2016/17 BUDGET BRIEFING
Report on Key Issues
HOUSE APPROPRIATIONS COMMITTEE (D)
JOE MARKOSEK, DEMOCRATIC CHAIRMAN
February 3, 2017

Unemployment Compensation Funding

State supplemental funding for the Department of Labor and Industry's administration of the unemployment compensation system through the Service and Infrastructure Improvement Fund, or SIIF, expired this past December.

Because of continued declines in federal funding (the primary source of revenue for the UC program), the expiration of SIIF means the UC administrative program will lose a revenue stream that provided up to a quarter of its annual funding.

To forestall disaster, House lawmakers passed HB 2375 during the 2015/16 legislative session, a short-term compromise extension, in a broad, bipartisan vote (175-13). The bill would have enabled ongoing discussions to find a long-term solution, but the Senate failed to pass it, effectively killing the bill and postponing the decision for the recently sworn-in legislature. .

With the large loss of funding, the commonwealth laid off 499 employees across all aspects of the program and three call centers were closed in Allentown, Lancaster and Altoona. As of this writing, Pennsylvanians trying to call the department to file a claim or get additional information about their unemployment benefits are experiencing hours-long wait times. This situation is very similar to the problems that led lawmakers to create the supplemental state funding stream in the first place.

What led to the creation of the Service and Infrastructure Improvement Fund?

With phone lines busy in 2013, the General Assembly took bipartisan action to alleviate the logjam of constituents who were unable to reach the unemployment compensation service centers to file for benefits, and to help offset declining federal funding.

Act 34 of 2013 established the Service and Infrastructure Improvement Fund to allocate a portion of existing employee contributions to the Unemployment Compensation Benefits Fund for administrative purposes. This infusion of resources stabilized operations, fixed some existing issues and improved service levels. Payments were made faster, busy signals decreased and appeals of eligibility decisions were decided faster.

Like the federal government, Pennsylvania collects employer taxes to fund unemployment benefits. Federal law requires all state employer UC taxes to fund benefits. However, Pennsylvania is one of three states that currently has an employee tax to help pay for benefits. These contributions are not restricted like employer taxes, which is why the General Assembly could allocate a portion of them to ensure unemployed Pennsylvanians received quality service levels when filing a benefits claim.

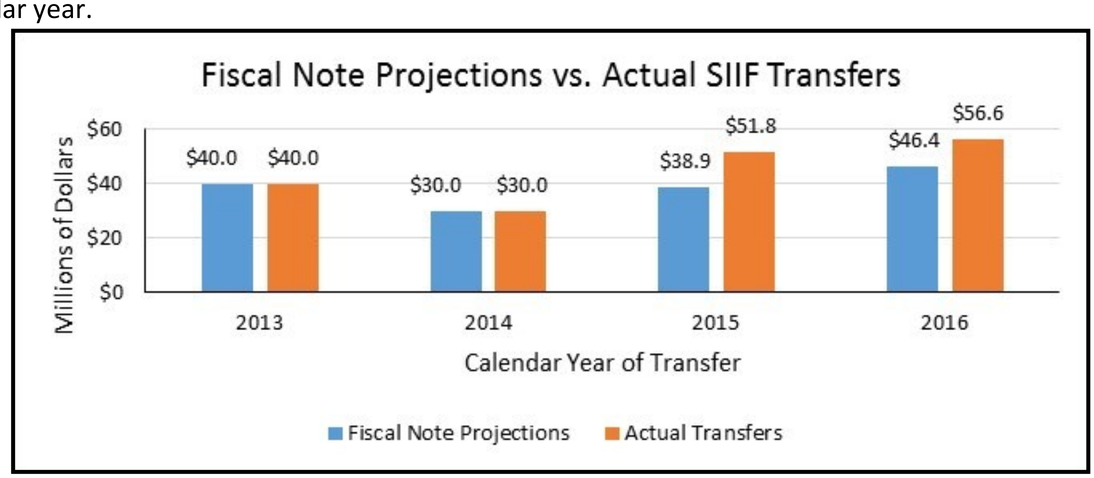
Under Act 34, SIIF funds were prioritized for discrete purposes:

> "Moneys in the Service and Infrastructure Improvement Fund are appropriated on a continuing basis, upon approval of the Governor, to the department to be prioritized for the following purposes:
>
> "(1) To improve the quality, efficiency and timeliness of services provided by the service center system to individuals claiming compensation under this act, including claim filing, claim administration, adjudication services and staffing and training of system employees.
>
> "(2) Expenditures for information management technology, communications technology and other infrastructure components that the secretary determines are likely to result in significant and lasting improvements to the unemployment compensation system.
>
> "(3) To pay the costs of collecting the contributions deposited into the Service and Infrastructure Improvement Fund pursuant to section 301.4(e)(2)."

The text of the law puts the highest priority on improvements to the service levels delivered to Pennsylvanians filing claims – including staffing levels. This language and contemporary sources like Gov. Tom Corbett's press release after he signed the bill into law confirm that additional resources would support staff costs and not, as has been suggested, just technological upgrades.

How much support did SIIF provide to the UC system?

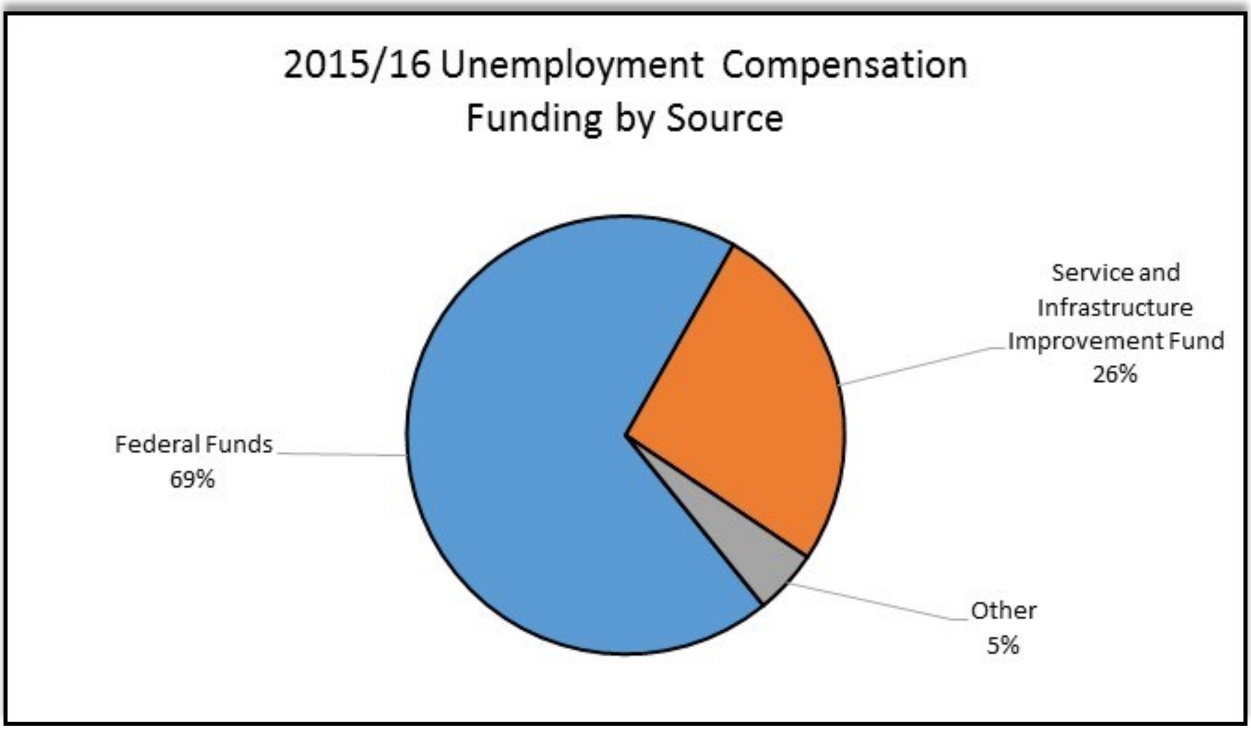
Statute laid out SIIF funding levels by calendar year. Fixed dollar amounts were allocated for the first two calendar years ($40 million in 2013 and $30 million in 2014). For the next two calendar years, the allowable transfer was equal to the difference between a $190 million cap (as adjusted for inflation) and the total federal administrative funding received for the preceding federal fiscal year. In essence, SIIF made up the difference between federal funding and the cap, ensuring the department had a steady base of funding. At the time of enactment, the fiscal note projected that the annual SIIF transfer would be between $30 million and $46 million per calendar year.

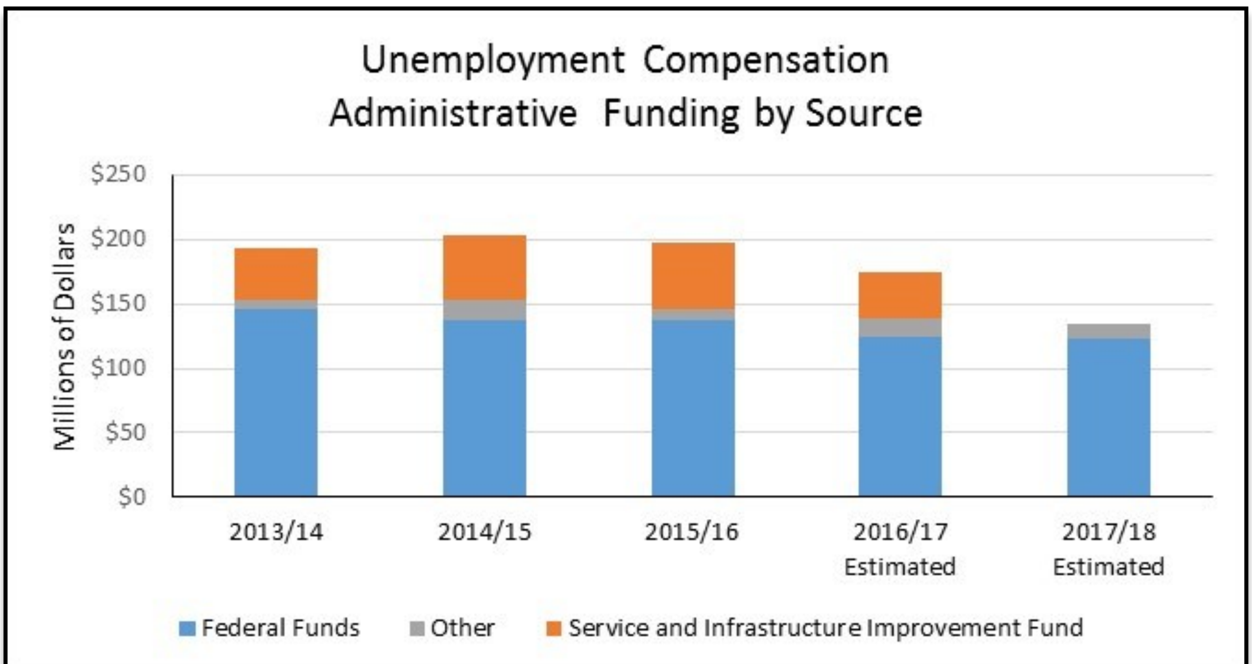


SIIF transfers ended up being higher than these projections. Since the past two years of SIIF transfers depended on the prior year's federal funding, **larger than expected declines in federal support meant a greater reliance on the SIIF backstop – and consequently a larger gap in the budget when SIIF transfers ended.** SIIF transfers over the four-calendar-year period totaled $178.4 million.

Note: While the commonwealth usually measures expenditures on a fiscal year basis (July 1 to June 30), the UC program has the added complications of federal funding allocated in line with the federal fiscal year (Oct. 1 to Sept. 30) and UC taxes computed on a calendar year basis. The different bases can make comparisons difficult, but where possible, this document uses the state fiscal year as the time period of measure. Since SIIF transfers run on a calendar year, this means existing law only contained a partial year of funding for the 2016/17 fiscal year.

For the last full fiscal year in which the total SIIF was authorized (2015/16), SIIF constituted more than one-quarter of the UC administrative funding.

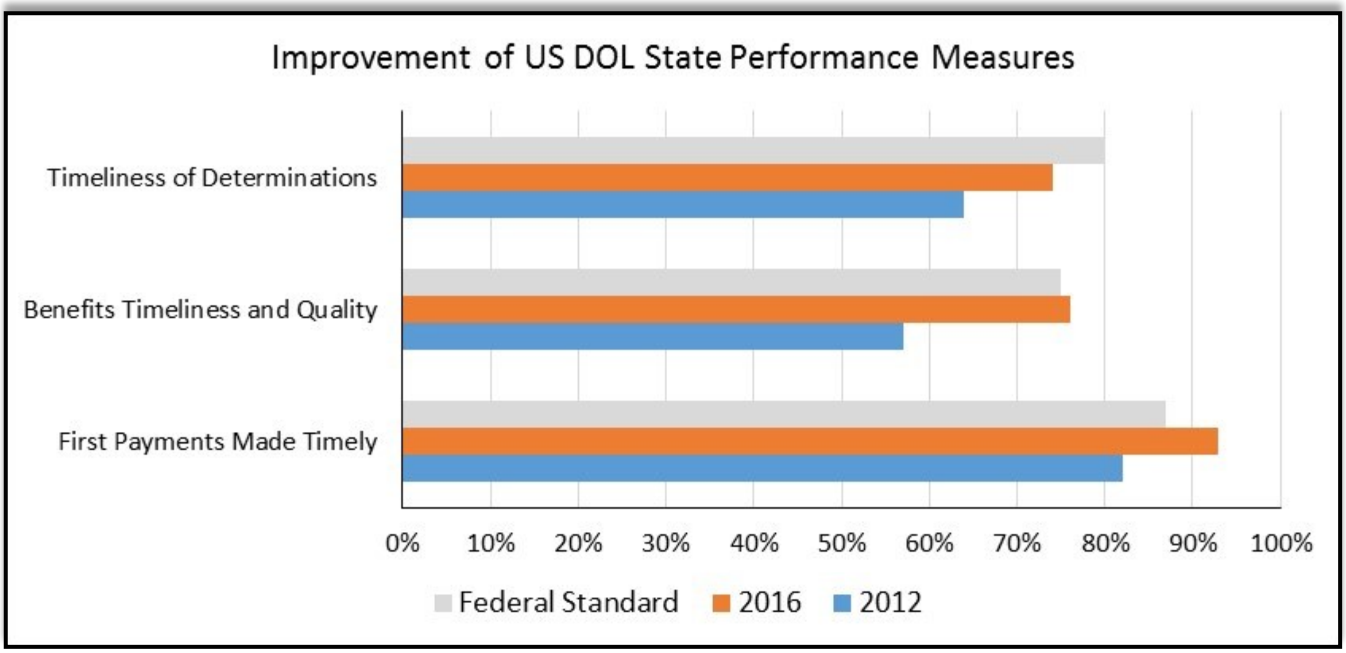




Forecast from L&I

Effects of SIIF Funds on Service Metrics to Pennsylvanians

The US Department of Labor tracks several performance metrics for state unemployment insurance programs, including benchmarks to gauge the effectiveness of operations. With the help of SIIF funds, Pennsylvania significantly improved its metrics and also met many of the federal benchmarks. The improvement is especially noticeable in timeliness, meaning the department improved how quickly decisions on benefit eligibility were made and how quickly payments began flowing to unemployed Pennsylvanians.

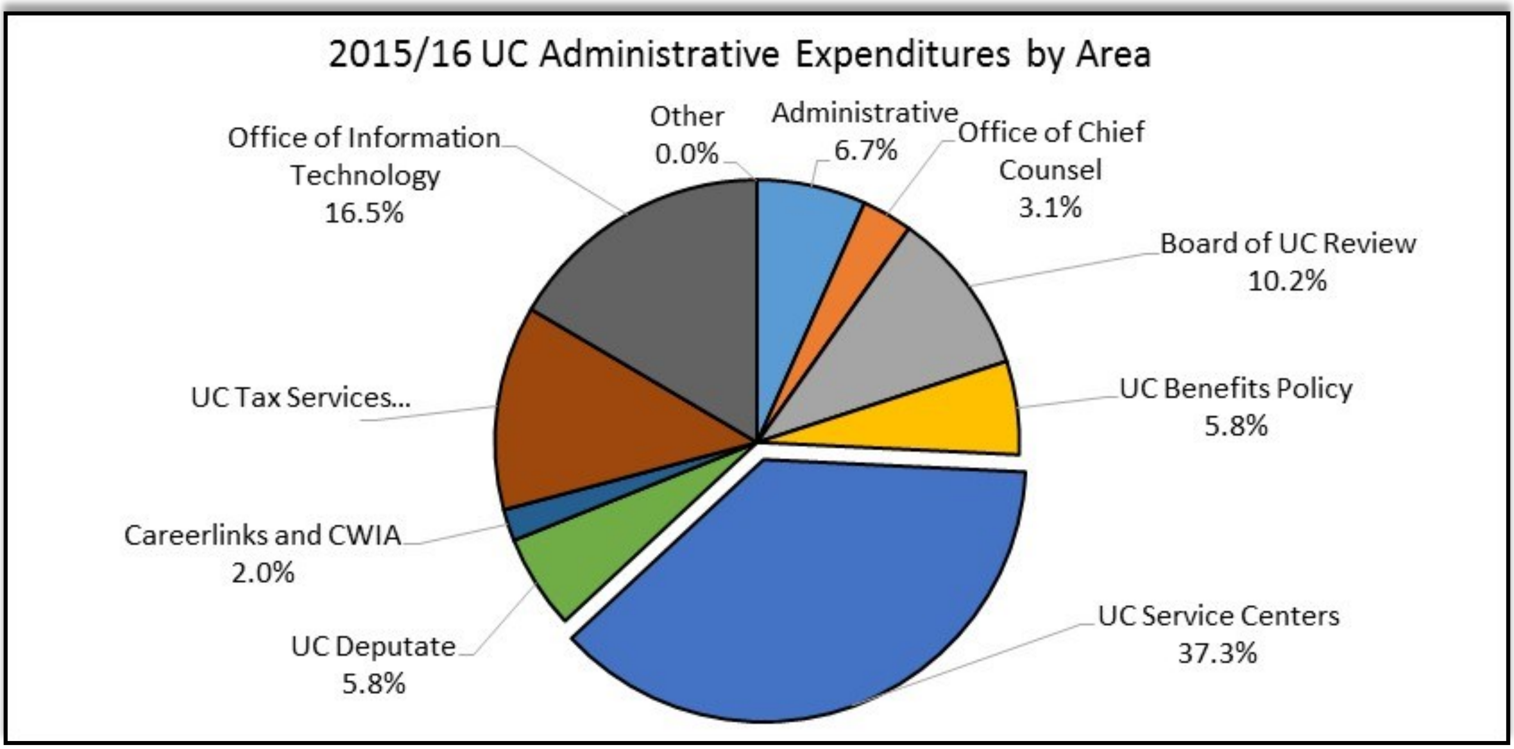


In addition, the timeliness of processing higher authority appeals of disputed claims significantly improved - dropping from 80 days in 2012 to 29 days in 2016, exceeding the federal benchmark of 40 days.

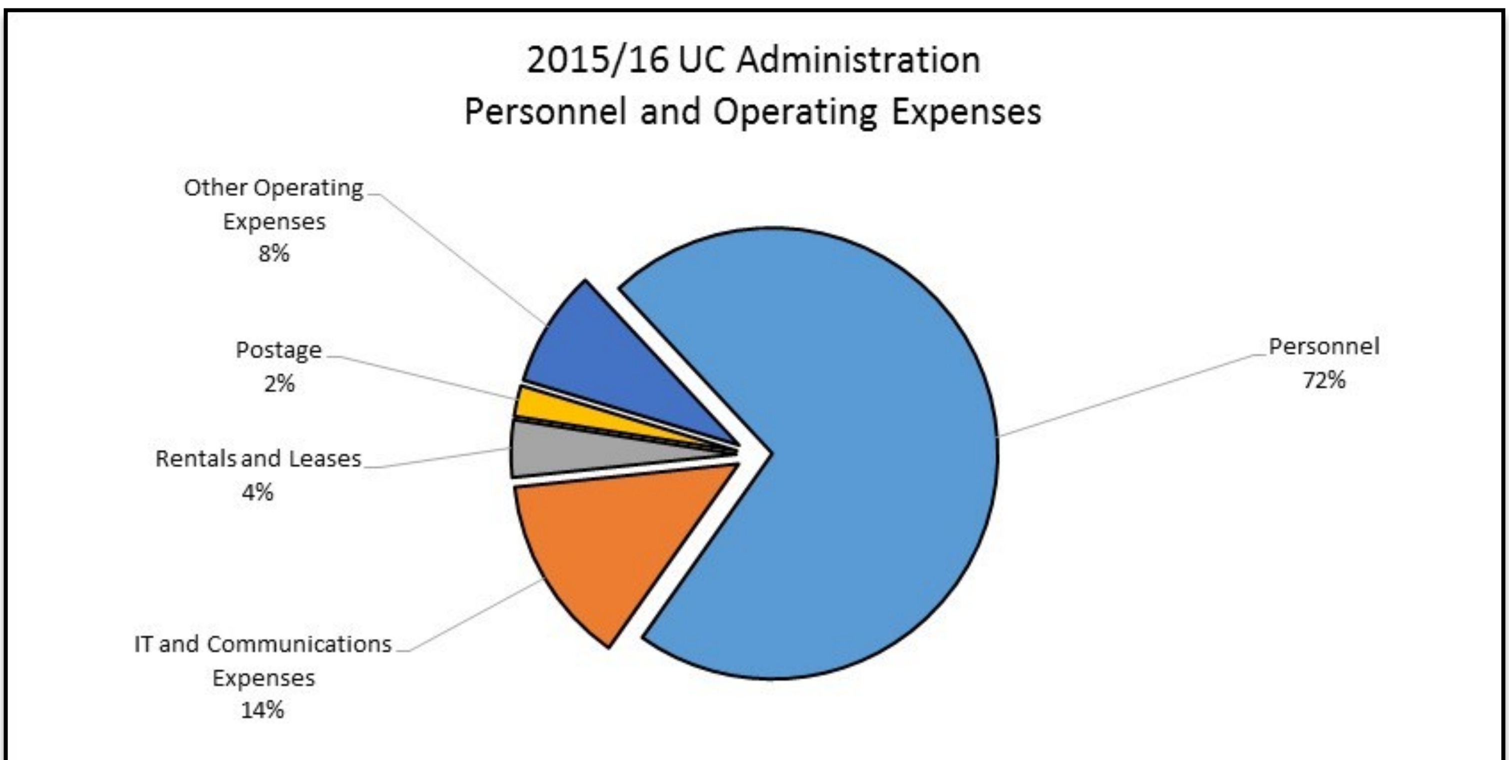
The UC Service Centers in Context

Inadequate service for Pennsylvanians filing an unemployment claim due to a lack of resources provided the impetus for SIIF. For this reason, most people associate the issue with the UC service centers that take calls and process claims. However, the UC administrative system as a whole is much broader. In addition to the service centers, the UC administrative expenditures encompass:

- A network of UC tax service offices to help employers comply with the UC law,
- A small portion of the cost of CareerLink offices helping Pennsylvanians find jobs,
- Part of the Center of Workforce Information and Analysis, which calculates unemployment rates and other labor market statistics,
- UC referees and the UC Board of Review, which hear appeals from employees and employers who dispute a UC claim determination,
- The Office of UC Benefits Policy, which deals with quality assurance, audits, fraud prevention and other efforts to help ensure accuracy and reduce inaccurate benefit payments and denials,
- IT staff and operational expenses, which run the computer and technical systems for the program,
- HR, administrative, budgetary, legal and support services for the UC program.



As the service centers comprise the largest individual component of the UC program area, they correspondingly saw the largest impact overall from the reduction in available resources when SIIF expired. Personnel in particular made up 72 percent of the total operating expenditures in 2015/16 – and a third of personnel costs were in the UC Service Centers.



Roughly half of operating expenditures in 2015/16 supported IT and communications related outlays. In testimony before the House Labor and Industry Committee in September 2016, L&I Secretary Kathy Manderino said the majority of IT expenditures are fixed and cannot be adjusted to meet changing funding levels.

IT Modernization

The ongoing, critical need to update the computer system used to administer the benefits paid to Pennsylvanians adds to the pressure on the UC program budget. The commonwealth entered into a large contract with IBM in 2006 to upgrade all facets of the UC computer system, a project known as UCMS.

Phase one of the UCMS project included systems used for case management and the administration of wage records. The second phase targeted the UC tax system and the ability of employers to maintain their accounts and pay UC taxes. The final phase was to address the benefits system, including filing of claims, adjudication of the claims and appeals.

The first two phases were completed with some difficulty. However the third phase addressing the benefits system fell behind schedule, ran over-budget and did not produce a reliable, working product. L&I engaged Carnegie Mellon University's Software Engineering Institute to assess the status of the benefits system project in August 2012. They found that the large number of serious defects in the software and the complexity of the code created risks for future errors. Given how critical unemployment compensation benefits are to Pennsylvanians and their families, the risks of proceeding to use unreliable phase 3 software were too great, and so the department terminated the IBM contract.

Despite this, the department still faced the reality of running the UC benefits program with an outdated, yet extremely important, legacy computer system that was increasingly expensive to maintain and had a declining number of people who had the experience and training to keep it operational.

The department regrouped and began planning another procurement process for a replacement system, starting in 2013 by looking to other states and the US Department of Labor to explore existing solutions appropriate for Pennsylvania. The following summer, the department searched for a project manager to help ensure a successful procurement process and finalized that contract in March 2015.

Working with the project manager, the department determined the requirements for the next RFP over most of the 2015/16 fiscal year and published the RFP in July 2016. The team is currently going through the technical details of the proposals, and hope to select a proposal by this May.

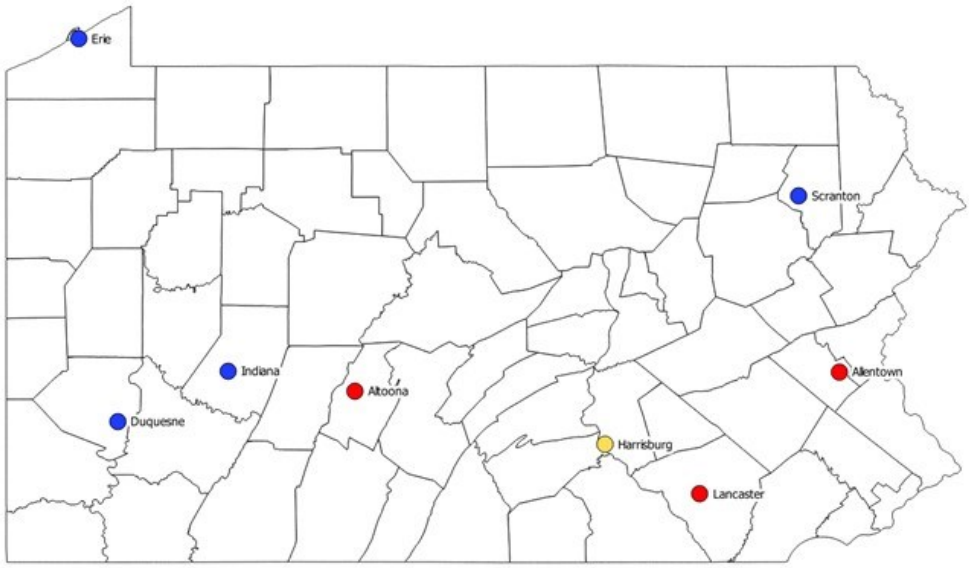
While the exact costs will not be known until the procurement process is complete, the need to modernize the UC benefits computer program adds additional costs to an already stressed budget.

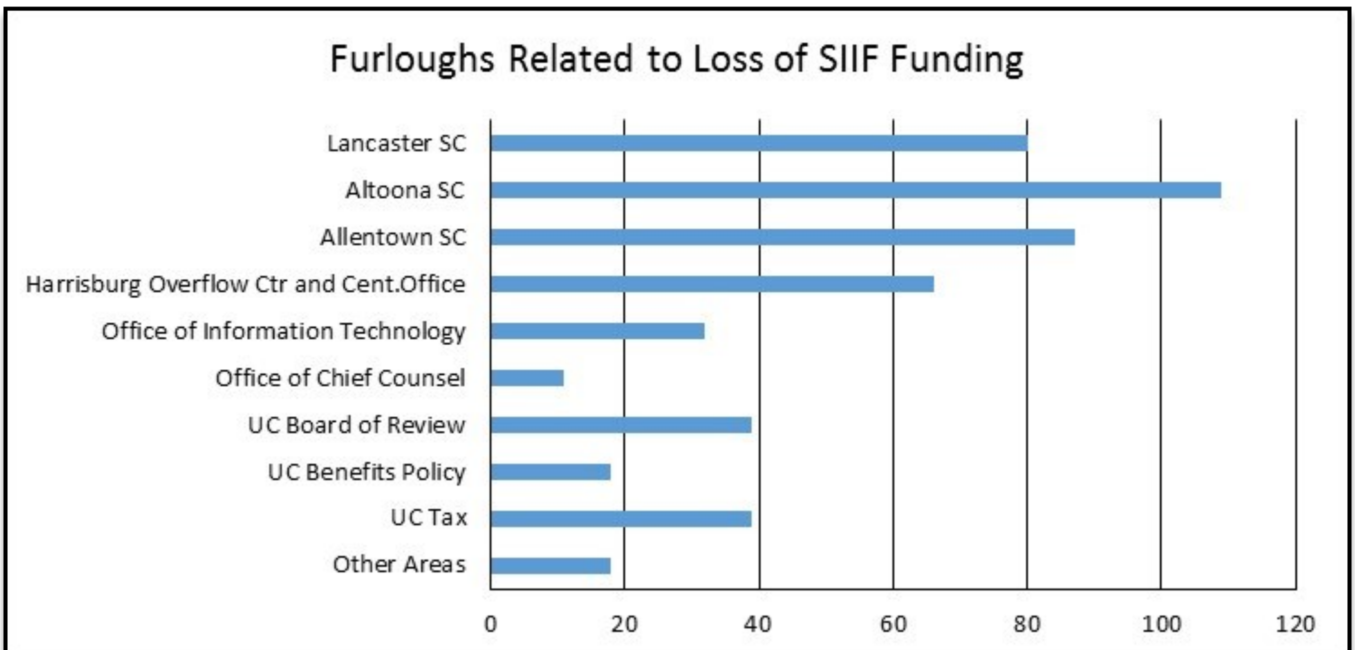
Combined with the loss of SIIF funding and the host of budgetary pressures facing all state agencies, the department was forced to cut costs where they were able, which mostly fell to personnel.

Recent actions: Closure of UC Service Centers and furloughs

Although it appeared that the General Assembly would authorize a short-term extension of SIIF funding for calendar year 2017 via HB 2375, the death of the bill in the Senate required the department to reduce expenditures for the balance of 2016/17 and 2017/18 to stay in line with available revenues. Since most expenditures are for personnel, and given the level of fixed costs on the operating side, furloughs were inevitable.

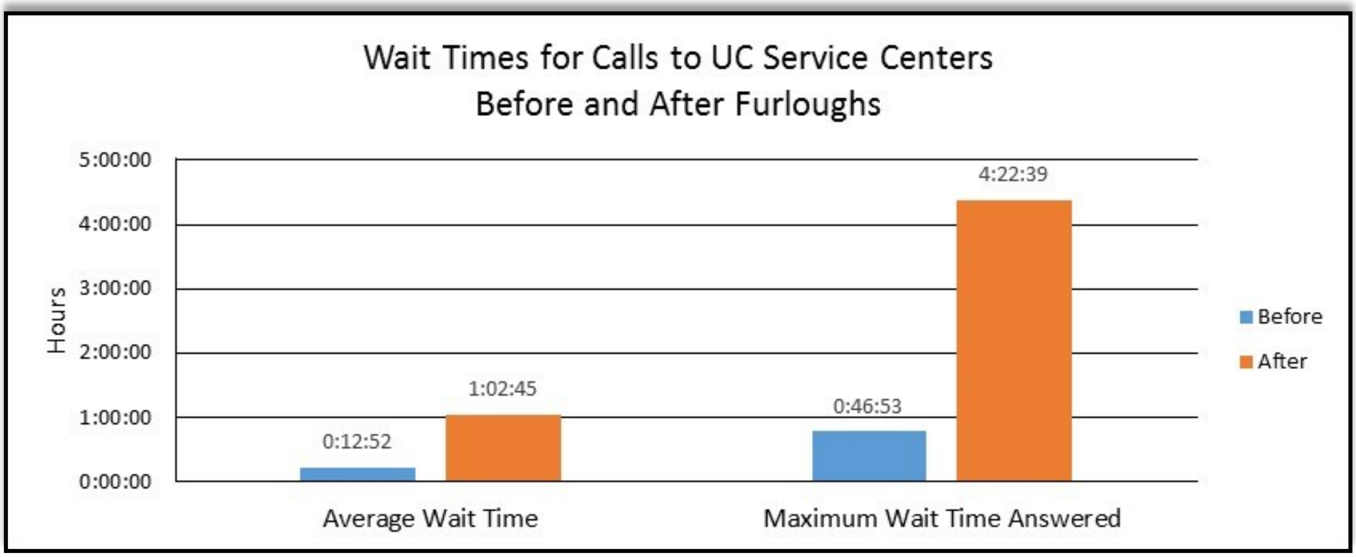
The department furloughed 499 employees. Three service centers closed in Allentown, Lancaster and Altoona and the Harrisburg Overflow Center also saw significantly reduced staff. The layoffs also touched UC areas and central services which support the program.





As of February 1, 85 furloughed employees were able to be placed into other positions elsewhere in the department or other state agencies. While this helps ease the impact to affected workers, the impact to administration of UC remains.

The furloughs had major impacts to wait times for people attempting to reach the UC service centers. As represented by four week periods for calendar weeks ending 10/8/16 – 10/29/16 (before) and 12/24/16 – 1/14/17 (after), the average wait time went from about 13 minutes to just over one hour. The maximum wait time that was eventually answered went from about 47 minutes to 4 hours 22 minutes.



Recap

Act 34's Service and Infrastructure Improvement Fund proved to be very successful in allowing the Department of Labor and Industry to use a portion of employee UC contributions to assure quality service levels for Pennsylvanians filing an unemployment compensation claim. However, the underlying problem for UC administration functions remains: federal administrative funds alone are insufficient to support current levels of service to citizens who are out of work.

The problems caused by the expiration of SIIF and the associated layoffs and service center closures will only grow worse without additional resources. Policymakers will need to weigh what constitutes acceptable service for their constituents, including wait times for claim filing and appeals, but also the health of other important functions that aren't always seen by the public. In the near term, if reduced service levels are deemed to be inadequate, then additional state funding will be necessary, either through a reenactment of SIIF or through another mechanism.

Acknowledgements

The authors greatly appreciate the assistance from staff of the Department of Labor and Industry, particularly Ms. Karen Campbell, and the Democratic staff of the House Labor and Industry Committee.

House Appropriations Committee (D)

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