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U.S. DEPARTMENT OF LABOR
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON HUMAN RESOURCES**

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Good morning. Chairman Herger, Ranking Member McDermott and distinguished members of the Subcommittee, thank you for this opportunity to discuss the President's Fiscal Year (FY) 2007 Budget proposals related to Unemployment Insurance (UI).

The Administration is committed to improving the benefit payment and tax integrity of the federal-state UI system and has developed a set of legislative proposals for your consideration that will give states new tools and resources to combat improper benefit payments and evasion of employer taxes. Reducing improper payments is an important component of the President's Management Agenda, and the Department of Labor (the Department) is committed to aggressively implementing this agenda to improve the results our programs deliver for taxpayers.

Although states put much effort into preventing, detecting, and recovering improper benefit payments, the number of such payments is still too high. This is a major concern for Secretary Chao and the Department. In FY 2005, an estimated \$3 billion in UI benefits were paid in error. We project that a little more than half of this amount, \$1.6 billion, is attributable to causes that states can detect *in the course of normal program operations* and potentially recover. However, to date, states have been successful in detecting only 59% of these estimated payments. Further, only about half of the

improper payments detected are subsequently collected. While access to new databases and automated data matches have improved states' ability to identify potential improper payments quickly, investigations required to establish payments as improper and collection efforts are still quite staff and time intensive. The Department is continuing to work with the states to find better and more efficient ways to reduce improper payments.

Thanks to your leadership, Chairman Herger and Ranking Member McDermott, and the bipartisan efforts of this Subcommittee and the Congress, loopholes in many state UI laws that had permitted some employers to pay less than their fair share of state unemployment taxes were closed when Congress enacted the SUTA Dumping Prevention Act of 2004 (Public Law 108-295). I am pleased to report that all states -- except Alaska -- have enacted state statutes to combat SUTA (state unemployment tax act) dumping. However, enforcement of the law is still essential. As Carl Camden of Kelly Services noted in last year's hearing on implementing this legislation "You can have the tightest laws on the books and the slickest detection tools in place, ... it's all meaningless if you drop the ball with enforcement." As states have begun implementing their SUTA dumping laws, it has become clear that these practices have been widespread and costly to state unemployment funds. Prior to implementation of SUTA dumping legislation, Michigan estimated it was losing between \$62 and \$95 million annually in state unemployment taxes because of this practice. In addition, as of April 2005, North Carolina showed just over \$18 million lost due to SUTA dumping. However, investigating potential cases of SUTA dumping is time consuming, and the legal costs associated with prosecution of these cases are quite high. No new Federal funds were provided to states to enforce their new SUTA dumping statutes.

Legislative Proposals

The Department believes that it is in many states' self-interest to devote additional resources to prevention, detection, and recovery of improper benefit payments and to enforcement of SUTA dumping laws. And the Department is committed to helping States obtain new tools and resources to help reduce fraud and benefit overpayments, as recommended in a recent Program Assessment Rating Tool review of the UI program. To this end, the Department has developed a set of legislative proposals that will give states access to additional resources to combat improper payment and employer tax evasion.

Allow States to Use a Percentage of All Recovered Improper Payments for Benefit Payment Control (BPC) Activities. Under current Federal law, all improper payments collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits.

We propose to amend Federal law to *permit* states to use up to 5% of all improper payments recovered to augment administrative funding for BPC activities. This 5% would be deposited in a special state fund where it could be used only for this purpose.

This amendment would reduce improper payments and increase improper payment recoveries by an estimated \$86 million over five years and \$236 million over ten years.

Allow States to Use a Percentage of Certain Tax Payments for Tax Integrity Activities. Under current Federal law, all taxes collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits.

We propose to amend Federal law to *permit* states to use up to 5% of tax payments recovered following a state investigation and assessment of taxes owed due to employer fraud or tax evasion such as SUTA dumping for additional UI tax enforcement activities. This 5% would be deposited in a special state fund and would be used only for this purpose.

This amendment would increase recoveries of unpaid taxes by an estimated \$13 million over five years and \$19 million over ten years.

Require States to Impose at Least a 15% Penalty on Fraud Improper Payments.

Currently, all states impose penalties on employers who are delinquent in paying contributions. It makes sense to require all states to impose a similar fine whenever it determines an individual has defrauded the system. The Department's Office of Inspector General (OIG) has devoted considerable resources to uncovering UI fraud; these investigations suggest that UI fraud schemes are more complex, costly, and far reaching than in the past.

Individuals who commit UI fraud – a very small percent of all beneficiaries – are sometimes required to do nothing more than repay the amount received fraudulently. While a limited disqualification from future benefits may be imposed, this sanction is meaningless if the individual goes back to work and remains employed. Although state laws provide for criminal penalties, cases are rarely prosecuted due to the relatively low dollar amounts involved and the high cost of prosecution.

Under our proposal, the Social Security Act would be amended to *require* states to impose a penalty of not less than 15% on improper payments that are due to fraud and to deposit any fines collected in a special state fund, from which they may be withdrawn

only for BPC activities. The proposal is limited to improper payments due to fraud to ensure that penalties will be required only when there was intent to deceive on the part of the beneficiary.

This amendment would reduce improper payments and increase improper payment recoveries by an estimated \$314 million over five years and \$855 million over ten years.

Allow States to Permit Collection Agencies to Retain a Percentage of Fraud Improper Payments and Delinquent Employer Taxes Recovered. Several states have explored using private collection agencies to collect certain improper payments or delinquent employer taxes. One of the problems states have encountered is finding a way to pay the private agency's costs of collection, which can be up to 25% of the amount collected. Federal law would be amended to *permit* up to 25% of any amount collected by the collection agency on fraud improper payments or delinquent taxes to be retained by that agency. This would be permitted only when the State UI agency has (1) made its own collection efforts and (2) declared the amount uncollectible. Thus, the proposal only applies to hard-to-collect debt that would not otherwise be collected.

This amendment would increase recoveries of improper payments and delinquent taxes by an estimated \$126 million over five years and \$341 million over ten years.

In addition, our budget includes legislative proposals that would support the Department's integrity activities by providing states with new tools to more effectively prevent, identify, and recover improper payments and delinquent taxes.

Prohibit States from Non-Charging Employers When Improper Payments Occur Due to Employer Fault. Our budget proposal also includes an amendment that

would reduce one of the most common reasons for improper payment – an erroneous initial determination of eligibility – by providing employers with an additional incentive to respond to state requests for separation information.

Employers sometimes fail to respond or provide incomplete or late responses to requests for information related to reasons their former employees were separated from employment. When this happens, payments may be issued based on the beneficiary's statement and "charged" to the employer's experience rating account, which may later cause his/her tax rate to increase. The employer may appeal after benefits have been paid and provide information at an appeal hearing that results in benefits being denied retroactively. The benefits already paid are established as improper payments, and in many states, the employer's account is relieved of those benefit charges. If the employer had responded fully and timely, the improper payment would have been avoided as well as the administrative costs connected with appeals and establishment and recovery of improper payments. States tell us they believe that some employers are not as conscientious as they should be in meeting deadlines for providing information about reasons for separation, and routinely file appeals at which information is provided that results in their being relieved of charges for benefits already paid.

To provide an incentive for more timely and complete responses, Federal law would be amended to *prohibit* relief from charging when the employer or its agent is at fault, even if the improper payment is eventually recovered. The prohibition would only apply if the improper payment was due to the failure of the employer to provide timely or accurate information and if the employer had established a pattern of failing to respond on a timely basis or adequately to such requests.

This amendment would reduce improper payments by an estimated \$84 million over five years and \$233 million over ten years.

Require Employers to Report “Start Work Date” to the State Directory of New Hires. The SUTA Dumping Prevention Act granted state UI agencies access to the National Directory of New Hires, which allowed states access to a wider universe of hires, including those by Federal agencies and multi-state employers who may report all new hires to a single state. Access to these data has proved to be extremely valuable. States matching UI payment files with the national directory have seen a significant increase in the number of improper payments identified compared to the number identified using their own state new hire directories. As you may know, individuals who are working and receiving UI benefits concurrently are the single largest cause of improper UI payments.

However, these data could be even more effective for UI payment integrity if all employers report the date when an individual started work. When the start work date is not provided to the directory, states must contact employers to get this information – a time consuming and costly process. In some cases, investigations may not be pursued because of the lack of the start date in the directory. The Department’s OIG has recommended amendments to Federal law to require employers to report a new hire's first day of earnings.

For this reason, we propose to amend Federal law to require that the date the individual starts work be reported by all employers to the applicable state directories of new hires, which in turn will report this information to the National Directory of New Hires. This amendment would reduce improper payments and increase improper

payment recoveries by an estimated \$60 million over five years and \$167 million over ten years.

Authorize the U.S. Department of the Treasury to Intercept Federal Income Tax Refunds for Certain UI Purposes. The Administration's FY 2005 and FY 2006 budgets included legislative proposals authorizing the U.S. Department of the Treasury to recover improper payments of UI benefits through offset from an individual's Federal income tax refunds via the Treasury Offset Program (TOP) – a government-wide debt matching and payment offset system that matches delinquent debts owed to various government agencies to Federal income tax refunds. This year's proposal is expanded to also authorize the collection of certain unpaid employer taxes using TOP.

Both the National Governor's Association and the National Association of State Workforce Agencies passed resolutions encouraging the use of the TOP system for recovering these debts.

This amendment would increase recoveries of benefit improper payments and delinquent taxes by an estimated \$1.677 billion over five years and \$3.55 billion over ten years, thereby contributing to state UI trust fund solvency and lower employer taxes.

Together, these seven legislative proposals would reduce improper payments and increase improper payment recoveries and delinquent tax collections by an estimated \$2.360 billion over 5 years and \$5.401 billion over 10 years. We are pleased that the FY 2007 Budget Resolution passed by the Senate and the Budget Resolution passed by the House Budget Committee both include our UI integrity proposal and are hopeful Congress will enact this legislation before the 109th Congress adjourns.

The FY 2007 budget also includes a legislative proposal that will give states the opportunity to demonstrate innovative initiatives to better serve the 21st century economy and workforce. The UI program was designed over 70 years ago when our economy and workforce were quite different than they are today. While the program has served our nation's workers and economy well, we should be open to exploring innovations that could improve its performance in the future.

Permit States to Request Waivers of Certain Federal Requirements. Certain requirements of Federal law may limit states' flexibility in establishing new ways to help beneficiaries become reemployed quickly or undertake other innovations to improve the administration of the UI program. This new proposal would authorize the Secretary of Labor to waive certain Federal requirements at states' request to permit them to run demonstration projects that would accelerate the reemployment of claimants or improve program administration. It is important to note that the Department could not grant a waiver if it would limit the state's ability to promptly determine and pay benefits to eligible workers or deny due process of the law. The demonstration would also have to be cost neutral with respect to the effect on the state unemployment fund. The proposal would permit states to experiment with program design in ways that may benefit unemployed workers and provide important experience and information for the federal-state UI system. We would welcome the opportunity to work with you on demonstrations that spur innovation and flexibility in the UI program.

Appropriations Requests

The legislative proposals I just described would give states access to additional funds in the long term. However, following enactment at the Federal level, state

legislation will be required before certain proposals related to new resources can be implemented. Thus, there would be some delay before these funds would be available. The Department's request for FY 2007 appropriations includes increased funding for state UI operations to reduce improper payments and speed the reemployment of UI beneficiaries. This modest increase of \$40 million would give states additional resources right away, in FY 2007, to expand certain improper payment reduction efforts.

Each of the increases proposed for FY 2007 would more than pay for itself in reduced benefit payment outlays from state unemployment funds. I hope that you will communicate your support for the initiatives described below to the Committee on Appropriations.

Combat Identity Theft. Also in support of UI payment integrity, the FY 2007 budget requests an appropriation of \$10 million to prevent and detect fraudulent UI claims filed using personal information stolen from unsuspecting workers. Most UI claims are now filed by telephone or the Internet, making the UI program convenient for unemployed workers to access and more efficient to administer. However, telephone and electronic access create new opportunities for schemes to obtain benefits fraudulently. The Department's OIG documented identity theft schemes in the UI program as a top management challenge. At the core of the OIG's concerns is that identity theft is now conducted by "nontraditional organized crime groups" that result in more sophisticated fraud schemes than previously seen within the UI program. The OIG reported that two schemes, one involving four states, were responsible for over \$11 million lost to the unemployment trust fund. Based on available data, we estimate that the nationwide

incidence of identity theft improper payments is approximately \$313 million a year out of benefit outlays totaling \$32 billion a year.

The \$10 million request for FY 2007 would be used to deploy a suite of safety checks that include automated address verifications, electronic screens to detect “at risk” claims, staff training to detect the warning signs that are indicative of fraud, increased investigative staffing, and enhanced employer outreach efforts. The requested funds for identity theft prevention and detection would enable states to staff positions to promptly examine and reconcile discrepancies in individuals’ personal identifiers before first payments are made. The proposed safeguards would more than pay for themselves, as these activities are expected to prevent an estimated \$77 million in improper payments. We think this is a good investment of scarce taxpayer resources.

Ensuring Continued Eligibility and Promoting Reemployment. Another key element to improving UI payment integrity is ensuring that UI beneficiaries meet requirements for continued eligibility. In general, beneficiaries must be able to work, be available to work, and actively seek work to remain eligible. Facilitating reemployment of UI beneficiaries is also a priority for the UI program. The best way to help UI beneficiaries is to help them find good jobs quickly. We have developed an initiative that supports both of these objectives.

Last year, the Department provided funds to 20 states and the District of Columbia to provide Reemployment and Eligibility Assessments, or REAs, to UI beneficiaries. A number of independent studies found that attention to eligibility and reemployment service needs assessments resulted in relatively shorter claims duration for beneficiaries by speeding reemployment and reducing improper payments. The REAs

strengthen the integrity of the UI program by assuring eligibility requirements are met and offering personalized assistance with work search plans and other services through One-Stop Career Centers. In the FY 2007 budget, we request an appropriation of \$30 million to expand the REA initiative to additional states for reviewing beneficiary eligibility and providing job search assistance in person. We estimate that this \$30 million expansion of current REA efforts would reap as much as \$151 million in savings to state unemployment funds.

Conclusion

Thank you for the opportunity to present initiatives that we believe will improve the benefit payment and tax integrity of our nation's UI program and promote innovations that can make it more responsive to the demands of our 21st century economy and workforce. We look forward to working with the Subcommittee on these issues. I will be glad to respond to any questions you may have.