommittee, the Navajo Nation appreciates this opportunity to present our views and recommendations regarding H.R. 294 the "Indian Tribal Government Unemployment Compensation Tax Act Relief Amendments."

The Navajo Nation is the largest Indian nation in America with a population of 250,000 members. Our reservation extends into the states of Arizona, New Mexico, and Utah, with an area of 17.5 million acres and is slightly larger than the state of West Virginia. The unemployment rate on the Navajo Nation averages 38% to 50% depending on the season. Over 56% of the Navajo people live below the poverty level. Per capita income averages $4,106, less than one third of that of the surrounding states. Basic necessities of life taken for granted elsewhere in the United States

are sorely lacking in the Navajo Nation—for instance, 77% of Navajo homes lack plumbing, 72% lack adequate kitchen facilities, and 76% lack telephone services.

Ironically, the Navajo Nation is viewed as one of the more prosperous Indian nations. Unfortunately, these types of conditions are mirrored at hundreds of other Indian reservations throughout the United States, with an average of 56% unemployment nationwide.

NAVAJO NATION STATUS AS A GOVERNMENT

The Navajo Nation is a government and its inherent sovereign powers have been recognized by the United States. A number of U.S. Supreme Court cases have specifically recognized the Navajo Nation government.

The Navajo Government has been called 'probably the most elaborate' among tribes. H.R. Rep. No. 78, 91st Cong., 1st Sess. 8 (1969). The legitimacy of the Navajo Tribal Council, the freely elected governing body of the Navajos, is beyond question. *Kerr McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195, 201 (1985). *See also*, *Williams v. Lee*, 358 U.S. 217 (1959).

The Navajo Nation has a three branch government. The Legislative Branch consists of a eighty-eight member Council with a Speaker selected from among the delegates. The Executive Branch is headed by a President and Vice-President, elected-at-large, who are empowered to carry out the laws of the Navajo Nation. The Judicial Branch consists of a three member Supreme Court and lower district courts.

The Navajo Nation provides essential governmental services within its territory. These services include law enforcement, courts, social services, education, health, natural resource protection and management, emergency services, economic development, and other governmental services. An example of the sophistication of the Navajo government is the Navajo judiciary. The Navajo Nation has an established civil and criminal court system which operates effectively at the trial and appellate levels as a separate branch of the Navajo Nation government. The courts of the Navajo Nation have been in continuous operation since the early years of the Twentieth Century. The Navajo Nation currently has seven general jurisdiction District Courts, plus a system of specialized limited jurisdiction courts such as the Family Courts and the world-renowned Peacemaker Court. The Navajo Nation Supreme Court, located in Window Rock, Navajo Nation (Arizona), exercises appellate jurisdiction over all matters arising within the Navajo Nation judicial and administrative forums.

For over 200 years the United States generally has upheld the principle that each Indian nation is a domestic dependent nation, free to manage its own internal affairs without state intervention. The right of self-government, which Indian people share in common with all other people within the United States, and which is a constitutionally protected right of all federal citizens, dictates that it is the prerogative of each Indian nation to determine what laws will govern its people and what rights its members and non-members shall have within the jurisdiction of that particular Indian nation. *United States* v. *Wheeler*, 435 U.S. 313 (1978); *Worcester* v. *Georgia*, 31 U.S. (6 Pet.) 515 (1832). See also, R. Barsh and J. Henderson, *The Road: Indian Tribes and Political Liberty* (1980). With respect to the Navajo Nation, its relationship with the United States is established and governed by two treaties, the Treaty of June 1, 1868, United States-Navajo Nation, 15 Stat. 667, and the Treaty of September 9, 1849, United States-Navajo Nation, 9 Stat. 974. The United States does not enter into treaties with private business organizations. Treaties are entered into between sovereign governments.

NAVAJO NATION AND FUTA

The Navajo Nation strongly supports H.R. 294, the "Indian Tribal Government Unemployment Compensation Tax Act Relief Amendments." Currently, the Federal Unemployment Tax Act (FUTA) does not specifically include "tribal government employers" within the definition of "government employers." H.R. 294 would allow the Navajo Nation's 6,242 employees to be treated the same as state and local government employees.

There are several reasons why Indian nations should be specifically included within the definition of "government employers." Simply put, Indian nations should be treated as government employers because Indian nations are governments. These Indian nations are the primary provider of essential governmental services within their jurisdictions, H.R. 294 simply recognizes this fact.

Various entities such as state governments, the U.S. Internal Revenue Service, and the U.S. Department of Labor, have interpreted FUTA differently, resulting in different treatment of tribal governments-depending in which region of the country they are located. Federal legislation is needed to resolve this matter for every tribal

government and to provide certainty for tribal governments. Currently, in many instances Indian nations are treated like private employers. Indian Nations, however, are much more than private organizations; they are sovereign governments with the inherent authority of self government. This legislation would recognize the inherent sovereignty of Indian Nations and accord the same treatment to Indian Nations as given to other states and local governments. Treatment as a private organization is contrary to well established federal policy and Supreme Court decisions recognizing the inherent sovereignty of Indian nations and their right to self-government.

CONCLUSION

In closing, the Navajo Nation supports the FUTA amendments which would accord to Indian nations the proper treatment consistent with their status as self-governing and inherent powers of governing. Continued treatment as private organizations must stop. These FUTA amendments recognize the Indian nations as being a significant component in providing the essential governmental services required within their jurisdictions.

Statement of John E. Echohawk, Executive Director, Native American Rights Fund

My name is John Echohawk. I am a member of the Pawnee Tribe of Oklahoma and serve as the Executive Director of the Native American Rights Fund (NARF). NARF is a national, nonprofit legal organization dedicated to securing justice on behalf of Native Americans and Indian tribes—something we have been doing for 27 years. Our mission is guided by five priorities. Two of these priorities include the protection of tribal sovereignty and holding governments accountable to Indian people and tribes. In this light, NARF joins the National Congress of American Indians, the Ute Mountain Ute and Southern Ute Tribes, the Red Lake Band of Chippewa Indians in support of H.R. 294, the Indian Tribal Government Unemployment Compensation Tax Relief Amendments of 1997.

H.R. 294 would resolve a long-standing problem confronting tribal governments—inequitable and differential treatment under federal unemployment tax law. This important legislation would effectively plug a loophole in the Federal Unemployment Tax Act (FUTA) to accord tribal government employers the same treatment as state and local government employers for unemployment tax purposes.

FUTA was enacted in 1935. It is a joint federal-state taxation system that levies two taxes on private sector employees throughout the Nation: a 0.8 percent federal unemployment tax and a state unemployment tax which ranges from nearly zero percent to more than 9.0 percent of payroll wages. However, FUTA exempts all federal, state and local government employers, as well as tax-exempt charitable organizations, from the federal FUTA tax and allows them to pay lower state unemployment taxes. While the Internal Revenue Code, 26 USC 7871, treats Indian tribal governments as states for numerous taxation purposes, FUTA does not expressly include tribal government employers within the definition of governmental employers. As a result, the IRS considers Indian tribal governments to be mandatorily covered as private employers under FUTA. Therein lies the problem which H.R 294 seeks to remedy.

While it has been long-settled that tribal governments are not taxable entities under the federal tax code because of their governmental status, in the 1980s the Internal Revenue Service began steps to force tribal governments to pay the federal portion of the tax, and to pay the higher tax rates that are applied to private sector, for-profit employers. This has imposed an unfair unemployment tax burden on tribal government employers.

Moreover, the failure to include tribal governments within FUTA's definition of governmental employers has led to differing interpretations as to whether and how tribes are covered under FUTA. State government, IRS and U.S. Department of Labor interpretations vary from state to state and region to region, resulting in differential treatment of Indian tribal governments. H.R. 294 would resolve these disparities by providing uniform treatment of Indian tribal governments nationwide.

It has come to our attention that there is some concern that enactment of H.R. 294 would result in an unfair benefit to tribal governments with regard to business-type activities conducted by tribes to produce revenues for tribal government services and treasuries. However, this should not be an issue. According to a November 6, 1995 Congressional Research Service study completed for the Senate Indian Affairs Committee (attached), state governments are actively involved in numerous

business-type economic activities that produce significant revenues for state treasuries, including 34 states which conduct lotteries and 18 states engaged in the sale of liquor, as well as a legion of other revenue-producing activities.

State governments are allowed under FUTA to treat state employees of these business-type enterprises like all other state employees—exempt from the Federal portion of the FUTA tax and subject only to reimbursement of FUTA claims actually paid. As a matter of equity and fairness, tribal government employees engaged in business-type activities should be treated the same way.

As you are aware, legislation similar to H.R. 294 was introduced in the 103rd and 104th Congresses, but did not advance. The time is long overdue for resolution of this long-standing problem which continues to visit inequitable and differential treatment upon tribal government employers and employees. We applaud you for scheduling a hearing on H.R. 294, and respectfully urge your Subcommittee to promptly take favorable action on this most important matter affecting the fundamental rights and interests of Indian tribal governments. Thank you for consideration of the views of the Native American Rights Fund.

Economics Division
Congressional Research Service • The Library of Congress • Washington, D.C. 20540-7430

Memorandum November 6, 1995

TO: Senate Committee on Indian Affairs
Attention: Philip Baker-Shenk

FROM: Dennis Zimmerman
Specialist in Public Finance

SUBJECT: Additional information on State business-type activities

As was explained in a memorandum dated November 2, 1995, the determination of whether a State government activity should be labeled a business-type enterprise is unclear. This determination depends upon the extent to which the State government activity is an effort to correct a private-market failure. In a telephone conversation on November 3, 1995, you requested that a list of State business-type activities be prepared within the constraints of data availability.

No State-by-State list of such business-type activities has been compiled by either the business community or by State governments. This situation reflects the uncertainties of making such a determination. The Census Bureau does separate State receipts by source. In general, receipts not classified as tax revenue or intergovernmental revenue are classified as charges and miscellaneous general revenue. These charges and miscellaneous general revenues are usually received in exchange for State performance of some service, provision of some good, or private use of some State asset. If one is willing to accept that such receipts are evidence of business activity, these data can be used to provide some idea of the extent to which States engage in business-type activities.

Table 1 lists 14 categories of activities for which States receive charges or miscellaneous general revenue. The Census does provide some guidance on the types of activities that are included in each category. But no information is available from the Census Bureau on the specific functions being performed by any given State. Some of the categories listed are quite narrow and require no further explanation. Others are quite general and a few examples of the types of activities included in the category will provide a broader view of the range of State activities.

Water transport and terminals—Includes ferry boats and docks and wharves for cargo and passenger transport.

Miscellaneous commercial activities—Includes markets, cement plants, cemeteries, etc. Although not provided by Census data, I know that North Dakota owns a commercial bank and Massachusetts and Michigan manufacture their own vaccines.

Natural resources—Includes milk testing fees, sale of products from agricultural experimental farms, and the sale of timber and mineral products from State lands.

Auxiliary enterprises in higher education—Includes college bookstores, dormitories, and revenue from athletic contests.

Parks and recreation—Includes swimming pools, golf courses, marinas, piers, skating rinks, and lease and use fees from stadiums, auditoriums, and convention centers. Although not provided by Census data, I know that West Virginia owns and operates lodges in its parks.

A non-zero amount opposite the State's name is considered evidence that the State conducts at least one of the business-type activities included in the category. The bottom row of the table provides a count of the number of States that receive revenue from the activities in the category.

If I can be of further assistance, please contact me at 78473.

file: indians2.mem

Table 1. State Charges and Miscellaneous General Revenue: Business-type Activities, 1993 ($1000s)

	Lottery	Liquor Store	Hospital	Highway Tolls	Water Transport & Terminals	Airports	Miscellaneous Commercial Activities	Natural Resources	Auxiliary Enterprises in Higher Education	Parks and Recreation	Utilities			
											Water	Electric	Gas	Transit
Alabama	0	130,321	686,949	0	44,294	0	0	10010	178,034	23,670	0	0	0	0
Alaska	0	0	0	40,761	0	47,677	63,849	11331	18,975	0	0	27,682	0	0
Arizona	115,955	0	0	0	0	0	0	18883	177,521	2,855	0	17,101	0	0
Arkansas	0	0	132,544	0	0	0	0	6406	90,034	12,367	0	0	0	0
California	772,416	0	1,769,362	134,382	0	0	0	550290	665,893	62,792	0	172,769	0	0
Colorado	99,620	0	43,829	0	0	0	0	12247	229,554	1,231	0	0	0	0
Connecticut	210,248	0	198,448	230	103	18,532	713	925	101,016	3,565	0	0	0	18,424
Delaware	36,932	0	27,198	33,224	0	0	0	2680	56,411	3,488	0	0	0	4,178
Florida	959,419	0	125,689	294,668	0	0	0	14176	230,439	17,110	0	0	0	4,852
Georgia	0	0	209,973	1,280	68,842	449	0	20225	198,032	121,517	0	0	0	0
Hawaii	0	0	110,811	0	57,037	382,262	0	9102	49,035	8,425	0	0	0	0
Idaho	25,688	46,095	1,333	0	0	32	135	46578	40,936	542	0	0	0	0
Illinois	621,172	0	229,496	258,598	0	0	0	9109	333,066	4,690	0	0	0	0
Indiana	172,672	0	342,251	68,289	3,129	68	0	26788	449,182	9,926	0	0	0	0
Iowa	69,349	83,882	350,211	0	0	781	7,661	9889	163,116	1,603	0	0	0	0
Kansas	49,814	0	168,373	43,541	0	0	0	16000	91,782	1,916	0	0	0	0
Kentucky	137,743	0	194,506	10,457	0	0	0	24814	131,333	41,169	0	0	0	0
Louisiana	211,564	0	564,499	30,102	41,087	0	0	26161	196,704	33,941	0	0	0	0
Maine	54,097	72,941	6,564	38,096	5	85	0	9381	52,186	2,389	0	0	0	0
Maryland	367,913	0	62,801	129,150	37,790	60,252	3,100	11933	208,070	3,239	0	0	0	71,117
Massachuse	579,598	0	192,147	158,088	61,762	171,968	0	19923	143,376	18,889	61,752	0	0	0
Michigan	483,305	454,856	857,677	14,998	2,011	112	0	23165	491,160	16,109	0	0	0	0
Minnesota	113,692	0	323,989	0	0	1,293	0	33298	191,230	10,011	0	0	0	0
Mississippi	0	124,010	141,984	0	5,890	0	0	13848	120,917	5,654	0	0	0	0
Missouri	102,784	0	192,962	0	0	0	0	22211	147,645	1,210	0	0	0	0
Montana	16,961	36,966	2,240	0	0	107	2,016	10745	46,770	977	0	0	0	0
Nebraska	0	0	189,276	0	0	763	0	13770	94,153	4,632	0	0	0	0
Nevada	0	0	3,503	0	0	0	0	2885	30,996	1,253	41,178	28,342	0	0
New Hamps	42,360	209,941	3,352	47,535	314	51	0	3224	63,624	8,940	94	0	0	0
New Jersey	621,111	0	228,054	532,200	8,982	0	0	24363	190,100	211,170	20,023	0	0	355,160
New Mexico	0	0	180,286	0	0	193	0	15843	74,229	2,153	0	0	0	0
New York	1,059,713	0	1,074,314	336,867	4,653	21,815	0	10295	331,247	80,710	0	1,392,830	0	684,299
North Carolin	0	0	191,271	1,373	24,147	0	0	23970	370,560	3,167	0	0	0	0
North Dakota	0	0	16,136	0	0	0	119,491	11259	70,851	970	0	0	0	0
Ohio	781,130	371,056	786,144	94,365	0	0	2,121	22715	389,862	7,135	0	0	0	0

Oklahoma	0	0	209,985	74,049	0	0	12	4707	188,883	17,216	3,580	211,445	6,411	0
Oregon	203,221	171,638	268,314	2,463	0	34	0	67544	118,234	11,210	0	0	0	45
Pennsylvania	639,952	671,703	736,284	277,367	0	9,488	0	34512	420,014	13,838	0	0	0	0
Rhode Island	46,494	0	13,626	9,289	207	9,189	1,238	1621	43,184	3,577	0	0	0	7,032
South Caroli	0	0	408,154	0	45,830	227	0	6207	171,633	15,753	0	546,878	0	0
South Dakot	61,921	0	1,005	0	0	0	41,240	5602	27,168	3,744	0	0	0	0
Tennessee	0	0	305,713	0	0	0	0	62642	158,711	20,382	0	0	0	0
Texas	704,086	0	666,775	51,251	0	0	0	17086	438,217	15,960	0	0	0	0
Utah	0	71,903	221,074	0	0	445	0	6153	99,862	3,883	0	0	0	0
Vermont	20,049	28,922	2,107	0	0	0	0	868	36,337	4,306	0	0	0	0
Virginia	378,154	253,497	794,631	42,218	3,180	0	0	7706	423,489	5,174	0	0	0	0
Washington	183,438	264,455	263,877	69,050	0	1	0	175372	226,387	185	0	0	0	0
West Virgini	48,234	46,284	37,004	41,850	0	0	0	3421	80,509	15,493	0	0	0	0
Wisconsin	188,149	0	411,118	0	0	0	0	44410	174,237	7,016	0	0	0	0
Wyoming	0	31,990	5,345	0	0	0	0	1753	28,043	29	0	0	0	0
Count of States with Enterprise	34	16	47	28	18	23	11	49	49	48	5	7	1	8

Source: Bureau of the Census, State Government Finances: 1993, Series GF-93.

Testimony of Joseph Weisenburger, Deputy Commissioner, New Hampshire Department of Employment Security, Concord, New Hampshire

Good morning Mr. Chairman and committee members. My name is Joseph Weisenburger. I am the Deputy Commissioner of the New Hampshire Department of Employment Security, a position I have held for over 15 years.

My comments support reforming the financial and program administration of the Employment Security system which includes the public employment service and the unemployment compensation system.

For over 60 years the Employment Security System and particularly the Unemployment Compensation System (UC) has served our nation well. However, in the last 15 years or so efforts to reduce federal spending in order to reduce the federal deficit have not considered the uniqueness of the unemployment compensation program. The result is a deteriorated program straining to meet it's objectives.

The problem is not the availability of resources because federal unemployment taxes, even without the .2% surtax, are sufficient to fund the proper and efficient administration of the program. The problems are the "budget driven" process used to appropriate funding and the inefficient use of administrative funds at both the federal and state levels.

Regarding the budget, a study of the budgetary treatment of the Unemployment Trust Funds prepared by Chambers Associates, Inc. for the Interstate Conference of Employment Security Agencies Inc. (ICESA) in March of 1993 found the following:

"Even though there is a dedicated source of funding for the administrative costs of the Unemployment Trust Fund programs and the cost of the Employment Service, the funding levels for these programs are discretionary. Thus, they are subject to specific or across-the-board reductions as part of the appropriations and Gramm-Rudman-Hollings processes. In addition, the funding levels are subject to OMB review and arbitrary reductions regardless of numbers of beneficiaries being served."

The study also found that budget rules can prevent the Unemployment Compensation program from achieving its objectives as a counter-cyclical program.

"Any legislation affecting unemployment benefits is subject to the elaborate Pay-Go rules that the Budget Enforcement Act of 1990 imposes. This act makes no distinction between programs financed with general revenues or programs financed with dedicated revenue. Pay-Go subjects unemployment compensation to a form of budgetary double jeopardy. Since its start, unemployment compensation has operated as a self-contained, self-financed system. While borrowing from the general fund was authorized, these loans had to be repaid with interest. Revenues would be adjusted to ensure that loans had to be repaid. Thus, it was truly Pay-Go. The Budget Enforcement Act added a second pay-go requirement. Legislation could not increase the deficit in the years covered by the current Congressional Budge Resolution.

To require the system be deficit neutral during a recession runs counter to the objectives of the program. In addition, to increase the cost of labor during a recession by increasing employer taxes to finance unemployment benefits is a way to increase unemployment."

Finally, the report concluded that budgetary rules are inflexible and do not permit needed exceptions for a program that is complex by statutory design.

"For as complex and diverse an organization as the Federal government, it is very difficult to develop general budget rules applicable to all programs without creating inequities because of particular program characteristics. Even when a special rule is developed for a few programs, it may not fit them all."

"A recent example of a special rule that did not work is the treatment of the State administrative costs in the Unemployment Compensation program. The Budget Enforcement Act of 1990 prescribed specific procedures for developing projections of the baseline, the ongoing cost of government. In general, the baseline is the most recent appropriation adjusted for inflation. For the administrative costs of certain social insurance programs, the baseline includes not only an inflation adjustment, but also, the percentage change in the beneficiary population for the current year. Inclusion of the Unemployment Trust Fund in this special definition works to the disadvantage of programs financed through this fund because the administrative costs include not only the processing of claims and payment of benefits, which fluctuate with the unemployment rate, but also the collection of State unemployment taxes, which remains relatively static. Revenue collection accounts for about one-third of State administrative costs. As a result, the baseline can seriously underestimate actual costs."

The budget process, because of the federal deficit, ignores the work load driven and self funding methods historically used to appropriate funding for the unemployment compensation program even though the administrative trust fund account is at its statutory ceiling and that will erode the integrity of the program.

The direct results are increased errors, longer unemployment duration and lower tax collections, which all reduce state benefit trust fund levels and therefore add to the federal deficit.

Eventually, employer benefit taxes will increase.

To address the funding shortfall a growing number of states are diverting money from their state taxes to use for program administration, leaving employers to pay twice for the program. These diversions also add to the federal deficit. The diversions have extended to fund training and other initiatives not directly related to UC benefits. An Interstate Conference of Employment Security Agencies (ICESA) survey estimates in FY 1997 states will supplement their programs with over $200 million in state funds.

Program inefficiencies are the result of budget decisions, an over reaching federal partner and outdated process. These inefficiencies waste hundreds of millions of dollars each year.

States lack the flexibility to operate an efficient program that meets the needs of its employers and workforce. The federal government determines the level and the use of resources available to each state. For example, over $50 million, more than the entire amount the states receive for the Bureau of Labor Statistics (BLS) programs, is allocated to gather statistics annually about benefit payment accuracy. While the information is important none of the money can be used to correct mistakes. The program simply identifies the same errors year after year. This relatively useless program was forced upon the states by regulations promulgated by the Secretary of Labor because of criticism of the department in its oversight of the state programs. States should develop their own quality assurance programs because each has a unique state UC law.

In 1993 the administration submitted and the Congress passed legislation requiring the states to "profile" UC claimants who were likely to exhaust their benefits and require them to participate in a program offering reemployment orientation and services to the extent those services were available. No additional funding was provided for reemployment services. The purpose was clearly to score $300 million annually in budget savings by disqualifying those profiled claimants who failed to participate. The savings covered other federal spending. Many professionals argue the deficit went up because it ensured claimants in training would exhaust their benefits.

Billions of dollars sit idly in the Extended Unemployment Benefit Account and the Federal Unemployment Account that would be more efficiently used in the state benefit accounts. Ironically, while these billions of dollars of employer taxes build the federal accounts to unnecessary levels the United States Department of Commerce grants billions in federal funds to the states for economic development.

Employers are required to pay unemployment taxes to two separate government agencies. Combining the FUTA tax report and payment with the state benefit tax and report will save employers enormous amounts of time and money. Those FUTA administrative funds (about $100 million) charged by the IRS to collect the FUTA tax leveraged with state administrative funds would be used more effectively.

Finally, I believe it is important to recognize the trench work performed by the public employment service and its potential to positively impact on the federal deficit and the goals of welfare reform.

The Alabama employment service recently completed a demonstration project designed to help unemployment compensation claimants get back to work quicker. Over a three year period the program saved $83.4 in benefit payments at an administrative cost of $20.5 million, a savings of better than $4. for each $1. invested.

Any reform proposal should strengthen the relationship between the employment service and the UC program.

Adequate funding for the public employment service supplemented with some welfare administrative funding can produce similar savings in public assistance programs.

In 1996, the Congress passed Welfare reform which focuses on "Work first." The States, individually have developed programs anticipating passage of welfare reform. All of these state programs have a work component as the core of their reform. In many states the welfare agencies have contracted with the Employment Service to provide placement and work search services for their clients.

As more and more welfare recipients transition from public assistance to work, their safety net changes from welfare benefits to unemployment benefits. Like most new entrants and re-entrants to the workforce these individuals will be the first af-

fected by negative changes in the economy. Without a strong public employment service, many will fall back on public assistance after they exhaust their UC benefits.

In 1997 employers will pay $6 billion in FUTA taxes. Only $3.4 billion will go back to the states for program administration. If the states are expected to run efficient and effective programs with their reduced resources they will need more program authority and greater flexibility in the use of these funds.

Statement of George V. Voinovich, Governor, State of Ohio

Mr. Chairman, Mr. Levin and members of the Subcommittee, my name is George V. Voinovich, Governor of the State of Ohio. As Ohio's Governor, I respectfully urge the subcommittee to give consideration to reforming the financing of the employment security system.

Our current system does not provide adequate funds for administration of the unemployment compensation and employment service programs by the states. It relies on tax dollars paid by employers for funding the administration of the employment security system. Currently, these "dedicated" dollars are being spent to support discretionary federal spending in other federal programs and to impact calculations of the federal deficit.

The current system has under funded state programs and overtaxed employers for many years. Under this system in 1995, 42 of the 53 states and jurisdictions receiving administrative funding for employment security functions received less than the FUTA taxes collected from employers from these states and jurisdictions. 1995 was not unusual. Since 1990, less than 59 cents of every employer FUTA tax dollar has been returned in funding for employment security to the states.

In Ohio, this shortfall in funding has resulted in the closing of 22 local employment service offices and the planned closing of 14 more in the next two years. The Ohio Bureau of Employment Services has cut 300 staff positions since 1993, and now is operating at historically low staffing levels. Almost every other state has had similar experiences as federal funding has been cut repeatedly, while large fund balances have accumulated in federal trust funds dedicated to fund the very activity that was being cut. I repeat: these unspent balances of dedicated funds are growing, as the very activities they are supposed to fund at the state level are being scaled back for lack of funds.

Despite the reduction in funding for the dedicated purpose of the FUTA tax, employer FUTA taxes have not been cut. In fact, the .2 surcharge, initially enacted on a temporary basis to fund extended benefits in 1976 has been continued, to build up reserves in the federal trust funds that are already at historically high levels and overflowing.

The system was originally designed as a federal-state partnership, with federal unemployment tax rates set only as high as needed to properly fund administration of employment security functions. The system has degenerated into one that taxes employers but shortchanges employment security programs to make funds available within the federal unified budget for discretionary spending unrelated to employment security.

It is time for a change! What we need is a system which properly funds states for administration and minimizes the tax burden on the employers who pay for it and need these state services.

In 1996, a number of state employment security agencies, including Ohio, frustrated with the current system, developed proposals for change. Simultaneously, employer representatives, including UBA, Inc., also developed proposals to change the system. Early this year, these state agencies and employer representatives combined their ideas into a proposal to establish a new framework for financing employment security. Ohio supports the proposal of the coalition of states and UBA, Inc., which I have attached for your review.

The proposal has been carefully crafted to address the federal/state partnership, appropriate funding levels, and employer taxes. The proposal includes provisions to:

- Dedicate employer FUTA tax dollars for administration of employment security by depositing them into dedicated state accounts within the federal unified budget;
- Transfer the responsibility for collecting and administering the FUTA tax from the Internal Revenue Service to the states to consolidate tax functions, reduce employer reporting burden and cut federal administrative costs;
- Limit increases in appropriation of administrative funds to individual states and the U.S. Department of Labor to 40% of the previous years appropriation to assure accountability and equitable distribution of administrative funds;

• Redefine the role of the U.S. DOL to focus on assuring compliance with federal requirements, performance review and oversight;

• Require that the states continue to provide public employment services in conjunction with the administration of the unemployment compensation program;

• Maintain the local Veterans Employment Representative (LVER) and Disabled Veteran Outreach (DVOP) programs;

• Increase flexibility by states to use real property initially purchased with federal funds to administer employment security functions at the state and local level;

• Distribute the balance in the federal Extended Unemployment Compensation Account to state unemployment compensation benefit accounts to improve state trust fund solvency, while continuing to provide for extended benefits for unemployed workers in times of recession; and

• Supplement federal revenue with state penalty and interest funds currently maintained outside the federal unified budget to aid in making the proposal revenue neutral.

I believe that the proposal of the coalition of states and UBA, Inc. addresses the fundamental issues of proper administrative financing, employer taxes to support administration, and the role of the state and federal government in administration of employment security. I urge you to give strong consideration to this proposal. Should you have questions, feel free to contact my Administrator of the Ohio Bureau of Employment Services, Debra R. Bowland, for information or help. You may contact her directly at 145 South Front Street, Columbus, OH, 43215, or by telephone at 614.466.2100.

I appreciate your personal consideration of my thoughts on this important matter. Thank you.

PROPOSAL
FOR
RESTRUCTURING EMPLOYMENT SECURITY

Background

For 60 years, payroll taxes paid by employers have funded the unemployment insurance (UI) and Employment Service (ES) programs, collectively known as the nation's employment security system. The system has been called a federal-state partnership. Federal law provides the framework, and the states operate the programs, but the federal government controls the system by using its authority to allocate resources and to issue mandates, regulations, and directives.

Federal grants to state employment security agencies (SESAs), from a federal payroll tax, fund administrative expenses in four major areas:

- Unemployment Insurance,
- Employment Service,
- Veteran's Employment Services, and
- Labor Market Information.

A separate state payroll tax funds unemployment insurance benefits.

Overview

Unemployment Insurance

The unemployment insurance system, created by the Social Security Act of 1935, is administered by each state, the District of Columbia, Puerto Rico, and the Virgin Islands under the oversight of the U.S. Department of Labor (DOL). Federal law provides the guidelines, but the 53 jurisdictions determine many requirements related to eligibility, benefit levels and tax rates.

The system has broad objectives:

- Alleviate hardship for the unemployed,
- Prevent unemployment,
- Stabilize the economy,
- Promote reemployment and
- Help small businesses remain solvent during economy recessions.

Alleviating hardship, the system's principal aim, is accomplished by partially replacing the loss of wages for unemployed individuals who have a demonstrated attachment to the workforce.

According to DOL, an estimated 8.4 million American workers will receive unemployment checks in FY 1997, totaling more than $23.2 billion. On the average, workers will receive benefits for just over 14.8 weeks.

The Employment Service

The Employment Service (or Job Service), established by the Wagner-Peyser Act of 1933, makes available, among other services, job search assistance to individuals, and recruiting and referral services to employers.

Services available to workers in more than 1,800 Employment Service offices nationwide include job referral and placement, skill assessment and counseling, referral to training, and job search skill-building activities. The Employment Service assists employers by screening and referring applicants for job vacancies, and providing critical labor market information for business and economic planning.

More than 18 million individuals received job search assistance from the Employment Service last year. The number referred to jobs was 8 million. Over 3 million individuals were employed or reemployed after receiving ES services at a cost of under $250.00 each.

Other programs administered by Employment Service staff in some states include:

- Alien Labor Certification,
- Federal Bonding,
- Economic Dislocation and Worker Adjustment Assistance,
- Migrant and Seasonal Farm workers,
- Workforce Opportunity Tax Credit, and,
- Trade Act Assistance/NAFTA.

Veteran's Employment Services

The Disabled Veterans' Outreach Program (DVOP) and Local Veterans' Employment Representatives (LVER) are mandated by Title 38 of the United States Code as grants-to-states programs. Funds are given to SESAs for staff who may **only** assist individuals who have served in the miliary.

DVOP staff maximize employment opportunities primarily for disabled veterans, and help those who are about to leave military service by conducting Transition Assistance Program workshops.

LVERs provide job placement and supportive services to veterans, and ensure local office compliance with federal performance standards for veterans' services.

Labor Market Information

Our nation's labor market information system is an essential part of its economic infrastructure, providing information about employment, jobs, and workers to a wide range of users. Most of the nation's labor market information is produced by SESAs in cooperation with the Bureau of Labor Statistics (BLS) and other federal agencies.

States collect, analyze, and disseminate data relating to employment, unemployment, and labor demand and supply. Information reported includes monthly unemployment rates, quarterly wages, monthly estimates of total nonagricultural employment, average hourly and weekly wages, monthly estimates of the labor force, and occupational trends.

The many users of this information include employer, job seekers, policy makers and analysts, economic developers, economists, and planners.

Financing

- **The employment security system is financed by two separate payroll taxes paid by employers.**

  The Internal Revenue Service (IRS) collects a federal payroll tax under the Federal Unemployment Tax Act (FUTA) to fund program administration. State employment security agencies collect a state payroll tax under state law to finance unemployment benefits. Employers must pay both FUTA and state unemployment taxes no more often than quarterly.

  - FEDERAL TAX. While FUTA requires employers to pay a gross federal payroll tax of 6.0 percent on the first $7,000 paid annually to each employee, if state laws conform with federal requirements, employers are eligible for a tax credit of up to 5.4 percentage points, or 90 percent. Employers in all states currently receive the tax credit.

    The current net tax rate is 0.8 percent, or a maximum of $56 per employee. This includes a 0.2 percent temporary surtax, added by Congress in 1976, now scheduled to end, after several extensions, January 1, 1998.

    DOL estimates FUTA collections of $5.9 billion in FY 97. Of this sum, $3.5 billion was appropriated to the states.

FUTA revenues finance the administration of the employment security system, paying for state and local offices which take claims, pay unemployment benefits, collect taxes from employers, handle appeals, provide employment services, and collect and disseminate labor market information.

FUTA funds also go to the DOL to pay for its oversight activities and to the IRS, which received almost $100 million in FY 1995 for collection activities.

The Federal share of extended benefits and loans to insolvent state unemployment accounts are other FUTA-financed activities.

- STATE TAX. UI benefits are funded by a state unemployment insurance tax paid by employers based on experience-rated systems, which vary by state. Employers with few layoffs typically have the lowest tax rates. State legislatures determine the tax rate and taxable wage base. While 11 states limit taxable wages to the federal minimum of $7,000, others have ceilings ranging from $7700 to $25,500.

- **The revenues from both federal and state taxes are deposited in separate accounts in the Federal Unemployment Trust Fund (UTF), and can be used only for administering the employment security system and paying unemployment benefits.**

The UTF has 59 accounts: 4 federal accounts, the Railroad Unemployment Insurance Account, the Railroad Administration Account and 53 state accounts. The funds in these accounts are invested by the U.S. Treasury Secretary in government securities in the same manner as social security funds.

- FEDERAL ACCOUNTS. In FY 97, 80 percent of FUTA collections, an estimated $4.72 billion, will go into the Employment Security Administration Account (ESAA). Funds for federal and state administrative costs for unemployment insurance, employment services, and certain veteran's employment services are appropriated from this account.

  The Extended Unemployment Compensation Account (EUCA) will receive the remaining 20 percent, an estimated $1.18 billion, to finance the federal share (half) of extended benefits, which are available during times of high unemployment.

  The Federal Unemployment Account (FUA) is used to finance loans to insolvent state unemployment accounts. When the EUCA account and the ESAA account both exceed their statutory limit, the overflow goes into the FUA. If that account is full the overflow goes to the state benefit accounts.

Federal agencies reimburse a fourth federal account, the Federal Employee Compensation Account (FECA), which funds benefits administered by the states for federal civilian and ex-military personnel.

- STATE ACCOUNTS. The taxes collected by the states are deposited with the U.S. Treasury, credited to the 53 individual state accounts in the UTF and are counted as federal revenue. If a state account is insolvent it may obtain a loan from the FUA.

- **Funds to operate the unemployment insurance programs are appropriated by Congress from FUTA tax monies and allocated to the states under complex and controversial formulas by DOL.**

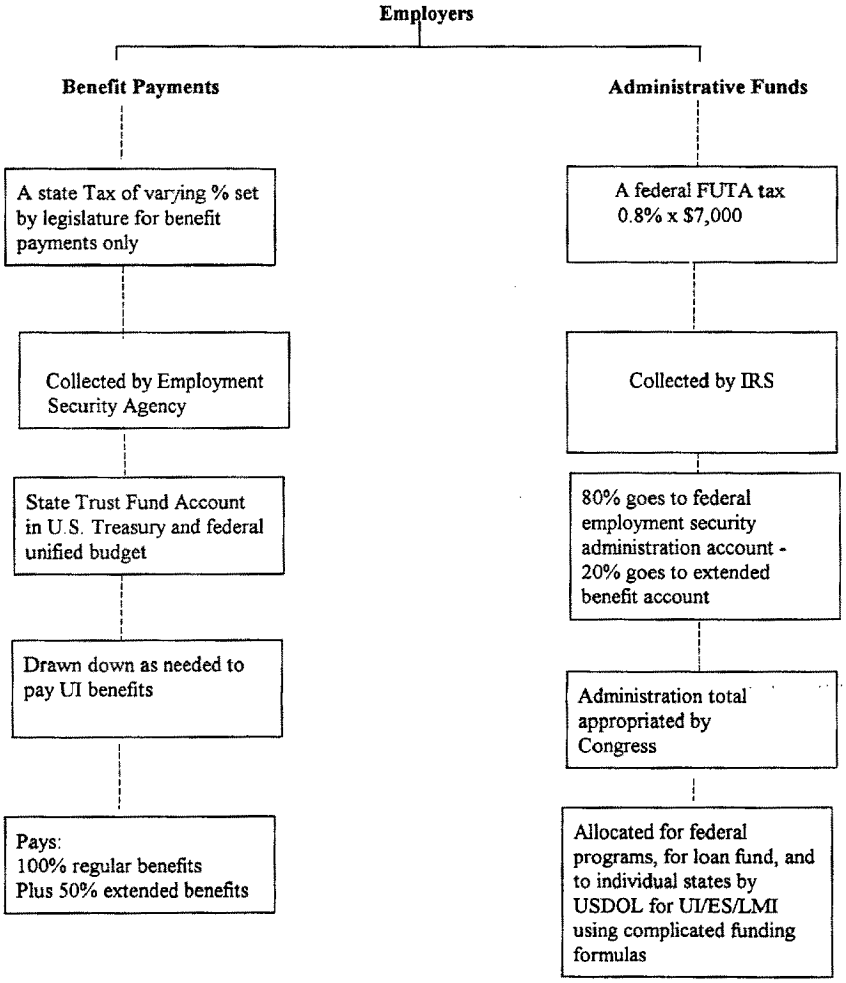
  State UI allocations are determined by (1) projecting the workload to be processed by each state based on the annual average workload the previous year and adjusting to the budgeted national workload base; (2) determining the staff required to process each state's projected workload; (3)multiplying the final staff-year allocation by the cost per staff year to arrive at dollar funding levels and (4) allocating overhead resources. Unfortunately this system does not work unless adequate resources are available.

  After the Congress appropriates funds, the Employment service grants are allocated through a legislative formula for Wagner-Peyser based on a state's relative share of the nation's civilian labor force and number of unemployed individuals using data for the most recent calendar year.

FUNDING FLOW CHART

Employment Security Financing System

Two taxes paid by the employer



The Problems:
Why Reform is Necessary

- **All the available funds yielded by the FUTA tax are not appropriated by Congress to underwrite the employment security system. According to DOL, in FY 97, $3.5 billion of the $4.7 billion in FUTA collected for administration was appropriated. In FY 1997, employers in most states will again pay more in FUTA taxes than they get back under the federal formula for allocating administrative funds, even though the ESAA was at its statutory ceiling. This deliberate under funding is penny-wise and pound foolish because it leads to increased benefit payments, due to increased unemployment duration, and less fraud detection. It will also lead to poorer tax collections and eventually higher employer benefit taxes.**

  Dedicated unemployment insurance tax revenues are accumulated in the trust fund to make the national budget deficit look smaller, rather than being spent to help get people back to work. As Congress deals aggressively with the budget deficit appropriations will be reduced even further in future years.

  Further, spending from the UTF for administration is subject to the domestic discretionary caps. During recessions, additional funds are needed to handle increased claims for unemployment benefits. The demand for employment assistance also varies with the economy. Discretionary budget caps make it difficult to secure sufficient funds during bad times.

- **States lack the flexibility to operate an efficient employment security system that meets the needs of their workforces. The federal government determines the level of resources available to each state and also maintains program authority.**

  Federal control of the system has increased over the years, resulting in restrictive administrative requirements and rigid procedures, which have left states less able to respond to the needs of their employers and workforces. Federal limitations on the use of FUTA funds among FUTA programs have led to unnecessary expenditures and meant that states often have been unable to achieve efficiencies.

  The federal role should be limited to:

  - Ensuring conformity of state laws and federal law,
  - Establishing performance standards,
  - Monitoring state performance,
  - Setting broad guidelines for program administration, and
    Ensuring that state operations comply with federal requirements.

- **A "temporary" 0.2 percent surtax, which amounts to a $14 per employee annual surtax paid by employers, or $1.4 billion annually, was enacted by Congress in 1976 to pay a debt incurred by repeated extensions of unemployment benefits, continues long after the debt has been repaid.**

  While the debt was paid in 1987 the tax has been extended several times to offset federal expenditures unrelated to unemployment insurance even though the money cannot be spent for other purposes. The president's FY 1998 Budget extends the surtax through the year 2006.

  The surtax suppresses job growth and economic development.

- **Employers are burdened by having to make reports and pay separate taxes to two government entities, one for the operation of the UI, ES, and LMI programs and one for paying benefits to individuals.**

  According to IRS estimates, it takes employers an average of 12 hours and 31 minutes to complete and file Form 940, the FUTA tax return. At a conservatively estimated hourly rate of $14, the nation's 6 million FUTA-paying employers spend a total of $1 billion annually complying with FUTA reporting requirements.

- **DOL accounting and reporting requirements are numerous and cumbersome.**

  Some of the mandated reports are:

  - UI Program and Budget Plan,
  - UI Quality Appraisal,
  - UI Quality Control, and
  - ES plan submitted to the Secretary of Labor,
  - SF 269 - ES Financial Status Report,
  - SAS 02B - UI State Time Distribution,
  - ETA 2215 - Annual UI Program Distribution of Staff Years in Dollar Levels,
  - UI-1 - UI Workload Estimates,
  - SC424A, B- State Agency Program Budget Plan,
  - UI-3 - Certification for UI Contingency for Quarter,
  - HB 365 - UI Quality Appraisal,
  - Quality Control Reports
  - SAS 61 - Status of Obligational Authorities,
  - ETA 227 - Overpayment Detection/Recovery Activities,
  - ETA 581 - UI Contribution Operations,
  - Quarterly ETA - 9002 report showing job order and applicant file data, and -
  - Quarterly Update on Services to Veterans.

- In 1996, the Congress passed Welfare reform which focuses on "Work first." The States, individually have developed programs anticipating passage of welfare reform. All of these state programs have a work component as the core of their reform. In many states the welfare agencies have contracted with the Employment Service to provide placement and work search services for their clients.

  As more and more welfare recipients transition from public assistance to work, their safety net changes from welfare benefits to unemployment benefits. Like most new entrants and re-entrants to the workforce these individuals will be the first affected by negative changes in the economy. Without a strong public employment service, many will fall back on public assistance after they exhaust their UC benefits. With continued cuts to the employment service these claimants, as well as regular UC claimants, will remain unemployed for longer periods of time exacerbating budget problems. The administration has proposed a $700 million appropriation to the USDOL for work search activity support for current AFDC recipients. DOL will likely allocate these resources through the JTPA. Since welfare reform focuses on employment, JTPA will duplicate these services available through the public Employment Service. Additionally some state and county welfare agencies are developing employment service programs of their own, even though the Congress has expressed concern about the plethora of federal funded duplicative employment and training programs. Finally, the same logic used for welfare reform isn't applied to UC recipients. Increased work search requirements with full support should be part of any reform of the Employment Security system.

- **DOL retains control of funds and rules used to construct buildings and buy real property.**

  - Reed Act Funds
    Title IX for the Social Security Act, among other things, provides for the distribution of excess FUTA funds to the states for the administration of the Employment Security system. These funds, referred to as "Reed Act" funds, were distributed in 1956, 1957, and 1958. The statutory time limits for use of the funds no longer exist, but restrictions on how the monies may be used remain. Many states have used Reed Act monies to erect office buildings. If these buildings are sold, the Reed Act funds must be reinvested in another federally "approved" project or returned to the UTF.

  - Administrative Funds
    DOL also controls administrative funds used to pay for office buildings and land. When a state sells property purchased with administrative funds, the proceeds must be reinvested in real estate or the federal funds must be repaid along with a proportionate share of the equity.

  - Rules related to real property use and support are counter productive to the Employment Security mission and one stop career center initiatives.

The Proposal

- Allow the temporary 0.2 percent FUTA surtax to expire 1998.

  This will return $1.4 billion each year to employers providing investment resources for business and stimulation of employment.

- Transfer the responsibility for collecting the FUTA tax from the federal government (IRS) to the states.

  This change will save almost all of the $100 million charged by the IRS for collection services. The states will increase collections because the tax is a primary tax for the state compared to FUTA being a tertiary tax for the IRS. States will retain the estimated $60 million in penalty and interest related to delinquent FUTA tax reporting.

- Consolidate the FUTA tax reporting requirements with state benefit tax reporting and payment.

  Employers will save hundreds of millions of dollars in reporting costs as a result of this change. Errors will be reduced resulting in administrative savings.

- The Employment Security Administrative Account (ESAA) is reconstructed to include separate subsidiary accounts for each state and the federal government.

- States are required to immediately deposit FUTA receipts into their account within ESAA, including all penalty and interest received from delinquent benefit tax and FUTA tax payments.

This is required because FUTA receipts will continue to be counted as revenue in the Federal Unified Budget. Additionally separate accounting is required for the change in procedures authorizing state legislators to make appropriations.

- The current balance in ESAA will be distributed to the state subsidiary accounts based upon each state's relative share of taxable FUTA wages (Sec 903a of the Social Security Act). Three percent of the balance will be transferred to the new federal subsidiary accounts, one percent to the federal administrative account and two percent to the small state hold harmless account.

  The existing reserve in the administrative accounts will be needed by states and the U.S. DOL to fund the transition costs. States will begin collecting FUTA taxes with the first calendar quarter in the fiscal year the reform becomes effective. The transition period will be the first two quarters of the fiscal year (10/1 to 3/30).

- Similar to the current requirement each state subsidiary account will be capped at 40% of the previous years appropriation. Annual surpluses in the state administrative account will flow directly to the state benefit account. A further amendment will transfer any surplus from the FUA account to the administrative accounts of each state based upon each state's relative share of covered employment.

- No more than 3% of the states annual FUTA collections will be transferred to the federal accounts, 1% to the DOL administrative account and 2% to the small state hold harmless account. These federal accounts will also have the 40% cap with surpluses returning to the state administrative accounts.

- The federal/state partnership will continue. However, the federal role will be limited to:

  - Ensuring conformity of state laws with federal laws,
  - Establishing UI performance standards,
  - Monitoring state performance,
  - Auditing the use of FUTA resources for FUTA related services, and,
  - Ensuring state operations comply with minimum federal requirements.

  Reporting requirements would be limited by the reduced role of the U.S. DOL

  The appropriate role of the U.S. DOL is to ensure states run proper and efficient programs, that worker and employer rights are protected and that the programs meet their objectives. Removing the funding and allocation authority from the U.S. DOL will reduce its tendency to micro manage the state programs and allow it to focus on its original mission of supporting states and maintaining the integrity of the Employment Security system.

- Congress will appropriate administrative funds to the U.S. DOL and the BLS for FUTA related activities, which will include the hold harmless funds for the small states impacted by these changes.

- Small states (CLF less than one million)with insufficient tax bases to fund the proper and efficient administration of their state program shall receive supplemental funding under criteria established by the Secretary of Labor funded by the 2% transfer from state administrative accounts to the small state hold harmless account and appropriated by the congress.

  For practical purposes this treatment is similar to the current allocation process. States are not precluded from using other state funds to support FUTA programs.

- States with insolvent administrative accounts may borrow administrative funds from the Federal Unemployment Account (FUA) known as the loan account.

- This proposal will restructure the extended benefit program so it can meet its goal of providing extended benefits during periods of high unemployment. Only a handful of states triggered on to extended benefits in the last recession.

  States will be required to provide 13 weeks of extended benefits with a trigger no more restricted than the current trigger. Eligibility criteria will follow the state law. States are not precluded from lowering the trigger level. The EUCA account will be repealed and the balance, which is expected to reach its statutory ceiling ($14 billion) in 1999 will be transferred to the state benefit accounts based upon each states relative share of taxable FUTA wages (Sec 903a of the Social Security Act).. There will be no impact on the federal budget because the state benefit accounts, like EUCA, are included in the federal budget. It will end confusion and save administrative funds.

- Retain the loan account but cap it at its current ceiling.

  Several states have expressed concern about eliminating the loan account. They strongly believe the grace period allowed to repay loans without interest is critical for their state and that turning to the private market place to borrow money would be costly and not accomplished quickly enough to cover current benefit outlays.

  The proposal retains the loan account (FUA) but caps it at its statutory ceiling of .25% of total wages which includes receivables. It will function as a revolving account. Any surplus at the end of the year will automatically flow to the state administrative accounts based upon each states relative share of covered employment.

- Amend FUTA to require states to provide public employment services with universal access where individuals can file claims for unemployment benefits and

receive re-employment services.
In order to establish accountability of the state agencies relative to re-employment services for UI claimants the agency will submit annual reports, at the state level, providing information on services and outcomes including:

- the proportion of the claimant population using re-employment services
- the proportion of employers using employment services
- information regarding referrals and placements
- information on other services such as counseling, testing, etc.

States will have the authority and flexibility to develop performance measures with benchmarks that best serve their customers while reporting on performance outcomes needed by employers and others interested in the program.

This change will ensure the future of the public employment service by tieing it more closely to the UI system as a conformity requirement while giving the states greater flexibility in determining the process which employment services will be provided.

The amendment would repeal all but the specific provision of Section 7 of the Wagner Peyser Act which describes the employment services allowed with FUTA funds.

- Maintain the local Veterans Employment Representative (LVER) and Disabled Veteran Outreach (DVOP) programs as required by Title 38 of the U.S. Code.

- Other than retaining its equity in state real property the U.S. DOL will relinquish all rules relative to the use of the state real property.

  Current rules are so restrictive they act against the mission of U.S. DOL programs and objectives. The states should determine the use of capital equipment and local facilities that will best serve the customer.

The Benefits

- Allowing the 0.2% temporary surtax to expire will stimulate employment and local economies.
- Combining the FUTA and state benefit reporting requirements will save employers hundreds of millions of dollars and reduce errors.
- States generally can expect increased resources for program administration resulting from efficiencies generated by this proposal.
- The proposed reform will save money and increase tax collection effectiveness.
- All federal trust fund surpluses will flow directly to state benefit accounts where it will positively effect claimant benefit levels and employer benefit taxes rather than sit unproductive in little used trust funds.
- State will have complete authority over employment service programs.
- Burdensome federal mandates which cause inefficiencies and impose increased costs will be eliminated. Time consuming and costly reports will be minimized.
- Flexibility in the use of capital equipment and facilities will improve customer service and a full use of the resource.
- Small states with small tax bases will be protected.
- The federal/state partnership will be maintained with the U.S. DOL more focussed on program integrity and program efficiencies than steering states though the funding lever in a direction not consistent with the states' need.
- A reduced federal role will result in more resources for service at the state level if needed or a transfer of those resources to the benefit accounts.
- The IRS will be replaced by state tax collectors who are more familiar with local employers and more responsive to their needs.
- This proposal will be budget neutral and may even produce savings over the long run. The following revenue will be available for state appropriation over and above the previous state allocations.

  1. $100 million in IRS fees for FUTA collection services.
  2. Est. $60 million in penalty and interest collected by IRS (1% of FUTA total collection.
  3. Est. $25 million in DOL ETA reduced role.

4. Improved FUTA collections. (Est $60 million). (States will do a better job collecting FUTA funds. A 1% improvement equals $60 million in FUTA revenue).

5. Depositing penalty and interest from benefit taxes into state administrative accounts will add approximately $240 million to the federal budget. A large portion of this P&I is not available to state programs because state legislatures use the funds for other unrelated purposes.

A more efficient program will produce trust fund savings by using an effective employment service to help reduce unemployment duration, by maintaining an appropriate level of fraud detection and improving benefit and FUTA tax collections.

Notes

- Several decades ago a few state employment security agencies elected to create retirement plans separate from their state retirement system. The U.S. DOL agreed to fund those retirement systems. Today a small number of retirees still receive their pension through this process. The estimated cost from FUTA is 1 million. The small state account will be used to fund the remaining pension systems.

- The 2% transferred from the state subsidiary accounts to the small state administrative accounts is an estimated amount. We have agreed to increase that amount if it is necessary to protect small states.

- Some states have an unusually high proportion of UCX and/or UCFE claims. The small state account may be used, if necessary, to support these activities. For example, the Washington D.C. agency processes UCFE claims for DC area federal workers, many of whom live in Maryland or Virginia.

- Under the newly required state EB program eligibility and work search requirements are based on the state's regular UC requirements. Only the trigger level, as a ceiling, is transferred from the federal extended benefit program.

- Once the legislation is in effect, states will likely review the need for state allocations including diversions from benefit trust funds. This will return integrity to the experience rating systems in those states and reestablish employer and labor's faith in the process.

- All fund transfers from the loan account (FUA), federal administrative account, small state administrative account and the extended benefit account (EUCA) to the state administrative accounts will be allocated based upon each state's relative share of FUTA taxable wages (Sec. 903a of the Social Security Act).

- Research conducted by the U.S. Department of labor and the New Jersey Department of Labor and evaluated by Mathematica Policy Research, Inc., has shown that intensive job search assistance (JSA) to unemployment insurance beneficiaries reduced receipt of benefits by an average of three-quarters of a week. Follow-up studies showed that the reductions carried over into the following year. The study states, "These findings suggest that the JSA component of the treatments led to the longer-term impacts. They also suggest that not only did the JSA component of the treatments lead to more rapid reemployment initially, but it also generated jobs that were more stable than those found by control group members."

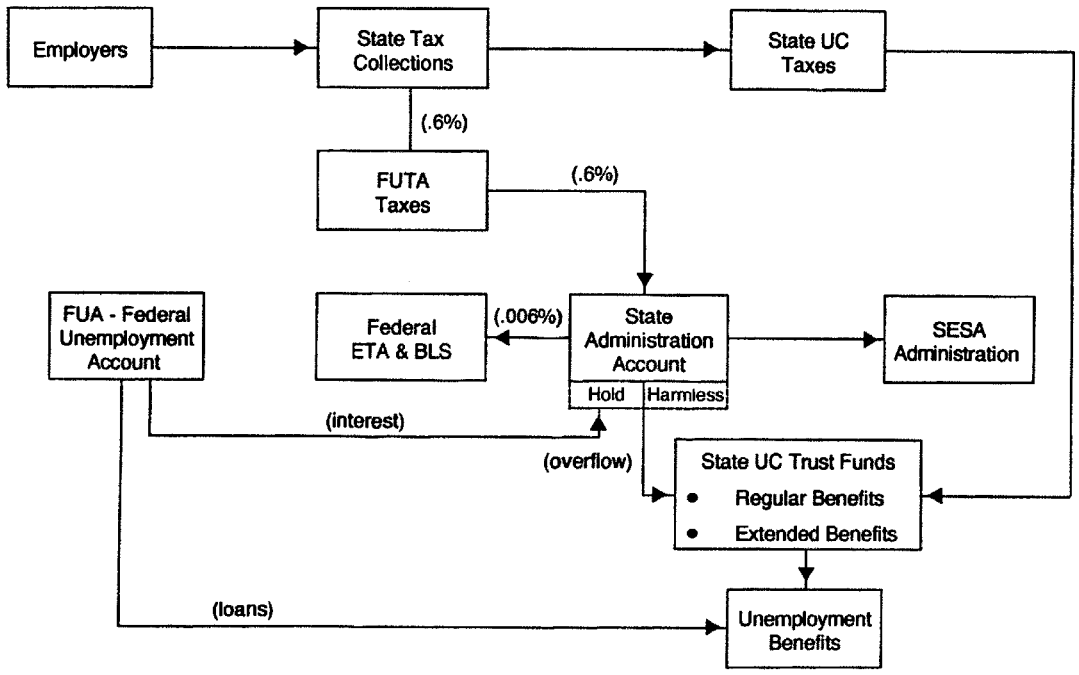
  In FY 1998, there are estimated to be about 8.6 million unemployment insurance beneficiaries. The average weekly benefit amount is estimated at $194.54. A reduction in three quarters of a week of benefits would save unemployment insurance trust funds $145.91 per beneficiary. Some UI beneficiaries are on temporary layoffs and do not need job-search assistance services and some are already receiving such services from the

employment service. A significant portion, however, could benefit from such services, but the employment service does not have the resources to provide them.

If funds were available to the state employment services to provide job search assistance to 2.6 million UI beneficiaries (just 30% of the total), the savings to the unemployment trust fund would be $379,366,000. The cost of providing these services would be approximately $152,050,000 [based on two hours of staff time per beneficiary; 1710 work hours per staff year, and an average annual salary of $50,000] yielding a net savings to the unemployment trust fund of $227,316,000 in FY 1998. Each new dollar invested in the employment service and directed to services to UI claimants saves the unemployment trust fund and the federal budget $2.50.

The proposal requires the states to deposit all penalty and interest receipts into their administrative account including penalty and interest related to benefit taxes. This requirement adds an estimated $240 million in revenue to the federal budget. (1% of benefit taxes) It is important to protect this revenue. Many state agencies have lost the use of P&I. The requirement returns those funds to the state program and limits the use of those resources to employment security programs.

PROPOSED
Unemployment Insurance Financing System
Tax Flows



Statement on Behalf of Luella Pennington, Chicago, Illinois, and the Pennington Class Opposing Legislation To Reverse Pennington v. Didrickson

I. Introduction

On behalf of Mrs. Luella Pennington and the plaintiff class in *Pennington v. Didrickson*, 22 F.3d 1376 (1994) we are responding to the April 17, 1997 advisory issued by the Ways and Means Committee's Subcommittee on Human Resources (the "Subcommittee") concerning the proposed legislation to overturn the *Pennington* decision.

The Federal "When Due" Requirement

Since 1938, section 303(a)(1) of the Social Security Act has required that states' unemployment insurance laws provide for "methods of administration ... reasonably calculated to insure full payment of unemployment compensation when due." 42 U.S.C. 503(a)(1) (the "when due clause"). At least since 1971, when the Supreme Court issued it unanimous decision in *California Department of Human Resources Development* v. *Java*, 402 U.S. 121, the when due clause has been interpreted to "require that a State [unemployment insurance] law include provision for such methods of administration as will reasonabl[y] insure the full payment of unemployment benefits to eligible claimants with the greatest promptness that is administratively feasible." 20 C.F.R. 640.3(a); *Java*, 402 U.S. at 130–33. In 1975, the Court reaffirmed those principles in a second unanimous opinion, *Fusari* v. *Steinberg*, 419 U.S. 379.

In *Java*, the Court considered the legality of a provision that suspended payment of benefits to any claimant who had won an initial determination, during the pendency of any appeal by the claimant's former employer. 402 U.S. at 122. Though the case concerned California's unemployment insurance code, the statutory provision at issue was used in 48 states. *See* Appendix to Appellants' Brief in *Java*, No. 507 (U.S. Sup. Ct. 1970) at 69–70. Nonetheless, the Court held that the provision violated the when due clause because "'when due' was intended to mean at the earliest stage of unemployment that payments were administratively feasible." *Id*. at 131.

After a thorough review of the Congressional history that led to enactment of the when due clause, Chief Justice Burger concluded that the when due clause was designed to provide prompt wage replacement to displaced workers both "to tide them[] over, until they get back to their old work or find other employment, without having to resort to relief," 402 U.S. at 131 (*quoting* HR Rep No. 615, 74th Cong, 1st Sess, 7 (1935)), and to "exert[] an influence upon the stabilization of industry." *Id*. at 132.

The Court's holding in *Java* confirms that the when due clause is not just some technical artifice in the Social Security Clause. Indeed, the Court said that "the congressional objective of getting money into the pocket of the unemployed worker at the earliest point that is administratively feasible ... is what the Unemployment Insurance program was all about." 402 U.S. at 135. Accordingly, any change in the requirement that states pay unemployment insurance when due constitutes an alteration of the most fundamental objective in the federal statute that governs the unemployment insurance program.

II. The Pennington Decision

The "base period" in any state's unemployment insurance program is the time period within which claimants must have earned sufficient wages to qualify for benefits. As defined in section 237 of the Illinois Unemployment Insurance Act, 820 ILCS 405/237, Illinois's base period is comprised of the "the first four of the last five completed calendar quarters immediately preceding the benefit year" ("Illinois' base period"). Accordingly, Illinois' base period skips any wages earned by a claimant in both the calendar quarter in which he files his claim (the "filing quarter"), because that is not a "completed" quarter, and the preceding calendar quarter (the "lag quarter"), because that is the fifth of the five completed calendar quarters prior to the benefit year. Consequently, when Illinois determines whether a claimant has sufficient qualifying wages, it disregards any wages earned in both the filing and the lag quarters (the "lag period").

In *Pennington*, the Court of Appeals for the Seventh Circuit held "that section 237 is an administrative provision and, as such, is subject to the timeliness requirements of the 'when due' clause." 22 F.3d at 1387. The legislation's proponents, including the Honorable Lynn Quigley Doherty, the defendant in the litigation through much of its history, decry the *Pennington* decision. But they do so without ever discussing its reasoning. Indeed, Gray Gilbert from the Ohio Bureau of Employment Security and ICESA concedes that the proponents have appealed to Con-

gress in the hopes of being heard by a forum that will not be restrained by an "intellectual exercise." Statement by Day Gilbert ("Gilbert Stmt.") at 5. In contrast, we urge Congress to read not only the *Pennington* decision, but also *Java* and its other progeny, and to consider the courts' reasoning and the legislative history underlying the when due clause. We believe that after intellectually honest reflection, Congress will agree that the *Pennington* decision assures prompt payment of unemployment insurance benefits in furtherance of a public policy that was embodied in the nation's unemployment insurance program at its inception because it is central to its purpose.

III. Illinois' Base Period Definition Is An Administrative Method, Not An Eligibility Criterion

A. Because the when due clause governs only the states' "methods of administration" of unemployment insurance programs, "applicable Federal laws provide no authority for the Secretary of Labor to determine the eligibility of individuals under a State law." 20 C.F.R. 640.1(a)(2); *see Ohio Bureau of Employment Services* v. *Hodory*, 431 U.S. 471, 482–87 (1977). The proponents rely heavily on this principle. *See e.g.*, Testimony by The Honorable Lynn Quigley Doherty ("Doherty Stmt.") at 1–2; Gilbert Stmt. at 3–4. As the court of appeals noted, however, the "truism [that the when due clause governs administrative methods but not eligibility criteria] simply begs the question and, consequently contributes nothing to the inquiry before us." 22 F.3d at 1382.

What is required, of course, is to determine whether Illinois' base period is an administrative method or an eligibility criteria. An eligibility provision "define[s] the class of persons eligible for benefits." *Hodory*, 431 U.S. at 486–87. In an effort to suggest that a lag period is necessary to determine eligibility, the proponents characterize the *Pennington* claimants as "individuals who would not qualify using the first four of the last five quarters," Gilbert Stmt. at 4, and that the *Pennington* decision "broaden[s] eligibility" to those who were not previously eligible. But that is not so. In fact, the *Pennington* claimants are, by definition, *only* claimants who *have* earned sufficient wages to qualify for benefits. 22 F.3d at 1385.

The lag period does *not* exclude claimants from eligibility; it just delays the time at which the state will consider a claimant's most recent wages in determining his or her eligibility. To argue the contrary, the proponents ignore the single most important fact about the operation of the Illinois base period: that the *Pennington* claimants become eligible for benefits by doing nothing more than waiting until sufficient time has passed to file a second claim, since wages that are initially disregarded because they fall in a claimant's lag period, become qualifying wages by the passage of enough time so that they fall within the first four of the last five completed calendar quarters prior to the filing of the later-filed claim. *Pennington*, 22 F.3d at 1385.

Thus, although Illinois' base period delays the time at which the state will count a claimant's most recent wages toward eligibility, it does not prevent a claimant from using those same wages so long as he waits a sufficiently long time before filing a claim. Causing a claimant to wait to receive benefits, however, is just what the when due clause was designed to prevent. *Java*, 402 U.S. at 131–33.

B. The legislation's proponents also urge that Illinois' base period "ensures that unemployment insurance will be available for workers with a genuine attachment to the labor force, but not necessarily for those with only a marginal connection." Doherty Stmt at 1; *see* Testimony by Albert R. Miller ("Miller Stmt.") ("The *Pennington* alternate base period would provide for the payment of unemployment benefits ... to individuals with no established connection to the workforce"). In fact, however, exactly the opposite is true: the lag period "causes ... [claimants] with relatively strong attachment to the work force to wait until that attachment has weakened before they can receive benefits." 22 F.3d at 1385. Thus, the contention that Illinois' base period restricts payment of benefits to claimants with stronger workforce attachment (or alternatively, that the *Pennington* decision will extend eligibility to those without such attachment) is not just wrong; it is perverse.

C. Furthermore, the proponents have repeatedly conceded that the purpose of Illinois' base period is solely administrative, not substantive. For instance, in the *Pennington* litigation itself, Illinois repeatedly admitted that the lag period "is necessary because some time is required for employers to report wages and for the [state agency] to make that information available in the local [unemployment insurance] offices where claims are first taken and adjudicated." 22 F.3d at 1387. And in his submission to the Subcommittee, Ms. Gilbert concedes that whether states can shorten their lag periods is dependent solely on whether "technology ... permits states to collect and process wage information more quickly." Gilbert Stmt. at 4.

These concessions confirm what the court of appeals found: that Illinois' base period is "an administrative method employed to accommodate the time needs of a wage record [data collection] system. In a world of high-speed information exchange, the lag quarter would not exist; yet an eligibility requirement like the 'voluntary leaving' provision [which disqualifies claimants who leave work without good cause attributable to the employer] would." 22 F.3d at 1387.

IV. THE *Pennington* Decision Is Not Only Consistent With, But Required By The Historic Interpretation Of The When Due Clause

A. The legislation's proponents argue that *Pennington* "represents a 180-degree departure from the manner in which both the federal government and states have construed the Social Security Act, since the statute's enactment more than 60 years ago." Doherty Stmt. at 1. They contend that this deviation from the historical interpretation of the when due clause was wrought by "unelected federal judges" intent on usurping the legislature's authority on "tax and spending policy." Doherty Stmt. at 1; *see id*. at 2 ("the appellate court was wrong because its decision vests unelected federal judges with the authority to substitute their judgment for governors and state legislatures with regard to tax and spending policy").

The district judge who decided the case, and the three court of appeals' judges, were all appointed by President Reagan. Moreover, the *Pennington* decision itself confirms that they are judicial conservatives.

For example, the proponents argue that "[t]he United States Supreme Court has held that the Social Security Act was intended to recognize the importance of each state establishing its own eligibility criteria for unemployment insurance." Doherty Stmt. at 2. But that, too, just begs the question of whether Illinois' base period is an eligibility criteria or an administrative method. Moreover, as set forth in Section I, the *Pennington* court's conclusion that Illinois' base period is an administrative provision, not an eligibility criteria, is not only consistent with Supreme Court precedent, it is required by *two unanimous* Supreme Court cases: *California Department of Human Resources Development v. Java*, 402 U.S. 121 (1971) and *Fusari v. Steinberg*, 419 U.S. 379 (1975). *See* 22 F.3d at 1386.

This history of when due jurisprudence belies the proponents' argument that *Pennington* represents judicial encroachment on legislative prerogatives. After all, the when due clause is itself a legislative enactment. And one with the backing of the Constitution's Supremacy Clause. U.S. Const., art. VI, cl. 2. It is, therefore, entirely appropriate for the federal courts to enforce the when due clause. Indeed, one cannot help but feel that the proponents disparage the federal courts so vigorously because they resent the fact that unemployed Americans went to the federal courts to enforce their rights against state policy that violates federal law. But just as the *Java* Court struck down a state's administrative provision because it delayed payment of unemployment insurance in violation of the timeliness demanded by the when due clause, the *Pennington* court concluded that Illinois' base period is an administrative provision that delays payment to eligible claimants.

B. The proponents contend, however, that "since the establishment of the unemployment insurance system, the Labor Department ... has considered a base period of the first four of the last five quarters to be consistent with the [Social Security] Act." Doherty Stmt. at 2; *see* Gilbert Stmt. at 4. That, too, is simply wrong. To the contrary, in 1962, the Secretary of Labor issued a policy statement urging states to keep their lag periods "as short as possible," *Unemployment Insurance Legislative Policy: Recommendations for State Legislation, 1962*, thus confirming not only that lag periods should not unnecessarily delay payment of benefits, but also that the Secretary has historically treated base periods as administrative methods, which are subject to his regulatory authority, rather than eligibility criteria, as to which he has no such authority. *See Pennington*, 22 F.3d at 1384.

The legislation's proponents rely on draft bills issued by the Secretary of Labor in 1932 and 1950, one of which includes a base period definition like the one used in Illinois. From these draft bills, the proponents contend that "[t]hroughout the history of the unemployment insurance program, determining the period that constitutes the base period for unemployment insurance claims purposes has been one of many eligibility criteria that federal law left to the states." Gilbert Stmt. at 3; *see also* Doherty Stmt. at 1 (*Pennington* "represents a 180-degree departure from the manner in which both the federal government and states have construed the Social Security Act, since that statute's enactment more than 60 years ago").

As the court of appeals noted, however, the "draft bills do not ... directly address the issue here: whether the lag period arrangement can be termed a matter of eligibility as opposed to a matter of administration." 22 F.3d at 1384. The court therefore concluded that:

the mere fact that the draft bills take notice of a lag period similar to the ... [Illinois base period] does not indicate that the lag period is in compliance with the 'when due' clause or the corresponding regulations. A state must pay unemployment benefits 'with the greatest promptness that is administratively feasible.' 29 C.F.R. 640.3(a). Needless to say, what was 'administratively feasible' when the draft bills were written—1937, 1950, and 1962—is much different from what is administratively feasible in today's technologically advanced world. *Id*. at n. 6.

C. Recent history also belies the proponents' contention that long lag periods are acceptable. Congress recently empaneled the Advisory Council on Unemployment Compensation ("Council") to study the nation's unemployment insurance program. *See* P.L. 102–164. The Council was chaired by Dr. Janet L. Norwood, the former Commissioner of the Bureau of Labor Statistics and a senior fellow at The Urban Institute, and a witness in this Subcommittee's deliberations. In its February 1995 report to the President and Congress, the Council recommended that "[a]ll states should use a movable base period in cases in which its use would qualify an Unemployment Insurance claimant to meet the state's monetary eligibility requirements." *Unemployment Insurance in the United States: Benefits, Financing, Coverage*, Advisory Council on Unemployment Compensation, Feb. 1995 at 17. The proponents thus ask Congress to reject a policy suggested to it by the very body Congress empaneled to provide precisely such advice.

D. Ms. Doherty also argues that "[i]n the 1970's Congress itself expressly recognized and took no issue with the states' widespread use of base periods consisting of the first four of the last five quarters." Doherty Stmt. at 2. But Congress dealt with base periods only in its enactment of 26 U.S.C. 3304(a)(7), which was designed to control for a wholly separate problem of "double dipping" by those claimants who try to reuse wages for second claims. Accordingly, the court of appeals determined that 3304(a)(7) "had nothing to do with the operation of the 'when due' clause and certainly did not address the issue of whether the type of base periods used in the Illinois statute violated that clause." 22 F.3d at 1383.

V. The Use Of An Alternative Movable Base Period Will Not Substantially Increase The Costs Of Operating The Unemployment Insurance Program

A. The proponents also argue that Illinois' base period "streamlines administration and minimizes the risk of fraud," Doherty Stmt. at 1, because it allows for verification of a claimant's wages with data that "should already be in the state's computer system when the initial claim is filed," *id*.; whereas use of an alternative base period would require employers to comply with "additional reporting requirements with penalties for noncompliance, to verify claimant earnings that had not yet been reported and entered into the state's computers." Miller Stmt. at 1. In fact, however, the testimony in *Pennington* confirms that a movable base period can be most easily designed by using the very same wage data—collected and processed in precisely the same way—that Illinois does now. The only difference would be that, instead of enforcing a mandatory delay on using a claimant's recent wage data, the state would assess eligibility based on those wages as soon as they were reported by the former employer and processed onto the state's data base, for any claimant who needed his more recent wages to qualify for benefits. Since exactly the same wage data would be collected in exactly the same way, a movable base period would neither affect the efficiency of the existing data collection system; nor increase opportunities to commit fraud by submission of improper wage statements; nor impose new paperwork burdens on employers or the state.

B. The proponents also argue, however, that the *Pennington* decision "could have a costly impact upon employers and state government[s] ... and aggravate the federal deficit by hundred's of million's of dollars." Doherty Stmt. at 1. Both she and Ms. Gilbert estimate that administrative costs in Illinois would be "million's of dollars in one-time costs and $2.5 million in yearly operating expenses." *Id*. at 3; *see* Gilbert Stmt. at 3 (quantifying the one-time costs at $13 million). The proponents also estimate trust fund outlays of 1.5%; but note one study that, they claim, indicates that alternate base periods could "raise state Trust Fund outlays by four to six percent." *see* Doherty Stmt. at 3; Miller Stmt. at 1. From these estimates, Doherty contends, the trust fund outlays for a movable base period would be between $100 to $400 million over 8 years, which she and the other proponents claim, would trigger automatic tax increases or rising deficits. *Id*. And she concludes from all these figures that the *Pennington* decision will "cause nationwide disruption in the various states' unemployment compensation system." *Id*. at 4.

None of this is realistic. First, as accurately described by the court of appeals, the claimants' evidence supports a narrowly-based challenge to the section 237-type base period; not a challenge based on any alternative base period that any litigant

might conceive. 22 F.3d at 1380 n. 3. Furthermore, as the proponents concede, eight states (Maine, Massachusetts, New Jersey, New York, Ohio, Rhode Island, Vermont and Washington state) already use movable base periods, and Michigan will begin doing so on July 1, 1997. Yet the sky has not fallen in any of those states. Indeed, the Council concluded "that advances in technology have made it feasible for all states to use the most recently completed quarter when determining benefit eligibility." *Unemployment Insurance in the United States: Benefits, Financing, Coverage*, Advisory Council on Unemployment Compensation, Feb. 1995 at 16.

Moreover, the provision that the Supreme Court struck down in *Java* was used in 48 states. *See* Appendix to Appellants' Brief in *Java*, No. 507 (U.S. Sup. Ct. 1970) at 69–70. Yet the proponents offer no evidence that compliance with *Java* disrupted the nation's unemployment insurance program at all.

C. The Department of Labor has received, but not yet published, a draft of a report on administrative costs of an alternative base period. The proponents apparently hope you will pass this legislation before seeing the report. We believe that, if you wait until it is published, it will confirm that Illinois' estimates are wildly inflated.

The proponents' estimates of administrative costs include unnecessary additional costs for a wage request system to obtain wage data before it is reported in the normal manner. The evidence at trial confirmed that if Illinois did pay to add a wage request component to a movable base period, that alternative would be "administratively feasible" in the sense that, if there was no cheaper alternative, the costs of those systems would be worth the benefits they would generate to the claimants. But, in Illinois, the marginal benefits of adding a wage request component is too small to justify its greater expense over the alternative of simply using the most recent wage data when it is reported in the usual course. Thus, while Illinois could enhance a movable base period system marginally by incorporating a wage request component, the when due clause does not require that it do so.

Those estimates also include costs for a "reachback" component to find claimants who were previously denied benefits. But the Eleventh Amendment to the U.S. Constitution, U.S. Const., amend. XI, prohibits the courts from ordering any such relief. *See Paschal v. Jackson*, 936 F.2d 940 (7th Cir. 1991).

The proponents' insistence on calculating the costs of a movable base period by including a wage request and a reachback component is designed merely to inflate the "costs" of a movable base period. The following table compares Illinois' cost estimates with those components included and the same estimates with those components eliminated:

	Estimate With Wage Request and "Reachback'	Estimate Without Wage Request and "Reachback"
Conversion Costs:		
Non-computer	$4.0 million	$411,260
Computer	$9.3 million	$5.8 million
Total conversion	$13.3 million	$6.2 million
Operating Costs	$2.6 million	$178,615

The table confirms that, if the costs of a wage request and a "reachback" component are eliminated, Illinois' estimates of the conversion costs would drop $7.1 million, from $13.3 million to $6.2 million, and its estimate of the yearly operating costs would drop $2.4 million, from $2.8 to $400,000.

D. As for trust fund outlays, the evidence at trial confirmed that an alternative base period in effect in Illinois during 1986 would have paid a substantial proportion of about 23,000 additional claimants approximately 13.6 million additional dollars, and approximately 13,000 claimants would have been paid benefits sooner. In 1994, the Director of the Illinois Department of Employment Security estimated that the additional benefits paid to claimants would be about $30–$40 million a year. *See* Director Doherty's letter of July 7, 1994.

The last time the proposed legislation was introduced, Illinois "high side" estimate is $93.75 million per year. Its latest "high side" estimate is $100 million annually. Doherty Stmt. at 3. But those figures assume that, because the percentage of claimants who receive benefits would increase by as much as 6% if the state used an alternative base period, the trust fund outlays would also increase that much. That

assumption is unquestionably wrong since the vast majority of claimants who would be benefitted by a movable base period are those who would receive at or near the minimum benefit amount.

Moreover, while the applicable federal statutes give the states wide latitude to assure the solvency of the trust fund by setting their own benefit amounts, tax rates and eligibility requirements, the when due clause is one of the few federal limits on the states' discretion. By assuring that states do not adopt methods of administration that unreasonably delay the payment of benefits, the when due clause enforces the congressional purpose of prompt payment to tide workers over during periods of unemployment and to prevent the deepening of recessions. *Java*, 402 U.S. at 130–33. Accordingly, a state may not justify a violation of the when due clause by claiming that it had to delay payment of benefits to maintain its trust fund balance. *See id*., 402 U.S. at 129–33.

The when due clause's assurance that states will honor the claimants' interest in prompt payment of benefits necessarily means greater outlays from the trust fund. But "the congressional objective of getting money into the pocket of the unemployed worker at the earliest point that is administratively feasible ... is what the Unemployment Insurance program was all about." *Java* 402 U.S. at 135. Thus, to complain that the states are obligated to pay benefits promptly from the trust fund is to complain of the very purpose of the unemployment insurance system itself.

E. For the same reason, the tax consequences for employers is not a cogent reason for abandoning the when due policy. Using the estimate that recipiency would increase by as much as 6% under an alternate base period, Mr. Miller assumes that trust fund outlays, and thus taxes, would increase by that same rate, requiring payment of as much as $40 million in additional taxes each year. Miller Stmt. at 1. As noted, however, since the vast majority of claimants who would be benefitted by a movable base period are those who would receive at or near the minimum benefit amount, the percentage rise in recipiency is larger than the percentage rise in trust fund outlays. And since taxes are related to trust fund expenses, they would not rise by 6% either.

Mr. Miller also urges that his company, Phoenix Closures, provides long-term, stable employment. Miller Stmt. 1. That being so, however, his workforce does *not* include *Pennington* class members since they are, by definition, those who do not have less recent earnings available to qualify for benefits. Moreover, since the tax system in Illinois, like most states, is experienced rated, employers, like Phoenix Closures, who do not have a substantial unemployment insurance claims experience, pay substantially less taxes than employers (such as seasonal businesses) that provide shorter, less stable employment. Thus, if we take Mr. Miller at his word, he has little, if any concern that his company will be burdened by whatever tax increase arises as a result of the *Pennington* decision.

Moreover, for many years, those employers who do employ *Pennington* class members have not had to finance unemployment insurance to pay benefits to the *Pennington* claimants. Those employers have therefore been permitted to escape that part of the excise tax they were supposed to pay for use of the nation's labor supply. Indeed, a study by the U.S. Department of Labor, using data from Illinois, concludes that some employers obtain a form of subsidy by laying off workers while their wages are still within the lag period, thereby avoiding the charge associated with those workers' unemployment insurance claims. *Unemployment Insurance and Employer Layoffs*, Occasional Paper 93–1, U.S. Dept. of Labor (1993). The researchers estimated that "27 percent of all (UI chargeable) layoffs for a 4–5 quarter period were free layoffs to the firms initiating the layoffs ... [and that] the percentage of layoffs that are free varies from only 13 percent for the largest firms to 39 percent for construction firms." *Id*. at xiv. They concluded that "this UI subsidy actually tends to destabilize rather than stabilize employment." *Id*. at 3.

The General Accounting Office ("GAO") agrees. A 1993 GAO report to the Chairman of the Senate Committee on Finance concerned the reasons why the percentage of unemployed workers who receive unemployment insurance benefits has declined. *Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized*, GAO/HRD–93–107 (Sept. 1993). In that report, which was also based on data from Illinois, the GAO noted that "[s]tate officials ... said some employers control employee work schedules and earnings to ensure that they do not meet the qualifying requirements." GAO Report at 5.

The unemployment insurance tax is a fair excise on employers' use of the nation's labor supply. We ought not undermine a 60-year old policy of paying prompt unemployment insurance benefits to eligible workers because some employers who hire the nation's most vulnerable workers prefer not to pay their fair share of the costs of unemployment when they lay those workers off.

VI. THE PERCENTAGE OF UNEMPLOYED AMERICANS WHO RECEIVE UNEMPLOYMENT INSURANCE BENEFITS IS AT AN HISTORIC LOW, MAKING THIS A PARTICULARLY INAPPROPRIATE TIME TO UNDERMINE THE PROTECTION OF THE WHEN DUE CLAUSE

The 74th Congress enacted the when due clause to assure that unemployed Americans like Mrs. Pennington receive prompt replacement of lost wages during periods of unemployment. *See Java*, 402 U.S. at 130–33. This is a particularly inauspicious time to undermine that policy.

In its 1993 report to the Chairman of the Senate Committee on Finance, the GAO confirmed that the percentage of unemployed workers who receive unemployment insurance benefits has declined to historic lows of less than 40%. *Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized*, GAO/HRD–93–107 (Sept. 1993). Moreover, in its 1996 report to Congress, the Council confirmed the GAO's conclusion, finding that, in 1995, 14 states paid unemployment insurance to a quarter or fewer of their unemployed workers, and that Illinois paid only 37.2% of its unemployed. *Defining Federal And State Roles in Unemployment Insurance*, A Report to the President and Congress, Advisory Council on Unemployment Compensation, Jan. 1996; *see* Table 4–2 "Ratio Of Unemployment Insurance Claimants To Total Unemployment, By State, 1995." Commissioner Norwood's testimony confirms that the most recent data shows that "only 37.4 percent of the unemployed in our labor force survey are receiving UI benefits." Testimony of Janet Norwood ("Norwood Stmt.") at 2. Even more frightening, she notes that "[r]esearch conducted by the Council staff found that the competitive pressures among the states to attract business could well lead to a continued decline in the percentage of unemployed workers who receive benefits." *Id.* at 4–5.

A recent study concludes that "[t]he presence of an alternative [movable] base period raises the number of monetarily eligible claimants by 6 to 8 percent." Vroman, Wayne, *The Alternative Base Period in Unemployment Insurance: Final Report*, Jan. 31, 1995. Thus, the *Pennington* decision offers some reversal of the precipitous drop in the rate of unemployment insurance recipiency. And the GAO has confirmed that "[t]he receipt of [unemployment insurance] benefits [is] an important factor in keeping unemployed workers above the poverty level." GAO Report at 5.

Commissioner Norwood's testimony also confirms that the unemployment insurance system in some states "discriminates against the working poor, exactly the group we most need to help in our society," Norwood Stmt. at 5, and that the problem of insuring the working poor against unemployment will grow more acute "as an increasing number of people move from welfare to jobs as the result of the recent welfare legislation." *Id.*

Now is not the time for Congress to undermine "the congressional objective of getting money into the pocket of the unemployed worker at the earliest point that is administratively feasible"—the very principle that defines "what the Unemployment Insurance program was all about." *Java* 402 U.S. at 135.

Statement of Hon. Stanley Crooks, Chairman, Shakopee Mdewakanton Sioux (Dakota) Community, Prior Lake, Minnesota

INTRODUCTION

Mr. Chairman, my name is Stanley Crooks, the duly-elected Chairman of the Shakopee Mdewakanton Sioux (Dakota) Community, a federally-recognized tribal government, located in Prior Lake, Minnesota.

Please accept the following as the written testimony of Shakopee Mdewakanton Sioux (Dakota) Community in strong support of H.R. 294, the Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments of 1997.

H.R. 294

First, I want to thank you for scheduling this hearing, and for inviting testimony on H.R. 294. My Tribe also wishes to thank Representative John Shadegg of Arizona for his introduction of H.R. 294 and his efforts to advance it and other measures designed to stimulate economic development on Indian reservations.

For many years, my Tribe has sought legislative relief like that proposed in H.R. 294. Rep. Shadegg stands in a long line of Congressmen and Senators who have lent their support to legislation substantially identical to H.R. 294. We are indebted to Members like the Honorable Rep. Collin Peterson, who introduced H.R. 838 in the 104th with Representatives Minge and Kildee as co-sponsors, and who introduced

H.R. 1382 in the 103rd with Representatives Kopetski and Richardson as co-sponsors. Likewise, we are indebted to the Honorable Sen. John McCain, who introduced S. 1305 in the 104th, with Senators Baucus, Campbell, Domenici, Inouye, Kyl, Stevens, and Thomas as co-sponsors, and who introduced S. 391 in the 103rd, with Senators Campbell and Durenberger as co-sponsors.

We are very grateful to each of these Representatives and Senators who have pressed forward on this issue, year after year. Today, Mr. Chairman, we are especially grateful to you for setting this hearing and focusing the Subcommittee's attention on this problem and how H.R. 294 would resolve it.

H.R. 294 would amend existing FUTA tax statutes to clarify expressly that tribal governments should be treated just as state and local units of government are treated for FUTA unemployment tax purposes. Under H.R. 294, no federal FUTA taxes could be assessed against tribal governments, (the same as with state and local governments and tax-exempt organizations). The bill language would expressly authorize tribal governments, like state and local governments and tax-exempt organizations, to contribute to a state unemployment insurance fund on a reimbursable basis for unemployment benefits actually paid out to former employees. The bill would also eradicate any unemployment tax liability of tribal governments who have not paid unemployment compensation taxes in the past in the good faith and reasonable belief that tribal governments were exempt, provided that no benefits were paid to their former employees.

OUR TRIBE'S EXPERIENCE WITH FUTA

Around 1990, Shakopee received a bill from the federal IRS demanding payment of a substantial amount of what were called back FUTA taxes. After costly negotiating, the amount demanded was adjusted downward and we paid it in full.

Ever since the late 1980's when IRS agents in our region began to impose a new interpretation of the FUTA law on us, Shakopee has contributed into the State fund and has paid, under protest, the remaining Federal portion claimed by the IRS after appropriate credits are made for our State fund contributions. Our experience-based tax rate as an employer, for purposes of our contributions to the State fund, is 1.3 per cent. This tax rate is calculated as if our Tribe was a for-profit, private sector business. But we are not. We are a government.

Our participation in the State fund is now permitted only under the terms imposed upon commercial, for-profit business employers. We are not allowed to participate as governmental employers on a reimburser basis.

At no time has either our non-participation, or our participation, been a burden on the unemployment compensation system. When we have not participated, we have not cost anyone anything.

Indeed, our tribal government has been subsidizing the private sector's use of the unemployment insurance system. Here's how the subsidy works. Under the present IRS interpretation of FUTA, all other governments in America and income-tax-exempt organizations do not pay the federal portion of the FUTA tax, and they are allowed to contribute to the State funds only those dollars required to reimburse the State funds for benefits paid out to their former employees. But the present federal interpretation of FUTA requires our tribal government to pay the federal portion of the FUTA tax that helps administer the system, and requires us to pay an advance, flat rate of tax to the State fund. In both the federal and state portions of the FUTA tax, our payments lower the costs that are borne by private sector employers. If my Tribe was treated like all other governments, we would pay only for the allowable benefits paid out to our former employees. But the policies being advanced by the IRS and by the U.S. Department of Labor today are forcing our tribal government to help insure the private sector.

NEW INTERPRETATIONS OF FUTA ARE BEING UNFAIRLY IMPLEMENTED AGAINST TRIBAL GOVERNMENTS

The policy against tribal participation as governmental employers has not been uniformly applied. An October 1, 1993 study by the Congressional Research Service showed a variety of approaches used by various states. Some states permitted tribes to participate as governments. Others, like Minnesota, did not.

Only last year did the U.S. Department of Labor clarify its policy on this matter, when it issued an unemployment insurance program letter (no. 14–96, April 12, 1996), advising state governments that——

[I]t is the Department's position that the granting of reimbursement status to Indian tribes liable for the Federal unemployment tax is inconsistent with the experience rating requirements of Section 3303(a)(1), FUTA. However, some States have nevertheless granted such Indian tribes reimbursement status. Although Congres-

sional action has been anticipated on this matter for a considerable time, it does not appear to be forthcoming. Therefore the Department is issuing this UIPL to assure consistent treatment of tribes for experience rating purposes.

The Labor Department opinion notes that since the FUTA statute does not require states to provide unemployment compensation coverage to tribal government employers, "State UC coverage has not always been extend to the tribes... . If tribes are not covered under State law, then they will not be eligible for any credit against the FUTA tax."

Under the Labor Department's interpretation of FUTA, a State may refuse to accept a Tribe's contributions to a State unemployment fund. In this situation, the Tribe has no coverage. And, the Tribe must pay the full, Federal rate under FUTA without any offsetting credit.

The result is that, at the whim of a State, a tribal government can be forced to pay the full Federal rate of FUTA tax and receive absolutely no benefit whatsoever. This interpretation of the statute produces a patently unfair result at odds with the intent of Congress in enacting FUTA.

TRIBAL SUPPORT FOR H.R. 294

Our Tribe is not alone in its support for H.R. 294. Many Tribes throughout the United States have supported identical provisions in prior sessions of Congress. H.R. 294 also enjoys the active support of the National Congress of American Indians, most recently in the form of NCAI Resolution SPK–95–060 on predecessor bill H.R. 838.

H.R. 294 deserves support by the Subcommittee because the bill would correct an inequity in the unemployment insurance tax code. In all fairness, Indian tribal governments should be treated, under FUTA, like all other governments and non-taxable entities are treated. We are not asking for more than what is fair.

H.R. 294 would remove the substantial uncertainty about tribal participation in FUTA that persists in Indian Country, by clarifying that coverage is mandatory for all tribal government employers on terms that are uniformly applied and administered. The bill would end the costly disputes that have erupted in some areas.

And, H.R. 294 would make FUTA consistent with the government-to-government relationship that has existed, ever since the treaty-making era began, between the United States and federally-recognized Indian tribal governments.

BACKGROUND ON THE SHAKOPEE MDEWAKANTON SIOUX (DAKOTA) COMMUNITY

Our Tribe has returned to an area that was once included in the millions of acres our ancestors roamed before they were forced to relinquish them under a series of disastrous land treaties. What remains of our lands are approximately 1,500 acres held in trust and in non-trust status for our Tribe. Our lands are located 25 miles south west of the Twin Cities of Minneapolis and St. Paul.

In recent years, economic development has surrounded us and our lands. And our Tribe has been a major factor in revitalizing our region.

Our tribal government is the largest employer in Scott County, with a workforce of approximately 3,900. Our tribal government provides a full range of governmental services to our Community residents. We administer social services for children and families, mental health and chemical dependency counseling, employee assistance, emergency assistance, public works, roads, water and sewer systems, health programs and a dental clinic, vehicle fleet and physical plant maintenance, membership enrollment, education assistance, regulatory commissions, economic planning and development, enterprise management and operations, cultural programs, an active judicial system, and many other governmental activities. Our tribal government builds all permanent Community infrastructure, including roads, water, and sewer systems, subdivision utilities, and tribal government structures. The Tribe also maintains a home loan program whereby any tribal member can gain access to loan money with which to build a home. And, the Tribe operates an economic development loan program for tribal members who are starting their own businesses. Fifteen businesses are now owned by individual tribal members, including a travel agency, a hair salon, rubber stamp shop, clothing store, and gift shop.

Our tribally-owned and controlled enterprises serve the Community and are an important source of governmental revenue for the Tribe. These include two casinos, a recreational vehicle campground, a hotel, a recreation facility, a children's entertainment and daycare facility, and a convenience store and car wash.

OUR TRIBAL GOVERNMENT ENTERPRISES CANNOT BE FAIRLY DISTINGUISHED FROM STATE GOVERNMENT ENTERPRISES UNDER FUTA

Since the 1970's, Federal policy makers in the White House and in the Congress have pursued a broadly bi-partisan policy of encouraging tribal government self-determination and self-sufficiency through the development, by the tribes themselves, of tribal economic enterprises.

At least three separate rationales have driven this Federal-Indian policy. First, there is a desire to reverse the process that has led to considerable land loss and resource deprivation of tribal resources over the past centuries. Second, there is an effort to enable Indian tribes to help rid themselves of the plague of poverty and under-development in Indian communities that has forced Native Americans, as a group, to the bottom of every known measure of economic and social well-being in America. And third, there is support for an approach that respects the sovereign authority of governments to set their own course and resolve their own problems in their own way. For the Shakopee Mdewakanton Sioux (Dakota) Community that has meant we have actively pursued the development of appropriate economic development, including gaming, in order to boost the governmental revenues of our Tribe.

In all fairness, my Tribe's economic enterprises cannot be distinguished from those owned and controlled by State and local governments throughout America. For this reason alone, my Tribe would strenuously oppose any effort to exclude from the scope of H.R. 294 those tribal government employees carrying out the economic enterprise activities of the Tribe.

State and local government employees typically are engaged in a wide variety of business-type activities. What makes them governmental is that they are under the exclusive ownership and control of state and local governments, and the revenues they raise are dedicated to governmental purposes. Our tribal enterprise are no different. In fact, by federal law, our gaming revenues must be applied to statutorily-prescribed governmental purposes.

A recent CRS and U.S. Census Bureau survey provided to the Senate Committee on Indian Affairs [attached] estimates that state governments derive $46.5 billion each year from business-type activities. Each of the employees in these enterprises, from lotteries to liquor stores to ferry boats to manufacturing plants, are all governmental employees who are treated as governmental employees for purposes of FUTA. It is unfair to suggest that Indian tribal government enterprises should be treated any differently.

CONCLUSION

On behalf of the Shakopee Community which I lead, I thank you for the opportunity to provide this testimony in strong support of early enactment of the provisions in H.R. 294.

H.R. 294 is about basic fairness, correcting an inequity that has recently arisen in the FUTA program. As a tribal government, we ask for nothing more in H.R. 294 than to be restored to the same status that has been accorded all other units of government and tax-exempt entities.

H.R. 294 would not provide tribal governments like Shakopee any special favor or special treatment. Instead, it would simply clarify that tribal governments like ours should be considered, under FUTA, for what we are—governmental employers.

If there is anything we can do to assist the Congress in refining and securing passage of H.R. 294, please do not hesitate to let us know. Thank you.

Economics Division
Congressional Research Service • The Library of Congress • Washington, D.C. 20540-7430

Memorandum November 6, 1995

TO: Senate Committee on Indian Affairs

FROM: Dennis Zimmerman
Specialist in Public Finance

SUBJECT: Additional information on State business-type activities

As was explained in a memorandum dated November 2, 1995, the determination of whether a State government activity should be labeled a business-type enterprise is unclear. This determination depends upon the extent to which the State government activity is an effort to correct a private-market failure. In a telephone conversation on November 3, 1995, you requested that a list of State business-type activities be prepared within the constraints of data availability.

No State-by-State list of such business-type activities has been compiled by either the business community or by State governments. This situation reflects the uncertainties of making such a determination. The Census Bureau does separate State receipts by source. In general, receipts not classified as tax revenue or intergovernmental revenue are classified as charges and miscellaneous general revenue. These charges and miscellaneous general revenues are usually received in exchange for State performance of some service, provision of some good, or private use of some State asset. If one is willing to accept that such receipts are evidence of business activity, these data can be used to provide some idea of the extent to which States engage in business-type activities.

Table 1 lists 14 categories of activities for which States receive charges or miscellaneous general revenue. The Census does provide some guidance on the types of activities that are included in each category. But no information is available from the Census Bureau on the specific functions being performed by any given State. Some of the categories listed are quite narrow and require no further explanation. Others are quite general and a few examples of the types of activities included in the category will provide a broader view of the range of State activities.

- Water transport and terminals—Includes ferry boats and docks and wharves for cargo and passenger transport.

Miscellaneous commercial activities—Includes markets, cement plants, cemeteries, etc. Although not provided by Census data, I know that North Dakota owns a commercial bank and Massachusetts and Michigan manufacture their own vaccines.

Natural resources—Includes milk testing fees, sale of products from agricultural experimental farms, and the sale of timber and mineral products from State lands.

Auxiliary enterprises in higher education—Includes college bookstores, dormitories, and revenue from athletic contests.

Parks and recreation—Includes swimming pools, golf courses, marinas, piers, skating rinks, and lease and use fees from stadiums, auditoriums, and convention centers. Although not provided by Census data, I know that West Virginia owns and operates lodges in its parks.

A non-zero amount opposite the State's name is considered evidence that the State conducts at least one of the business-type activities included in the category. The bottom row of the table provides a count of the number of States that receive revenue from the activities in the category.

If I can be of further assistance, please contact me at 78473.

file: indians2.mem

Table 1. State Charges and Miscellaneous General Revenue: Business-type Activities, 1993 ($1000s)

	Lottery	Liquor Store	Hospital	Highway Tolls	Water Transport & Terminals	Airports	Miscellaneous Commercial Activities	Natural Resources	Auxiliary Enterprises in Higher Education	Parks and Recreation	Utilities			
											Water	Electric	Gas	Transit
Alabama	0	130,321	686,949	0	44,294	0	0	10010	178,034	23,670	0	0	0	0
Alaska	0	0	0	40,761	0	47,677	63,849	11331	18,975	0	0	27,682	0	0
Arizona	115,955	0	0	0	0	0	0	18883	177,521	2,855	0	17,101	0	0
Arkansas	0	0	132,544	0	0	0	0	6406	90,034	12,367	0	0	0	0
California	772,416	0	1,769,362	134,382	0	0	0	550290	665,893	62,792	0	172,769	0	0
Colorado	99,620	0	43,829	0	0	0	0	12247	229,554	1,231	0	0	0	0
Connecticut	210,248	0	198,448	230	103	18,532	713	925	101,016	3,565	0	0	0	18,424
Delaware	36,932	0	27,198	33,224	0	0	0	2680	56,411	3,488	0	0	0	4,178
Florida	959,419	0	125,689	294,668	0	0	0	14176	230,439	17,110	0	0	0	4,852
Georgia	0	0	209,973	1,280	68,842	449	0	20225	198,032	121,517	0	0	0	0
Hawaii	0	0	110,811	0	57,037	382,262	0	9102	49,035	8,425	0	0	0	0
Idaho	25,688	46,095	1,333	0	0	32	135	46578	40,936	542	0	0	0	0
Illinois	621,172	0	229,496	258,598	0	0	0	9109	333,066	4,690	0	0	0	0
Indiana	172,672	0	342,251	68,289	3,129	68	0	26788	449,182	9,926	0	0	0	0
Iowa	69,349	83,882	350,211	0	0	781	7,661	9689	163,116	1,603	0	0	0	0
Kansas	49,814	0	168,373	43,541	0	0	0	16000	91,782	1,916	0	0	0	0
Kentucky	137,743	0	194,506	10,457	0	0	0	24814	131,333	41,169	0	0	0	0
Louisiana	211,564	0	564,499	30,102	41,087	0	0	26161	196,704	33,941	0	0	0	0
Maine	54,097	72,941	6,564	38,096	5	85	0	9381	52,186	2,389	0	0	0	0
Maryland	367,913	0	62,801	129,150	37,790	60,252	3,100	11933	208,070	3,239	0	0	0	71,117
Massachuse	579,598	0	192,147	158,088	61,762	171,968	0	19923	143,376	18,889	61,752	0	0	0
Michigan	483,305	454,856	857,677	14,998	2,011	112	0	23165	491,160	16,109	0	0	0	0
Minnesota	113,692	0	323,989	0	0	1,293	0	33298	191,230	10,011	0	0	0	0
Mississippi	0	124,010	141,984	0	5,890	0	0	13848	120,917	5,654	0	0	0	0
Missouri	102,784	0	192,962	0	0	0	0	22211	147,645	1,210	0	0	0	0
Montana	16,961	36,966	2,240	0	0	107	2,016	10745	46,770	977	0	0	0	0
Nebraska	0	0	189,276	0	0	763	0	13770	94,153	4,632	0	0	0	0
Nevada	0	0	3,503	0	0	0	0	2885	30,996	1,253	41,178	28,342	0	0
New Hamps	42,360	209,941	3,352	47,535	314	51	0	3224	63,624	8,940	94	0	0	0
New Jersey	621,111	0	226,054	532,200	8,982	0	0	24363	190,100	211,170	20,023	0	0	355,160
New Mexico	0	0	180,286	0	0	193	0	15843	74,229	2,153	0	0	0	0
New York	1,059,713	0	1,074,314	336,867	4,653	21,815	0	10295	331,247	80,710	0	1,392,830	0	684,299
North Carolin	0	0	191,271	1,373	24,147	0	0	23970	370,560	3,167	0	0	0	0
North Dakota	0	0	16,136	0	0	0	119,491	11259	70,851	970	0	0	0	0
Ohio	781,130	371,056	786,144	94,365	0	0	2,121	22715	389,862	7,135	0	0	0	0

Oklahoma	0	0	209,985	74,049	0	0	12	4707	188,863	17,216	3,580	211,445	6,411	0
Oregon	203,221	171,638	268,314	2,463	0	34	0	67544	118,234	11,210	0	0	0	45
Pennsylvania	639,952	671,703	736,284	277,367	0	9,488	0	34512	420,014	13,838	0	0	0	0
Rhode Island	46,494	0	13,626	9,289	207	9,189	1,238	1621	43,184	3,577	0	0	0	7,032
South Caroli	0	0	408,154	0	45,830	227	0	8207	171,633	15,753	0	546,878	0	0
South Dakot	61,921	0	1,005	0	0	0	41,240	5602	27,168	3,744	0	0	0	0
Tennessee	0	0	305,713	0	0	0	0	62642	158,711	20,382	0	0	0	0
Texas	704,086	0	666,775	51,251	0	0	0	17086	438,217	15,980	0	0	0	0
Utah	0	71,903	221,074	0	0	445	0	6153	99,862	3,883	0	0	0	0
Vermont	20,049	28,922	2,107	0	0	0	0	868	36,337	4,308	0	0	0	0
Virginia	378,154	253,497	794,631	42,218	3,180	0	0	7706	423,489	5,174	0	0	0	0
Washington	183,438	264,455	263,877	69,050	0	1	0	175372	226,387	185	0	0	0	0
West Virgini	48,234	46,284	37,004	41,850	0	0	0	3421	80,509	15,493	0	0	0	0
Wisconsin	188,149	0	411,118	0	0	0	0	44410	174,237	7,016	0	0	0	0
Wyoming	0	31,990	5,345	0	0	0	0	1753	28,043	29	0	0	0	0
	10,178,954	3,070,460	13,953,184	2,835,741	409,258	725,739	241,576	1,530,046	9,052,947	867,181	126,627	2,397,047	6,411	1,145,107
Count of States with Enterprise	34	16	47	28	18	23	11	49	49	48	5	7	1	8

Source: Bureau of the Census, State Government Finances: 1993, Series GF-93.

GRAND TOTAL FOR ACTIVITIES $46,540,278,000

TEXAS WORKFORCE COMMISSION
May 7, 1997

The Honorable E. Clay Shaw, Jr.
United States House of Representatives
2408 Rayburn House Office Building
Washington, DC 20515–0922

Dear Congressman Shaw:

I speak for our Commissioners and many Texas employers when I tell you how much we appreciate your interest in resolving the "Pennington" issue and your willingness to give a fair hearing to reform of the administrative financing for employment security programs. As part of the record of the hearing of the Subcommittee on Human Resources on April 24, 1997, I submit the following comments.

Since Pennington v. Didrickson arose several years ago, Texas officials have been unequivocal in supporting the State of Illinois position. The Employment Security System federal/state "partnership" relegated setting of base periods to the states; for many years the unemployment insurance program has operated successfully under this premise. We are firm in our conviction that the federal court in Illinois decided the Pennington case incorrectly and the states' right to set individual base periods is by precedent and logic the correct position. I am sending you for the record a copy of the letter that the Texas Workforce Commissioners sent to our congressional delegation alerting them to the issue.

I also wish to state our support for administrative financing reform. Such reform is long overdue. Employers are paying too much in FUTA taxes and receiving too little in services. State agencies, under great pressure to deliver quality employment and training services to hard-to-serve populations as well as traditional job seekers, are strapped for funds. Pretending that there are legitimate reasons for excess FUTA collections other than federal deficit reduction is a myth that contributes to public cynicism. In particular, continuing the 0.2% FUTA surtax on wages, although its purpose was served 10 years ago, is unjustified. These are dollars that should be used by employers to continue economic growth, not for masking the deficit. There are, however, many legitimate reasons to allow states to collect their own administrative taxes as several of the proposals before this committee have indicated. For the record, I am enclosing an article that appeared in the our agency's newsletter for employers, Texas Business Today. It describes the current situation and the benefits states would derive from reform of the administrative financing system.

Thank you for allowing me to contribute to the record. I would be happy to respond further if any of the Committee members have questions.

Sincerely,

MIKE SHERIDAN
Acting Executive Director

[The attachments are being retained in the Committees files.]

Statement of Ute Mountain Ute Indian Tribe, Towaoc, Colorado; and Southern Ute Indian Tribe, Ignacio, Colorado

Mr. Chairman and Members of the Committee:

This joint statement is submitted on behalf of Colorado's two federally recognized Indian tribes with the longstanding hope that this honorable committee will adopt and support legislation expressly permitting federally recognized Indian tribes to be treated under the Federal Unemployment Tax Act in a manner similar to state and local governments. As reflected in a Congressional Research Service study of February 16, 1989, submitted to the then Senate Select Committee on Indian Affairs, treatment of Indian tribes for FUTA purposes under certified state unemployment programs was a case study in confusion, inconsistency and unfairness. Even for tribes, such as ours, that have worked with Congress and state legislatures to resolve our difficulties, the confusion reported to the Senate Select Committed in 1989 persists. In fact, under a directive issued by Director Mary Ann Wyrsch of the Unemployment Insurance Service, U.S. Department of Labor, dated April 12, 1996, it is currently stated, under threat of decertification of state programs, that it is un-

lawful to treat Indian tribes like other governments for FUTA purposes. In order to correct this unfair situation, Congressman Shadegg has introduced H.R. 293. We urge the committee to adopt this needed legislation so that the oldest governments in our nation, Indian tribes, can extend to their employees the same unemployment protections provided to other government workers.

Some background on this matter may be helpful. Because Indian tribes are recognized under federal law as quasi-sovereign governments, many state governments, including Colorado, determined them to fall outside the scope of state unemployment programs. In our case, despite repeated efforts to enroll in the Colorado unemployment program, we were deemed legally ineligible to participate. Our employees were, therefore, not able to obtain the protection provided by the state's unemployment insurance program. Nonetheless, under FUTA, we assertedly incurred sizeable federal unemployment tax liabilities, which the Internal Revenue Service sought to collect during the mid 1980s.

As part of the 1986 Tax Reform Act, pursuant to an amendment introduced by our former Senator William Armstrong, Congress provided retroactive FUTA tax exemption relief to tribes such as ours, which had not been permitted to participate in state programs. (Pub. L. No. 99–514, 1705). That amendment, however, extended such relief only up until January 1, 1988, by which time tribes and states were expected to have resolved their differences regarding participation in state programs.

In keeping with the opportunity provided by Congress, our tribes worked with the Colorado General Assembly to allow for our participation in the state program. In 1987, the state unemployment insurance law was amended to include our tribes within the definition of "political subdivision" for the limited purpose of our tribal participation in the state program. This treatment allowed us to pay for unemployment insurance costs at the same level as county and municipal governments and at a more favorable rate than would have been assigned to new employers. Between the effective date of that legislation and issuance of Unemployment Insurance Program Directive of April 12, 1996, all proceeded well.

Without some legislative remedy, the directive of April 12, 1996 threatens to undo all that we accomplished less than a decade ago. Threatened with decertification, the State of Colorado has amended the state law excluding us from the governmental portion of their program. However, in recognition that we are working hard to obtain a legislative solution, the effective date of that change has been postponed until July 1, 1997. The increased rates that would otherwise be applied to our tribes would multiply our unemployment insurance costs many times, and between our tribes we estimate increased annual costs approaching one-half million dollars.

Our concerns have been discussed by Indian tribes throughout the country. Such broadbased organizations as the National Congress of American Indians have urged passage of legislation to eliminate discrimination against tribal governments in administration of FUTA. Fortunately, a legislative vehicle to correct the inequities of the current system has been introduced.

As elected leaders of two affected tribes, we hope that you will respond to this national problem by supporting H.R. 294, a bill to enact the "Indian Tribal Government Unemployment Compensation Act Tax Relief Amendments of 1997." That legislation will provide states the authority to allow tribal governments to participate in certified state programs along with other governments. The legislation also provides tribes the option to participate in state programs. With passage of H.R. 294, we strongly believe that all concerned parties will finally have the explicit authorization apparently demanded by the Department of Labor as a condition to recognition of effective state-tribal relations.

In conclusion, we appreciate the opportunity to provide this testimony to committee, and we request that it be printed in your record of proceedings.

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