

Opinion: Another reminder there's no free lunch

By Dan Walters, CalMatters

It's doubtful whether more than a relative handful of Californians have heard of the Unemployment Insurance Fund.

It is, however, one of state government's largest activities – and a case study in political mismanagement.



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Currently, California employers pay about \$6 billion in payroll taxes into the UIF each year. And currently, the state Employment Development Department annually pays almost that much to jobless workers.

Superficially, that would appear to be a sustainable equation, but in reality, it's not.

During periods of high payrolls and low unemployment, such as this one, the UIF should be building reserves that could cope with an economic downturn, when claims for jobless benefits increase.

That's the way it used to work – until political expediency and recession undid it.

In 2001, the UIF had a \$6.5 billion positive balance. But the governor at the time, Democrat Gray Davis, owed big political

debts to unions that financed his battle with two very wealthy Democratic rivals in 1998.

Davis repaid his debt to public employee unions in 1999 by sharply increasing pension benefits for state workers – a move later emulated by most local governments – on assertions that investment earnings would pay for them without more taxpayer money.

Similarly, Davis repaid his debt to the private sector unions in 2001 by backing a sharp increase in unemployment insurance benefits on the assertion that the UIF, with its \$6.5 billion reserve, could easily afford it.

Both backfired when recession clobbered the state's economy twice in the new century's first decade.

Eventually, the California Public Employee Retirement System sharply increased mandatory "contributions" to make up for investment losses and pay the increased benefits.

Meanwhile, the first recession in 2001, coupled with the increased benefits, quickly depleted the UIF and by 2004 the state was borrowing from the federal government to keep checks flowing.

The UIF regained solvency and reached a \$3.6 billion reserve as the state emerged from recession, but when the economy declined again with the bursting of the housing bubble, that cushion quickly evaporated.

By 2009, with the UIF once again in the red, the state once again tapped Uncle Sam for loans, and when it could not repay the nearly \$10 billion debt, the feds indirectly raised payroll taxes on California employers.

Employers will have paid about \$9.5 billion in those extra taxes by next year, when the loans will be retired. A new report on the UIF, issued last month, says it should have a

\$1.8 positive balance by the end of 2018.

All good? Not by a long shot.

Because payroll taxes are only barely keeping up with unemployment insurance outflows now, during a period of low joblessness, the fund cannot build a healthy reserve. Or as, the new report puts it, “the current financing structure leaves the UI Fund unable to self-correct and achieve a fund balance sufficient to withstand an economic downturn.”

There are four ways to make the UIF truly solvent – raise the payroll tax rate, widen the wage base on which the rate is paid (it’s now \$7,000 a year), reduce benefits and/or tighten eligibility for benefits.

The first two draw resistance from employers while labor unions and other employee groups oppose the latter two.

However, as we’ve learned from the pension crisis or the years of neglected maintenance on state highways, there’s no free lunch.

Short-term expediency, such as boosting benefits without putting aside money to pay for them or letting maintenance slide because raising gas taxes is politically difficult, just makes the eventual days of reckoning that much more difficult.