Testimony on Governor's Bill 881 (an act establishing a paid family and medical leave program)

Submitted by Scott Shepard, Policy Director

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Good afternoon. My name is Scott Shepard. I am the Policy & Research Director for the Yankee Institute for Public Policy, Connecticut's free-market think tank. I submit this note in opposition to **Governor's Bill 881**.

Saving against the possibility of a debilitating illness – for oneself or a family member, or in anticipation of a birth or adoption, or for related contingencies, is an extremely wise move. Creating incentives for employers so that they might in turn help their employees save for such eventualities might make for fiscally prudent social policy in some circumstances.

The paid FMLA program proposed in **Governor's Bill 881**, however, is very different. It will charge all workers to pay for a *general* benefit, which will encourage workers to themselves take the paid leave generously. This will lead to a relatively high use rate, which will require increases in the payroll tax. Higher payroll taxes will add to the sense that the FMLA is an entitlement for which workers are paying a hefty amount, which will further encourage employee use – which will then require further *automatic* increases in the payroll tax. Because this proposal is unsustainable in its very design and can be expected to result in significant tax hikes very quickly, Yankee Institute opposes it.

Governor's Bill 881 would mandate, initially, a 0.5 percent payroll tax for all employees to fund an up-to-$900/week paid FMLA benefit for all workers for up to 12 weeks per year every year.

The mean annual wage in Connecticut is somewhat less than $60,000/year.[1] Because that average includes all income, not just the amount below the payroll-tax cap,[2] using it for these purposes technically (even if only in the short term) overestimates the amount of revenue that will be generated by this tax. Using it, nevertheless, for

[1] *See* https://www.bls.gov/oes/current/oes_ct.htm.

[2] *See* Governor's Bill 881 at 5.

simplicity's sake yields this result: the average Connecticut worker will pay $300/year as a result of the initial 0.5 percent payroll tax. Assuming very conservative administrative costs for the program of 10 percent of collections and benefit payments, it will take nearly 40 workers' payroll taxes to support one worker's full use of the FMLA benefit each year.

It follows, then, that if just 2.5 percent of workers take full advantage of paid FMLA – and no one else takes any FMLA time at all – the program will nevertheless go broke almost immediately at a 0.5 percent payroll tax, requiring the payroll tax to be raised within a year of benefit payments beginning.

How high will the tax get? That depends on how many workers take partial or full advantage of the FMLA benefit each year.

It's not clear what the initial use rate will be. We can expect the rate to be fairly high, however, because under the governor's proposed legislation, the benefit would pay out between 82.33 and 90 percent of a worker's weekly wage, up to a total of $900 per week for 12 weeks per year. This would make Connecticut's benefits more generous in aggregate than those of any other state that has adopted paid FMLA. There are currently five states with paid family medical leave: California, New Jersey, New York, Washington, and Rhode Island. California's benefits run from 60-70 percent of an employee's wages for up to six weeks. New Jersey pays two-thirds of an employee's average weekly wage, up to $637 per week for up to 6 weeks. New York pays 55 percent of an employee's average weekly wage, up to $746.41 per week for up to 10 weeks. Washington gives between 50-90 percent of an employee's wage, for up to 12 weeks, with a maximum of $1,000 per week. Rhode Island offers 60 percent wage replacement for up to 4 weeks.

This higher payment will induce more people to use the benefit than otherwise would, which in turn will drive up the costs of the program, which in turn will drive up the payroll tax. To see why, consider an entirely predictable and probable scenario. An employee or a family member faces a medical problem. The employee could work during that period, and would have worked but for the paid FMLA. With FMLA, however, that employee can take leave that will cover nearly the whole of the employee's wages – and so not terribly discomfit the family's economy – to deal with the problem. There are no other negative consequences to taking that time, because the employee will never face higher premiums or other effects from taking leave, as the employee would if paid FMLA were a true insurance program. Moreover, the employee knows that he is paying a payroll tax into the FMLA fund, though he is likely unaware of how little of the benefit will be covered by his own tax payments. Considering all of these facts he gratefully takes the paid leave.

If only one in 40 workers follows this logic in the first year, the whole of the program's fund will be used up that year. And since the Labor Commissioner is empowered and required under this proposal to keep the program funded at 140 percent of the previous year's expenditures, this one-in-forty use rate will result in an almost immediate *40 percent increase* in the FMLA payroll tax. Workers will notice that increase, and, as the payroll tax rises, feel both more justified in taking paid FMLA time and more cheated when they notice that many others are taking the paid time that they are paying for but have not taken advantage of. Both of these factors will increase workers' likelihood of taking paid leave – which will in turn require further increases in the payroll tax, which will in turn encourage more people to take advantage of the benefit.

This spiral would be initiated with a use rate of just, on average, *two-and-a-half percent* in the first year. Any higher initial rate will accelerate the process. From this, we conclude that the paid FMLA benefit, as structured under the governor's proposal, will likely very quickly become unsustainable. We have not seen any effort by the state of Connecticut to suggest that the use of the benefit is likely to remain limited or the program to be able to sustain itself at the initial .05 percent payroll tax. If the state were to undertake such a calculation, we would need it to show its work carefully; the state hardly has an impressive track record of properly calculating the cost of benefit programs. But in this instance it appears not even to have tried.

In fact, **Governor's Bill 881** appears to have been designed in direct anticipation that the payroll tax will have to rise fairly quickly – and also designed to shield legislators, as far as it can, from having to take responsibility for those increases. The legislation empowers and requires the Labor Commissioner to set the payroll tax rate every year at a level sufficient to fund the program at 140 percent of the previous year's payouts. No legislative action will be required to approve this rate increase. No program that has been designed to function at the initially anticipated rate would require such an automatic rate adjustment mechanism.

In short, then, the Governor's Bill proposes a new entitlement program (1) that establishes a new tax that then can be raised every year without any action by any elected official, (2) that by its design will encourage high use rates that will require significant tax increases, and it does so (3) without any evidence whatever to suggest that this obvious design flaw will not cripple the program while also – and rapidly – imposing another punishing tax on Connecticut's already seriously overburdened tax payers.

This proposal is irresponsible and dangerous. We oppose it.