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THE REPORT OF

The Legislative Research Committee

ON

Merit Rating in Unemployment Compensation

FOR THE

Ninetieth and Ninety-first Legislature

MAY 12TH, 1942

A REPORT OF THE LEGISLATIVE RESEARCH COMMITTEE ON MERIT RATING IN UNEMPLOYMENT COMPENSATION FOR THE 90th AND 91st LEGISLATURE

The 90th Legislature passed an order (Senate Paper 529) that the Legislative Research Committee make a study of the subject of merit rating as it applies to Unemployment Compensation and make such recommendations to the next regular session or any intervening special session of the Legislature as it deems advisable for the improvement of the Maine law on the subject matter. The business of the Committee prevented its completing its study of this subject matter in time for a report to the special session of the 90th Legislature, and this report is formally submitted to the regular session of the 91st Legislature, but the Committee feels that it can properly assume that many members of the 90th Legislature will return to the 91st Legislature, and as the subject matter is complicated it has seemed advisable to supplement its formal report to the 91st Legislature by making the same report as an intermediate report to the 90th Legislature. It is hoped thereby that those members who return to Legislative service may have some preliminary background which will assist Legislative discussion when action is taken upon the Committee's formal report to the next Legislature.

Procedure

The procedure which the Committee has followed in its study may be briefly outlined as follows: The Committee first commissioned its Attorney, Mr. Donald W. Webber, to assemble and study available material upon the subject and to prepare a summary of the viewpoints of those interested in the subject in the State of Maine. The Committee's Attorney held numerous conferences with persons known to be interested for or against proposed legislation, including representatives of employers and of labor and of the public, and he further obtained material and opinions from the Maine Commission and staff members, all of whom proved most cooperative and helpful. The Committee wishes to acknowledge particularly the assistance of Mr. John Bache-Wiig, Chief of the Benefits Division, who has given generously of his time and experience in assisting the Committee's study. There was assembled in the Committee's files a substantial volume of research material, including Legislative Document No. 881,

Senate Paper No. 433, which was the merit rating bill proposed at the last Legislature and sponsored by certain employers, prior reports of the Maine Unemployment Commission, laws and material from seventeen states (the states selected were those having the longest experience and those which have had no experience, but which have had analytical surveys of the subject matter prepared), material prepared by the Social Security Board, the minority, majority and unanimous reports of the Interstate Conference of Employment Security Agencies, and other statistical or informational material from various sources.

After this material had been studied and analyzed the Committee received from its Attorney a 12-page preliminary report in the form of a summary analysis of the statistics involved, problems presented and arguments for and against an experience rating program. The Committee studied this material and then held a three-day session which was divided into three parts: first, a discussion and analysis of the problems presented; second, a public hearing, which was duly advertised, which lasted for a full day and which was extremely well attended, and third, a further discussion and a determination upon certain policies unanimously adopted by the Committee to be incorporated in the Committee's report to the Legislature. At the public hearing the Committee heard numerous employers and employer representatives, embracing a wide and diversified field of industry and mercantile business, all of whom endorsed some form of experience rating for Maine. The Committee heard representatives of organized labor, all of whom either qualifiedly or unqualifiedly opposed any program of experience rating at this time. The Committee heard Commissioners Fortin and Bennett and also several distinguished visitors from other states, including Mr. Sterry R. Waterman, a member of the Vermont Unemployment Compensation Commission since its inception and for several years its Chairman, and Mr. Edward F. Connolly, who sponsored and assisted in the preparation of the Massachusetts act as it relates to experience rating. The Committee also had Mr. Clifford Somerville, former Chairman of the Maine Commission. The Committee feels that the views expressed at its public hearing represented a fair cross-section of all the arguments which can properly be advanced for or against experience rating, and the public interest shown at this hearing was greatly appreciated by the Committee.

Federalization of Program

There have been numerous indications that efforts were being made and might be continued in the future to Federalize the entire system of Unemployment Compensation. The Employment Service Division, so-called,

which embraces that portion of the Commission's activities relative to registration for employment and placement, has already been taken over by the Federal government, the reason given being that the national interest for defense in the emergency was involved. The Committee has good reason to believe, however, that further efforts to Federalize the program and abolish the functions of state governments will be vigorously opposed by the states and within the Congress of the United States, and the Committee recommends that the Legislature proceed upon this assumption. Although it is self-evident that a Federalization of the program would render meaningless any state legislation, the Committee recommends that the Legislature deal with the problem of experience rating upon the assumption that the states will be left to solve this problem for themselves, provided of course that all state legislation must meet the requirements of existing Federal legislation.

Previous Proposed Legislation

Legislative Document No. 881, Senate Paper No. 433, which was the merit rating bill proposed by employers at the last Legislature, has been carefully studied by the Committee. Reduced to its simplest terms this legislation proposed to safeguard the reserve fund at two times the average annual benefits paid from the fund within the last three years, to provide rates for employers having a good experience, ranging from 1% (one percent) of payroll to 2-7/10% (two and seven-tenths percent) of payroll, and penalty rates for employers having an unfavorable experience from 2-7/10% (two and seven-tenths percent) of payroll to 3-7/10% (three and seven-tenths percent) of payroll. The Committee could not conclude that this legislation provided an adequate safeguard for the reserve fund, nor that penalty rates were necessary or desirable, and the Committee therefore will in this report propose legislation embracing those features of the proposed legislation found to be good, but incorporating changes designed to correct the undesirable features of the proposed legislation.

Background

Under the present existing system each employer pays a total tax of 3% upon his total payroll, of which 3/10% (three-tenths percent) goes to the Federal government and 2-7/10% (two and seven-tenths percent) goes to the state. The Federal portion of the tax is used to pay administrative and overhead costs, and the balance of the tax is available for the payment of benefits to unemployed individuals who are eligible, the unused excess being set aside in the state reserve fund. Present Federal legislation permits the adoption of a scale of experience rates by any state according to a plan which the state may itself devise, providing however

that no state plan will be approved by the Federal government if it does not adequately safeguard the reserve against future depressions and if it does not base the rate for any particular employer on his actual unemployment experience. It is further requisite that any employer must have had at least three years' experience under the act before he can be awarded a rate better than 2-7/10% (two and seven-tenths percent).

On January 31, 1940, the Maine commission reported in writing to the Governor and included a brief statement on the subject of merit rating, in which it was stated that the machinery was set up to measure employer experience and that it would be later possible to report intelligently on the desirability of the program for Maine.

On January 15, 1941, the Commission reported to the Governor on merit rating for Maine, the basis of study being the period from January 1, 1938, through June 30, 1940. The state first started paying benefits in 1938, although it had received contributions in the two previous years, and whether or not 1938 was an unusually bad employment year the fact remains that it was the worst year thus far. In that year employers paid in $3,717,806.05 and employees took out $4,535,455.04. This is the only year thus far in which benefits have exceeded contributions.

In order to readily understand what employer groups might naturally be expected to favor or oppose an experience rating program it is enlightening to know that the construction group had the worst experience, paying out $1.79 in benefits for every dollar contributed to the fund; that the best experience was that of the financial services, insurance and real estate group, which only paid out 16c in benefits for every dollar of contributions. If penalty rates were to be established it would appear likely that they would be paid by the following larger industry groups: i. e., construction group, textile manufacturers, manufacturers of lumber and timber basic products, manufacturers of shoes, leather and leather products, manufacturers of stone, clay and glass products, and services allied to transportation. Those who would substantially benefit by experience rating would be the following: i. e., manufacturers of food and kindred products, manufacturers of apparel and products made from fabrics, manufacturers of furniture and finished lumber products, manufacturers of paper and allied products, printing, publishing and allied industries, manufacturers of iron and steel and their products, manufacturers of transportation equipment, except autos (note this classification includes shipbuilding), manufacturers of machinery, except electrical, trucking and warehousing for hire, utilities, wholesalers and retailers, banks and securities.

The fund did not grow rapidly for some time, and in fact only a year ago it had only grown to 4½ million, of which 4 million had been ac-

cumulated in 1936 and 1937 before any benefits were paid out. The Commission gives as its reasons for the slow growth of the reserve fund the following: i. e., that Maine had paid out a higher percentage of its contributions in benefits than any other state; that it had in fact paid out 68-1/10% (sixty-eight and one-tenth percent) of all it had taken in, against the national average of only 39-2/10% (thirty-nine and two-tenths percent); that Maine pays benefits to partially unemployed workers and has done so from the beginning and has a heavy volume of these because of so much seasonal industry; that the benefit structure in Maine has been very liberal from the beginning, as for example the fact that benefits accrue if a worker only earned $144 in the previous calendar year, as against a larger figure in many states. War time conditions and defense employment have of course had a marked effect on the reserve fund, and the natural resulting diminution of benefit payments has resulted in turn in a rapid increase in the fund. As of the close of 1941 the fund exceeded 7½ million. It is over 9 million today, and if present conditions continue there would appear to be every prospect of a net increase in the reserve fund in 1942 of at least 3½ million, which would bring the fund up over 12 million. This is probably a conservative estimate, as some experts have expressed a belief that the fund may be up to 13 or 14 million in the early part of 1943. The Commission in its report endorsed the idea of experience rating in principle, but expressed its fear that the fund was not yet large enough for a safety reserve. Now that the fund is apparently headed toward 12 million or better we would appear to be rapidly approaching the time when the objection as to impairing the safety margin of the reserve fund could no longer be raised. Authorities estimate the desirable margin of safety for a reserve fund all the way from 1½ to 3½ times either the average annual benefits or the benefits paid in the year of worst experience. In our case using the 1938 figure of $4,535,455 as the base (year of worst experience), 1½ times that figure is $6,803,182, and 3½ times that figure is $15,874,092. It should be borne in mind that even in a year of serious post-war depression the amount of money which can be drawn out in benefits is automatically limited by the benefit structure itself (for example, a worker can only draw $18 a week for 16 weeks maximum), and it must be further borne in mind that under any conditions which might reasonably be anticipated there would always be some measure of employment going on and some contributions continuing to come into the fund. Assuming that the conservative truth lies somewhere between the extreme figures quoted it would seem apparent that 12 million dollars, which is more than 2½ times the year of worst experience, may represent a fairly accurate safety level for the reserve fund. The Committee noted that those who opposed experience rating at this time on the

basis of a possible impairment of the reserve fund, and who urged that the safety level be maintained at figures higher than 12 million dollars, were at the same time urging the present liberalizing of the benefit structure, which in itself would constitute a drain on the fund. The Committee therefore could not conclude that these opponents were entirely convinced of the logic of their own position. The Committee has satisfied itself that a formula which would not permit the reserve fund to fall below 12 million dollars is both safe and conservative, and will therefore incorporate that safety factor in its proposed legislation.

Definition and Arguments

The first state experience rating plan in effect was that of Wisconsin in 1938. As of January 1, 1942, at least 37 states had plans in effect or going into effect on that date. One state had a plan passed to go into effect January 1, 1943, and several states had pending studies and reports coming from their Commissions. There is little or no uniformity among the several plans. The term "merit rating" is little used at present, it being generally agreed that the term "experience rating" is far more applicable and expressive of the truth. Experience rating is a term applied to a variety of methods in unemployment compensation designed to permit employers whose employees enjoy relatively steady employment to receive lower contribution rates than those whose operations are less stable. The primary objectives of experience rating plans are generally considered to be: (1) stabilization of employment; (2) the allocation of the tax burden more nearly in proportion to the unemployment risk, and (3) the prevention of abuses of the system by both workers and employers. This last objective is usually referred to as policing the act.

The proponents and opponents of experience rating may be roughly subdivided into three groups: (1) Those who favor experience rating with or without penalty rates; (2) those who favor experience rating only if no penalty rates are involved, and (3) those who oppose experience rating in any form.

The proponents of experience rating advance arguments which may be briefly stated as follows: (1) That employers are encouraged to stabilize employment if by so doing they will get better rates. (2) That employers take more interest in the fund if they have some control over the rates they pay into it. (3) That varying rates based on hazards and accident experience has proved successful in Workmen's Compensation and that unemployment is sufficiently analogous so that the rates should be placed on a basis which approximates actuarial insurance rates. (4) That unemployment contributions represent a cost of production which should properly be passed on to the consumer, but that the consumer of A goods

should not have to bear the cost of unemployment in the B goods industry, nor should the employer who makes A goods have to add to the price of his goods the cost of another employer who makes B goods and has a bad unemployment experience. (5) That experience rating would tend to eliminate excess reserves of labor by organizing the labor market and reducing fluctuations. (6) That the casual laborer would be re-absorbed in some other industry, and the regular workers with regular work and better wages would stimulate business confidence and normal, healthy business expansion. (7) That ill-conceived and poorly planned expansion programs which are the first to collapse in time of depression would be discouraged by the high contribution rates which would result. (8) That uniform contribution rates give employers no incentive to assist the proper administration of the act. (It is an admitted fact that employers are winking at claims which would be quickly invalidated if the employer protested the allowance of the benefit. He has nothing to gain by opposing the employee's claim and he feels that he can best keep harmony and labor peace by keeping quiet. There are also instances of actual collusion between employers and employees to obtain illegal benefits. There are other instances of raiding the fund, the method being that employers rotate the employment of workers during slack seasons so that the maximum number may receive all the benefits for which they are eligible each year.) (9) That industry which would normally enjoy a good rate under an experience rating plan may move to sister states if it cannot get that rate here. (Maine is surrounded by states which have experience rating plans).

The opponents advance the following arguments: (1) That the profit motive alone is the greatest inducement to an employer to stabilize employment, and the rewards in profits for stabilization greatly outweigh any possible savings in tax rate that could be proposed. If this incentive has not been sufficient to stabilize employment it is wishful thinking to believe that a slight decrease in payroll tax would perform the miracle. (2) That certain businesses are of their very nature highly seasonal, and unemployment in those industries will exist in spite of the efforts of the employer or in spite of any tax incentive which may be offered. (3) That the analogy to Workmen's Compensation is fallacious. In the latter case choice of personnel, education and the introduction of safeguards against injury are devices which control industrial accident hazards. Safety can almost always be achieved by proper care, but the causes of unemployment are much more intangible and beyond control of the employer. (4) That as to interstate competition the slight differential in rate would probably not be enough to induce any business to remove or stay, as location is usually determined by such factors as plant investment, source of raw materials,

skilled labor market, freight differentials, nearness to market, etc. (5) That an employer starting a new business would be at a disadvantage. His competitors might be enjoying a low rate, but for at least three years he would have to pay 2-7/10% (two and seven-tenths percent) because of the Federal requirement. (6) That where a new risk is added to business —that of high contribution rates in event of failure, normal business expansion may be curtailed. (7) That it may be dangerously static to stabilize employment at the present level. Our working population is being increased by 50,000 youths each year. To the extent that employment is stabilized for one group another is denied the right to work. There would tend to be created two groups, one totally unemployed and one totally employed, and a problem of permanent relief would follow. (8) That if employers become anxious to gain a good experience they will be inclined to object to benefit claims on general principles and without good cause, which in turn will increase the administrative problem and create bad feeling between employers and employees. (9) That the principal purpose of unemployment compensation is to alleviate the suffering and economic ill which unemployment produces, and therefore experience rating or anything tending to reduce the tax should be deferred until the benefit structure has been substantially liberalized.

The Committee has carefully weighed all of these arguments for and against an experience rating program. It seems evident that some of the arguments of the opponents lose their full force when applied to a program which does not include penalty rates. The Committee is satisfied that the arguments against penalty rates greatly outweigh the arguments for, and there is far greater justification for instituting an experience rating program if that program does not include penalty rates. The Committee will, therefore, omit all penalty rates from the rate structure in its proposed legislation.

The Committee is convinced that on the whole there is good reason for adopting an experience rating program in Maine under present circumstances. It is apparent that by the time legislation can be passed the reserve fund will have grown to what must on the most conservative basis be considered an adequate safety margin. It is possible and even probable that the fund on the present rate structure would continue to grow rapidly, and the excess which would thereby be piled up over safety requirements would not serve any purpose which would in any way compensate for the burden and drain upon the business and industrial life of Maine. The Committee is satisfied that this growth of an excess reserve should be curtailed in some way. It is impossible to declare a moratorium on the tax which could be enjoyed by all taxpayers, because that would be in

direct violation of Federal requirements. Only two possible methods present themselves: (1) To increase the benefits paid, by liberalizing the benefit structure, and (2) by adopting an experience rating program which will reduce the contributions of those taxpayers whose unemployment conditions do not add greatly to the general unemployment problem in Maine. As to the first possibility the Legislature has already provided for the further liberalization of the benefit structure by making it mandatory upon the Commission to increase the weekly benefit amount after public hearing when it appears that the size of the reserve fund is adequate, and as a result the maximum weekly benefit amount has been increased from fifteen to eighteen dollars and the benefit structure approximately twenty per cent by order of the Commission under authority of the Legislature. The Committee has carefully examined the entire benefit structure under present legislation and is satisfied that the structure is liberal; that it is in accord with the policies of a majority of the states, particularly with the weekly benefit amount increased. The Committee has concluded that a further liberalization of the benefit structure might have the result of placing too high a premium on unemployment, there being always the ever-present danger of making unemployment too attractive. The Committee has therefore concluded that Maine has now reached the point where an experience rating program is justifiable and necessary, and is further of the opinion that the fund is now increasing so rapidly that further delay would be unwise, and therefore recommends that proposed legislation on the subject be passed by the 91st Legislature as emergency legislation so that the new rates can go into effect for the year 1943.

The Committee has studied the rate structure in other states and has found that experience rates run as low as zero, but the Committee has concluded that the program for Maine in its first and experimental stages should be conservative, and it therefore recommends that no rate be given less than 1-5/10% (one and five-tenths percent), and that the rates range with three point breaks from 1-5/10% (one and five-tenths percent) to 2-7/10% (two and seven-tenths percent). The Committee has studied the various state formulas which are used in computing rates and is satisfied that the basic method proposed in the previous bill submitted to the Maine Legislature is simple, fair and easily administered. This method establishes the ratio between the average annual payroll for the previous three years and the amount which is the difference between the total contributions and the total benefits of the employer over his entire experience.

Acting upon the recommendation of experts in the Unemployment Compensation Commission the Committee has adopted as one of its proposals

an additional safeguard which would provide for the immediate re-establishment of all rates at 2-7/10% (two and seven-tenths percent) provided that it appeared in any six months' period, according to a formula, that dangerous inroads were beginning upon the fund. This provision would serve to anticipate the full force of a depression before it had had an opportunity to seriously deplete the reserves, and this safeguard would be in addition to the safeguard establishing the safety minimum of the fund. Also upon similar recommendation the Committee proposes a successor account provision under which one who purchases or inherits a business takes over as an element of that business the experience of the former employer, upon which rates are based. Upon similar recommendation the Committee is proposing a change in the present law having to do with disqualification for voluntary termination of employment. It is apparent that an employer's rate should not be adversely affected by voluntary terminations on the part of employees. The only proper exceptions are (1) voluntary quits which actually result from conduct of the employer which makes the employment intolerable, and (2) cases of illness. In the latter case the employee is, under other provisions of the act, not eligible for benefits until the illness terminates and he is again available for work, but upon his again becoming available he should undoubtedly be protected in event he is unable to resume employment. These reasons underlie the proposed change in the section of the law dealing with voluntary termination.

Conclusion

The Committee firmly believes that experience rating will very definitely assist the policing of the act. The Committee hopes that experience rating may tend to cause some stabilization of employment in industries where it is possible. There is some satisfactory evidence that real progress has been made in Wisconsin and in other states along this line, but the Committee does not feel that the results to be hoped for in this direction are so extensive as to make this a primary objective of experience rating. The Committee has concluded, however, that some equitable curtailment of the rapid and excessive growth of the fund is both necessary and desirable, and that the fairest and most just method of such curtailment is tax relief to that business which adds least to the unemployment burden. The Committee cannot believe that the duty of any individual taxpayer to alleviate the general unemployment burden is anywhere near in proportion to the burden which many taxpayers are now required to carry. At its public hearing various employers presented figures covering their own contributions and the benefits drawn by their employees over the past three years, which are here presented in the form of a table.

Employer	Contributions	Benefits
A	$19,700.	$1,400.
B	30,808.	4,892.
C	24,000.	6,000.
D	Each 1.00	.11
E	35,904.	600.
F	2,321.	None
G	3,152.	None

Under the experience rating program as proposed, even those employers whose employees have drawn nothing out in benefits will still pay over half as much tax as they paid before. Since they have no employment problem of their own, that will represent their contribution to the general social problem of unemployment, and the Committee concludes that that contribution will be more nearly commensurate with their public duty to society at large than the amount they have been required to pay in the past.

On the basis of the reasons given in this report, the Committee has caused to be drafted legislation which will be presented to the 91st Legislature. The proposed draft of a bill will not be available for study until sometime in the summer of 1942, because it is necessary and desirable to check the proposed rates against statistics of the Unemployment Commission, which checking operation is now in progress. As soon as the Committee's proposed draft has been checked as to rate structure and is in final form, it will be released for study.

Mr. Robert McNamara, of Winthrop, participated in the study preliminary to this report, and joined in the conclusions expressed in the report, but because of his having now left the State to engage in military service, he is not available to sign this unanimous report.

This unanimous report is respectfully submitted, and dated this twelfth day of May, 1942.

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On Behalf of the Senate

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