There is no doubt that North Carolina's unemployment insurance system needs reform. North Carolina's policymakers must first establish forward financing to fix the trust fund's current problems and ensure that an adequate trust fund balance built up in good times that can be paid out without borrowing or raising taxes in downturns. Unfortunately, the proposal being considered by Revenue Laws and the General Assembly would do nothing to put in place the policies that support forward financing but make more likely the pay-as-you-go model that will put the fund in crisis during future downturns and create political pressure to cut benefits.

The Budget & Tax Center has put forward an alternative proposal for reforming the state's unemployment insurance system that takes into account the best available research on what works to ensure an adequate system is funded with the full and equitable participation of employers.[1] Policymakers should be guided by an approach that seeks to do the following:

- **Build a system that can better weather economic downturns** by ensuring adequate fund levels to reduce the reliance on borrowing to meet benefit payments in downturns.
- **Maintain the system's ability to support the economy** by ensuring that the wage replacement function of the unemployment insurance system is adequate to support workers seeking work.

Here are the key financing recommendations from the Budget & Tax Center with available data on its impact on contributions to the state's trust fund and achieving solvency.

Recommendations

Expand the taxable wage base through better indexing. North Carolina is one of 17 states that wisely index their taxable wage bases for growth in payrolls. However, North Carolina's taxable wage base is only indexed to 50 percent of the state's average annual wage. Increasing the taxable wage base from this current level incrementally to a higher percent of the average annual insured wages paid in the state could significantly improve the solvency of North Carolina's trust fund.

According to simulations run by the Upjohn Institute, setting the taxable wage base to 60 percent of the state's average annual wage would achieve solvency by 2016 alone and increase contributions in the first year of implementation by about $55 million and then incrementally increase in future years along with the growth in wages in the state.

Reform the experience-rating system to better align taxes paid with benefits from the unemployment insurance system. An employer's unemployment-insurance tax rate is based on his or her experience rating— employers with more workers claiming unemployment benefits pay higher tax rates. However, there are important ways in which North Carolina can strengthen the link between taxes paid and benefits claimed.

1. ***Increasing the standard beginning rate for a new employer to 2.7 percent***. There are 48 states with beginning rates higher than North Carolina's and 12 states with beginning rates higher than 2.7 percent. Analysis by the Upjohn Institute finds that an increase in the

[1] For a review of policy levers in unemployment insurance financing reform see Wayne Vroman, Urban Institute, Center on Budget and Policy Priorities, National Employment Law Project and the Upjohn Institute.

standard beginning rate to this level would increase contributions by $50 million in the first year of implementation.

2. ***Raising the minimum tax rate from zero percent to .5 percent.*** The majority of states have minimum tax rates below 1 percent. A minimum tax rate of .5 percent would ensure full participation by employers in financing the unemployment insurance system.
3. ***Increasing the maximum tax rate to 8 percent.*** There are 34 states with maximum contribution rates higher than North Carolina.
4. ***Better aligning the tax-rate range and increments with an employer's experience of layoffs.*** There will be a need to additionally address the tax-rate ranges within the middle of the tax range where the majority of the taxable wage base and employers are in the state. More precise modeling of these changes requires access to the US Department of Labor models. However, both the Upjohn Institute and the Division of Employment Security model an increase by .2 index points. Such a change according to the Employment Security Division would result in an additional $58 million each year in contributions.

   However, it is additionally important that changes between tax schedules or formulas be triggered based on solvency measures that provide some assurance of a sufficient balance to withstand downturns. The preferred measure to trigger changes in the tax schedules would be an average high cost multiple of 1.

Do no harm to the wage-replacement function of unemployment insurance. Fundamental to the purpose of the unemployment insurance system is maintaining consumer demand so that the economy can be stabilized in periods of downturn. This is achieved by ensuring that workers have temporary wage replacement so that they can meet basic needs and remain connected to the labor force. ***Formulas to calculate benefit amounts should be tied to wages in the economy to ensure that the wage replacement function is sufficient to serve its stabilizing function and does not erode over time.***

Strengthen re-employment services and establish work-sharing for future downturns. North Carolina's job deficit—the number of jobs needed to make up for those lost and keep pace with the growing working-age population—is at half a million. As jobs return, it is critical that North Carolina policymakers invest in re-employment services that work: training for new industries at community colleges, one-on-one career counseling, and additional supports for workers taking on lower-wage work. ***This requires having in place, whether through the Worker Training Trust Fund or some consistent state appropriation, sufficient funds to support innovation and implementation in this area.***

Summary

These proposals have the potential to bring the state's trust fund to solvency in three years or along the same time frame as is currently being proposed by members of Revenue Laws committee. And yet these proposals include none of the widespread benefit changes that will negatively impact workers and the overall stabilizing function of the system to the economy. Moreover, experts on unemployment insurance system design have identified these policy levers as critical to strengthening the financing of unemployment insurance system. The Division of Employment Security in spring 2011 recommended similar financing changes as did the Upjohn Institute in its May 2012 report. Policymakers should be informed by the best available evidence of what works to fix the state's unemployment insurance system and should pursue policies that ensure its ability to protect the economy—workers and business alike—in downturns.