
SENATE COMMITTEE ON LABOR, PUBLIC EMPLOYMENT AND RETIREMENT

Senator Jerry Hill, Chair

2019 - 2020 Regular

Bill No:	AB 805	Hearing Date:	August 11, 2020
Author:	Obernolte		
Version:	June 25, 2020		
Urgency:	Yes	Fiscal:	Yes
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SUBJECT: Unemployment insurance: contribution rates

KEY ISSUE

Should the Legislature cap employer contribution rates for 2021 and 2022 at the applicable contribution rate paid into the Unemployment Insurance Trust Fund in 2020?

ANALYSIS

Existing law:

- 1) Establishes within the Treasury of the United States the Unemployment Trust Fund. The Secretary of the Treasury is authorized and directed to receive and hold in the Fund all moneys deposited by a State agency from a State unemployment fund or otherwise deposited in or credited to the Fund. (42 U.S. Code §1104)
- 2) Defines “Unemployed” to mean an individual who, in any week, meets any of the following conditions:
 - a) Any week during which he or she performs no services and with respect to which no wages are payable to him or her.
 - b) Any week of less than full-time work, if the wages payable to him or her with respect to the week, when reduced by twenty-five dollars (\$25) or 25 percent of the wages payable, whichever is greater, do not equal or exceed his or her weekly benefit amount.
 - c) Any week during which he or she performs full-time work for five days as a juror, or as a witness under subpoena.

(Unemployment Insurance Code §1252)

- 3) Provides eligible workers with unemployment compensation benefits from the Unemployment Fund. (Unemployment Insurance Code §1251)
- 4) Requires all employers in California to pay into the Unemployment Insurance Trust Fund, created by federal law, in order to fund the Unemployment Insurance System. The tax payment cannot be deducted from the workers’ wages, and the employer’s contribution rate is based on how many of the employer’s former employees utilize the UI system. (Unemployment Insurance Code §§976 & 977)

This bill:

- 1) Caps employer contribution rates for 2021 at the applicable contribution rate paid into the Unemployment Insurance Trust Fund in 2020, including the solvency surcharge.
- 2) Declares that, due to the need to temporarily relieve employers of the added financial burden of increased contribution rates caused primarily by the COVID-19 pandemic, it is necessary that this bill take effect immediately.

COMMENTS**1. A Jump into the Dark: The Big Questions of AB 805:**

As discussed above, the funding for the Unemployment Trust Fund is from mandatory taxes paid by employers. The amount paid is a function of the employer's payroll and the utilization or experience of the employer – in other words, California levies a UI payroll tax on the first \$7,000 of wages (taxable wage base) of each employee, and the tax rate increases or decreases based on how frequently an employer's former employees access the unemployment insurance system. **AB 805** would freeze tax rates at the 2020 level for 2021, preventing EDD from assessing a higher tax rate on an employer.

How will California Make up for the UI Fund Shortfall?

California has the lowest permissible taxable wage base, resulting in a structurally insolvent system – when hit with a recession, the UI Fund will almost immediately run a deficit, requiring loans from the federal government. If EDD is additionally prevented from adjusting contribution rates to move the Fund towards solvency, that will require additional borrowing by the State of California from the federal government.

While California has repaid the loans taken out since the onset of COVID-19, this bill may necessitate additional borrowing. As federal law prohibits the loans from being repaid from UI assessments, **the interest on these loans will need to be paid by either the general fund or from borrowing from another state-controlled fund.** In 2011, California needed to borrow \$303.5 million from the Disability Insurance Fund to cover UI interest payments. Unlike in 2011, California's Disability Insurance fund is impacted by the recession due to COVID-19. That could necessitate that the interest payments come out of the general fund.

Who Will Benefit from AB 805?

As noted above, EDD applies UI taxes to an employer's payroll. If an employer has 10 employees, they will pay more in UI taxes than an employer with 2 employees. Therefore, the larger the employer, the more likely they will receive a tax benefit from AB 805.

However, this is only part of the story. Even if a hypothetical employer has a relatively stable workforce, the tax rate is applied to a narrow sliver of payroll: \$7,000. On average, California's employers paid a tax rate of 4.1% -- \$287. The employers with the highest

utilization paid 6.2% -- \$434. As 6.2% is maximum tax rate, employers with large seasonal workforces or large workforces with significant turnover will disproportionately benefit from a capped tax rate, socializing the costs of keeping the system solvent to other employers. This is known as *socialization*.

With AB 805, employers that laid off large numbers of workers during COVID-19 will maintain low UI tax rates, while employers that did not lay off their workforce will see no benefits whatsoever. This means that AB 805 will **socialize the costs of large employers laying off their workforce** to employers with more stable workforces, including small businesses.

2. Proponent Arguments:

None on file.

3. Opponent Arguments:

The California Labor Federation, arguing in opposition of the bill, argues the following:

“California’s UI program offers modest but essential assistance to those unemployed through no fault of their own. UI recipients typically earn \$40-\$450 per week, based on qualifying wages, for up to 26 weeks, though this amount can be extended during crises such as that currently before us. While these benefits are a far cry from what was actually lost, they provide a critically important lifeline to those unable to work despite being ready, able and willing to do so.

Two main flaws have historically crippled the effectiveness of our UI program: underfunding and low benefits. Regarding underfunding, the system is notorious for immediately diving into insolvency during recessions, given that employer contribution rates remain far below that necessary to adequately fund even our extremely low weekly benefit amounts.

Worse yet, this insolvency requires California to borrow massive sums from the federal government to keep benefits available, and this borrowing generates correspondingly massive interest payments. For example, the 2008 mortgage crisis and subsequent recession sent California’s UI fund into insolvency for nine years, requiring the state to repay \$1.4 billion in interest on federal loans. Much of this interest was taken from the 100% worker-funded SDI fund and only repaid at the end 2019; all \$1.4 billion was ultimately paid by general fund monies.

As concerning as the chronic insolvency may be, our abysmally low benefits are even worse. On average, workers only receive about 26% of what was earned while working. Only eight states offer lower wage replacement percentages, and these figures don’t account for California’s high cost of living, meaning that California is arguably already the worst state in the nation in which to be an unemployed worker.

But even these blatantly inadequate benefits stretch the system beyond solvency, over and over again, given that employers simply don’t pay enough to fund it. Even at the F+ rate

class schedule, with a 15% solvency surcharge, which is the highest amount employers can possibly pay under our existing rate schedule, employers only pay an average of 68 cents per \$100 of payroll. The corresponding amounts for employers in Oregon and Nevada are \$1.42 and \$1.12, respectively.

This underfunding is, by far, the most important flaw to fix in our system. Without a solution, benefits will continue to remain wholly inadequate and workers will continue to suffer. However, AB 805 (Obernolte) goes in the opposite direction and *reduces* employer funding of UI during what will very possibly be the system's greatest funding crisis in history.

Not only will this bill move us farther away from the solution we need, it will delay our ability to repay what will certainly be staggering federal loan amounts and generate untold millions in additional interest, paid from the general fund, while the general fund is also facing possibly its biggest funding crisis in history. Ideally, we would be now focused on a massive overhaul of our system to increase benefits and improve solvency, but at a minimum, we should not take a crippling crisis and—in multiple ways—make it significantly worse.”

4. Prior Legislation:

AB 103 (Ting), Chapter 22, Statutes of 2020, prohibits unemployment compensation benefits paid to an unemployed individual from being charged against the reserve account of a tax-rated employer, unless the employer or an agent of the employer was at fault, as prescribed. Under the bill, this prohibition would become inoperative on January 1, 2021, unless the Director of Employment Development makes a specified determination.

SUPPORT

None on file.

OPPOSITION

California Labor Federation, AFL-CIO

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