MEMORANDUM

HOUSE FISCAL AGENCY

DATE: September 28, 2011

TO: House Committee on Appropriations

FROM: Mark Wolf, Senior Fiscal Analyst
Paul Holland, Fiscal Analyst

RE: Unemployment Insurance Interest Liability

This memorandum provides an update on the Unemployment Insurance Agency's receipt of loans from the U.S. Department of Labor (DOL) under Title 12 of the federal Social Security Act to continue to paying regular state UI benefits. The Senate recently passed SB 237, a FY 2010-11 supplemental appropriations bill appropriating funding for the UIA to meet its interest obligation due on September 30th. The outstanding balance as of September 26, 2011 was **$3,181,759,874.29.**

The state's interest obligation on its Title 12 advances is approximately **$106.0 million.** The Michigan Employment Security Act provides for a solvency tax to pay this interest liability. To date, the solvency tax has generated **$47.8 million** in FY 2010-11. The Michigan Employment Security Act also establishes the Contingent Fund, to which solvency tax revenue is credited, but which is also credited with interest on contributions (UI taxes), penalties, and damages imposed under the act. Except for solvency tax revenue, the Contingent Fund is used to support the UIA, and may be used to pay interest on Title 12 advances. There is approximately **$20.0 million** in the Contingent Fund that can be used to pay the state's interest obligations. The state's remaining liability, **$38.25 million**, is being provided through a General Fund supplemental appropriation (SB 237). Federal and state law provide that funding for any interest payments cannot be paid (directly or indirectly) by a state from its unemployment trust fund.

Unemployment Trust Fund

Federal and state unemployment contributions (tax receipts) are credited to the federal unemployment trust fund (UTF), and expended pursuant to state and federal law. Within the federal UTF, there are several distinct accounts used for the payment of administrative expenses, the payment of benefits, and the provision of loans to the states. The most notable of these accounts are the 53 state accounts, more commonly known as the state unemployment trust funds. State unemployment tax revenue is credited to its account within the federal UTF. Funds within a state UTF are only to be expended for the payment of regular state unemployment benefits and the state's portion (generally half) of extended unemployment benefits (EB).

As evidenced by the Michigan Employment Security Act's declaration of policy, the UTF is designed such that it accumulates fund balances during times of economic prosperity and draws down those reserves during economic downturns.[1] The counter-cyclical nature of the UTF is indicated in the chart below, which shows contributions to, benefits paid from, and the year-end balance (net outstanding Title 12 advances) of the state UTF from 1980-2010. As shown in Figure 1, the state UTF is

[1] Section 2 of the Michigan Employment Security Act, 1936 (Extra Session) PA 1, MCL 421.2. The section states, in part, "[t]he systematic accumulation of funds during periods of employment to provide benefits for periods of unemployment by the setting aside of unemployment reserves to be used for the benefit of persons unemployed through no fault of their own, thus maintaining purchasing power and limiting the serious social consequences of relief assistance, is for the public good, and the general welfare of the people of this state."

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insolvent, with a negative balance, net of outstanding loans, of more than $3.5 billion, as of the end of the 2010 calendar year.

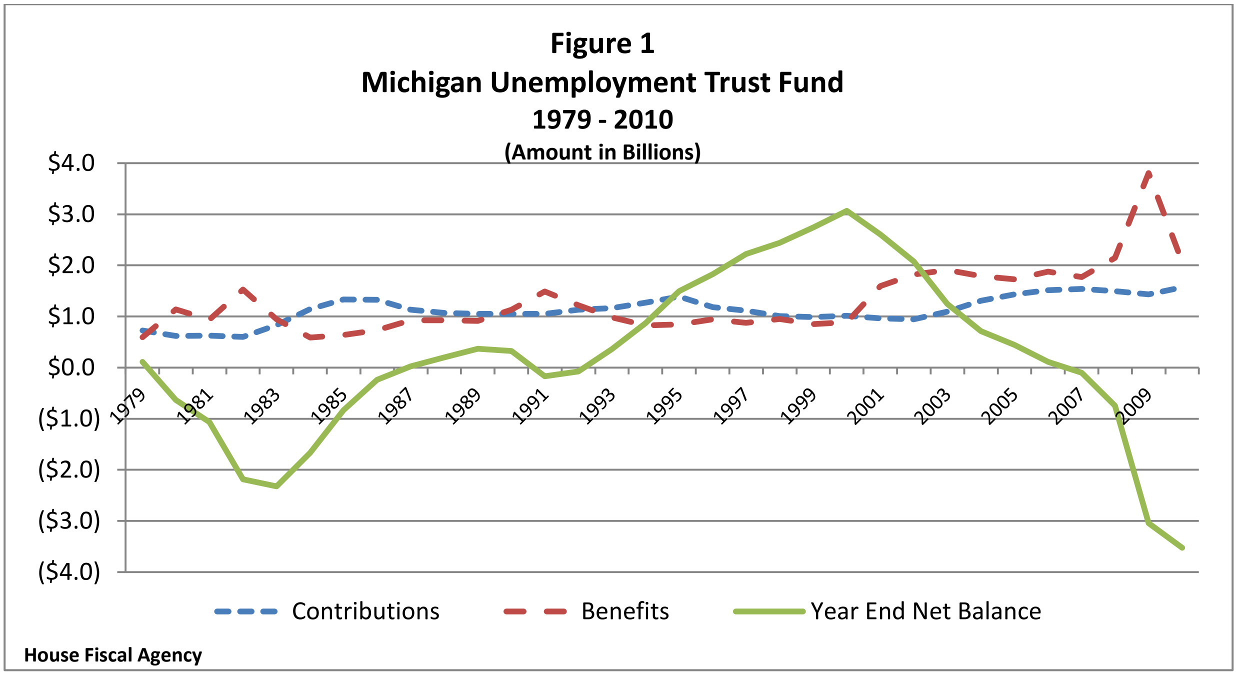


Figure 1
Michigan Unemployment Trust Fund
1979 - 2010
(Amount in Billions)

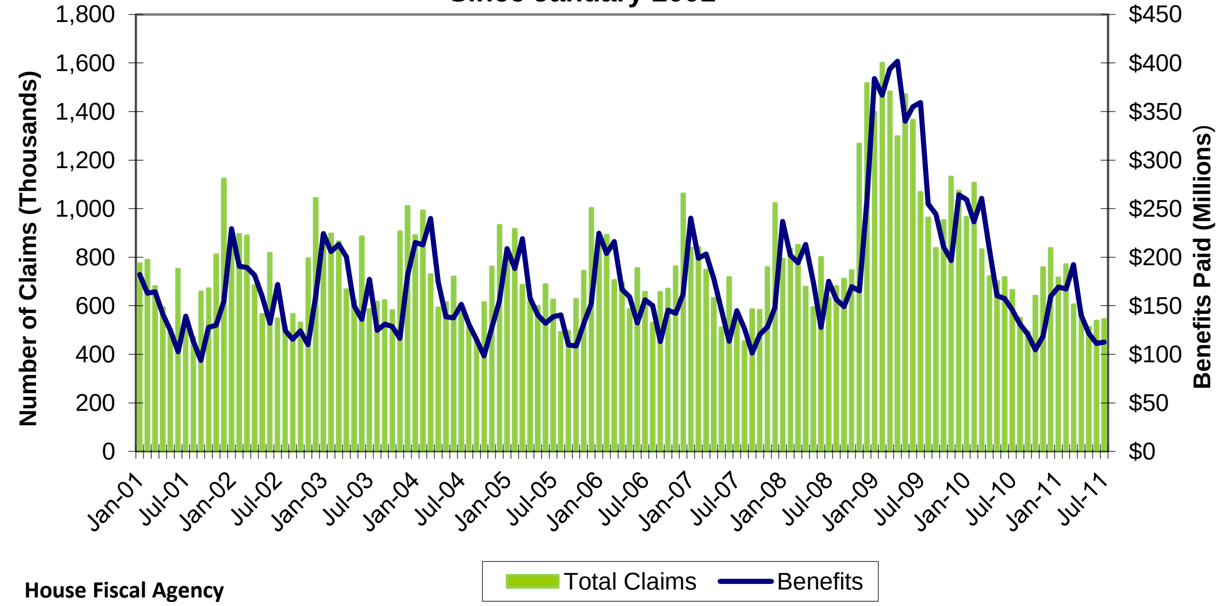
Source: U.S. Department of Labor, Employment and Training Administration; Michigan Unemployment Insurance Agency; U.S. Department of Treasury, Bureau of the Public Debt.

The trust fund balance reached a high point of more than $3.0 billion at the end of CY 2000, and soon after legislation was enacted that simultaneously lowered the state UI tax base and increased the maximum weekly benefit amount.[2] Following a period of historically high unemployment claims, the trust fund became insolvent with a negative net balance (including outstanding Title 12 advances) of $3.1 billion. Significant repayments made throughout 2011 by the UIA, due to higher state UI tax revenue and lower benefit payouts and coupled with increased federal UI taxes have raised the net balance of the UTF (not reflected above).

Weekly benefit claims (initial and continuing claims) are now falling from their recent historic highs to more "normal" levels. During one week in January 2009, nearly 400,000 initial and continued claims for regular benefits were filed with the UIA. By comparison, weekly initial and continued claims during the first two weeks of September 2011 were around 110,000 in both weeks. Figure 2 shows total monthly claims (initial and continuing claims) and benefits paid since January 2001.

[2] For a critical review of these actions see, Mike Evangelist and Rick McHugh, "Can't Get There From Here: Facing Reality in Financing Michigan's Unemployment Insurance Program," National Employment Law Project, August 2011, http://www.nelp.org/page/-/UI/2011/MI_UI_Report_Cant_Get_There_From_Here.pdf?nocdn=1. For a general discussion of state financing policies see, *Unemployment Trust Funds: Long-Standing Financing Policies Have Increased Risk of Insolvency*, Governmental Accountability Office, GAO-10-440, April 2010, http://www.gao.gov/new.items/d10440.pdf. In response to high unemployment claims and benefit outlays, and growing Title 12 balances a number of states (including Michigan) have enacted laws seeking to reduce the costs of UI benefits. See, *Unemployment Insurance: Consequences of Changes in State Unemployment Compensation Laws*, Congressional Research Service, Report R41859, July 8, 2011, available publicly at, http://www.uwcstrategy.org/Home/pdfs/CRS_Report_Changes_UI_Benefit_laws2011.aspx.

Figure 2
Monthly UI Benefit Claims
Since January 2001



Source: Unemployment Insurance Agency; U.S. Department of Labor, Employment and Training Administration.
Note: The chart shows the total number of initial and continued claims filed. Claimants who filed for multiple weeks during an unemployment spell are counted multiple times. Claims data does not include claims filed for any federally-funded extended benefits through the extended benefits (EB) program or the Emergency Unemployment Compensation (EUC) program. Benefits for those two programs are not paid for through the state UTF.

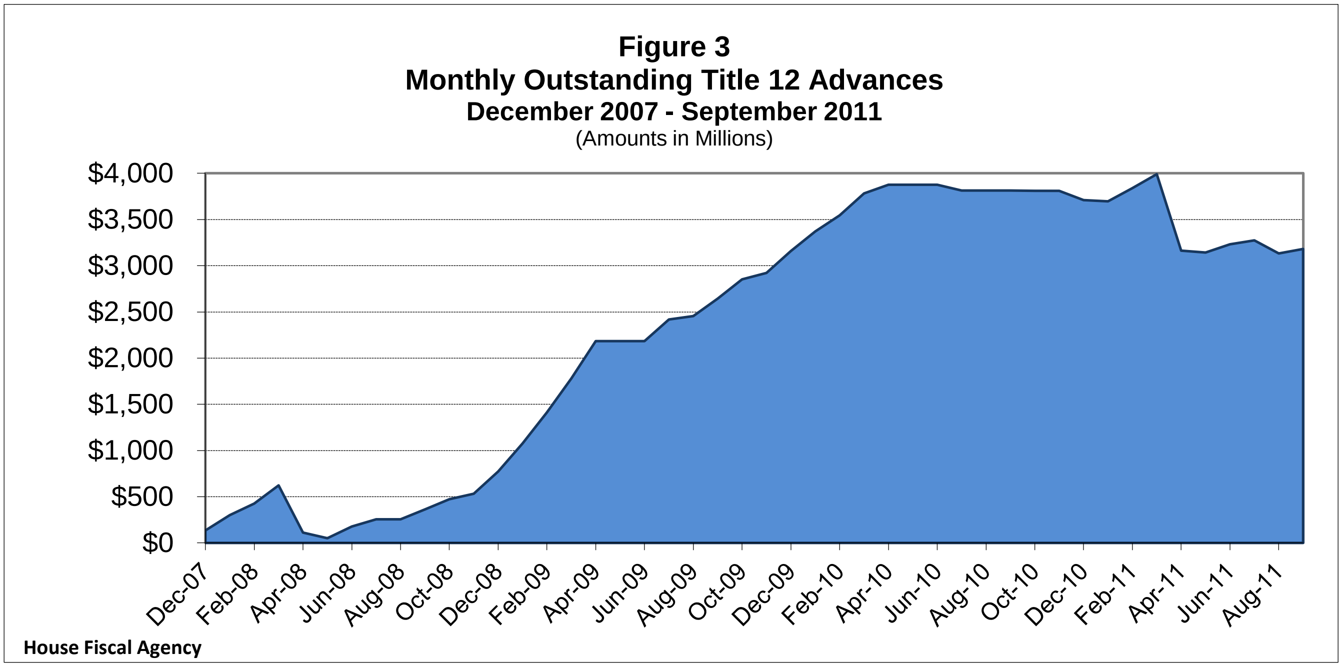
Title 12 Advances

Title 12 of the federal Social Security Act permits states to receive advances (loans) to pay unemployment benefits when the state unemployment trust fund does not have sufficient resources to pay benefits.[3] On this point, the Congressional Research Service notes, "[i]n budget terms [unemployment insurance] benefits are an entitlement (although the program is financed by a dedicated tax imposed on employers and not by general revenues). Thus, even if a recession hits a given state and as a result that state's trust account is depleted, the state remains legally required to continue paying benefits."[4]

Title 12 advances made to states bear interest at a rate, as determined by the U.S. Department of Treasury, based on the earnings yield of the federal UTF in the last quarter of the prior calendar year. For CY 2011, this rate is 4.0869%.[5] The American Recovery and Reinvestment Act of 2009, P.L. 111-5 (H.R. 1) temporarily waived any interest due from the date of enactment (February 17, 2009) through December 31, 2010. Under provisions of Title 12 and related regulations, interest began accruing on January 1, 2011 and is due on September 30, 2011.

[3] See, also, Section 60 of the Michigan Employment Security Act, MCL 421.60, which authorizes the governor to request Title 12 advances.
[4] See, *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States*, Congressional Research Service, Report RS22954, available publicly at http://www.fas.org/sgp/crs/misc/RS22954.pdf.
[5] See, Department of Labor, Unemployment Insurance Program Letter 09-11, *Interest Rate on Title XII Advances During Calendar Year (CY) 2011*, http://wdr.doleta.gov/directives/attach/UIPL/UIPL_9-11.pdf

Figure 3 shows the cumulative amount of Title 12 advances still outstanding at the end of the month for each month since December 2007. The outstanding balance as of September 26, 2011 is **$3,181,759,874.29.** The present estimate is that the state will continue to have an outstanding Title 12 advance balance for the next 6 or 7 years.



Source: U.S. Department of Treasury, Bureau of the Public Debt. **Note:** September 2011 balance is through September 26, 2011.

Under Title 12, there are two types of loan repayments. Voluntary repayments are made by the state when it has sufficient resources in its UTF to repay all or a portion of the advances received. When a state makes a voluntary repayment, it repays the advances it most recently received.

States also repay advances through an increase in federal UI taxes. Under the Federal Unemployment Tax Act (FUTA), contributing employers pay a tax of 6.0% on a taxable wage base of $7,000 per employee.[6] Employers who comply with the law receive a credit equal to 5.4%, which now reduces the effective FUTA rate to 0.6%. The credit reduction reduces the standard credit by 0.3% percentage points, with the credit reduction increasing each year. For Michigan employers, the credit reduction became effective on January 1, 2009, first payable by January 31, 2010. Michigan employers are now subject to a credit reduction of 0.9%.[7] Payments made through this reduced federal credit repay advances that have been outstanding the longest, with the additional revenue attributable to the reduced credit in received in 2011 being applied to advances going back to June and July 2008. To date, Michigan employers have paid an additional **$206.7 million** in increased FUTA taxes as a result of the credit reduction.[8]

[6] A 0.2% surtax added onto the base FUTA rate in 1976 (and extended many times since then) expired on June 30, 2011.

[7] The tax equates to $63 per employee (0.9% × $7,000). IRS Form 940, payable to the IRS on January 31, 2012. Most employers make quarterly FUTA deposits, with amount attributable to the credit reduction payable with the 4th quarterly deposit (due January 31st).

[8] Under the Michigan Employment Security Act, MCL 421.19(a)(5), positive balance employers receive a credit on their state UI tax return for one-half of the increased FUTA taxes attributable to the credit reduction.

Table 1

Title 12 Advances Received and Repaid

Year	Advances Received	Advances Repaid Voluntary	Advances Repaid FUTA Reduction	Year End Balance
CY 2006	$165,800,000.00	($165,800,000.00)	$0.00	$0.00
CY 2007	$637,000,000.00	($502,400,000.00)	$0.00	$134,600,000.00
CY 2008	$1,354,900,000.00	($717,000,000.00)	$0.00	$772,500,000.00
CY 2009	$2,386,582,333.32	$0.00	$0.00	$3,159,082,333.32
CY 2010	$717,700,000.00	($100,000,000.00)	($66,390,574.22)	$3,710,391,759.10
CY 2011	$1,136,710,035.32	($1,525,052,418.39)	($140,289,501.74)	$3,181,759,874.29

Source: U.S. Department of Treasury, Bureau of the Public Debt; Unemployment Insurance Agency.
Note: CY 2011 figures are through September 26, 2011.

Funding Sources for Interest Payments

Federal and state law provide that funding for any interest payments cannot be paid (directly or indirectly) by a state from its unemployment trust fund. If a state uses its trust fund to pay its interest liability, the state could be subject to decertification by the Department of Labor, which would increase the federal tax liability of employers, through the elimination of the entire FUTA credit, and result in the loss of administrative funding.

Under state law, interest payments are made from the UIA's Contingent Fund, penalty and interest account, which consists of revenue from penalties and damages, as well as interest on contributions, and other fund earnings. The act also credits to the fund any revenue from the solvency tax imposed on certain employers for the express purpose of making interest payments. The money in this fund, other than solvency tax revenue, may be used by the UIA for administration or to pay interest on Title 12 advances. Approximately **$20.0 million** in the Contingent Fund will be available for the current interest obligation.

Under the Michigan Employment Security Act, if the state unemployment trust fund has a balance, as of June 30th in a given year, that is less than the amount of any interest-bearing advances still outstanding, contributing employers with a negative balance in their experience account (e.g. those that have paid less in state unemployment insurance taxes than their former employees have received in benefits) are subject to an additional "solvency tax" beginning at the start of the next calendar year. As of June 30, 2010, nearly 30% of contributing employers were "negative balance" employers. The maximum solvency tax rate is 0.75% (on a tax base of $9,000 per employee), which equates to $67.50 for each employee for the tax year. The solvency tax was re-instated on January 1, 2011, and has generated **$47.8 million** in revenue to date in FY 2010-11. Together, the Contingent Fund balance and available solvency tax revenue account for $67.8 million, leaving a shortfall of **$38.25 million** to made up through a GF/GP supplemental appropriation to the UIA (SB 237).

State Repayment Requirements

As noted earlier, state interest payments are due by September 30, 2011. On this point, the Department of Labor has stated, "When a state accepts a Title XII advance, it takes the responsibility to pay all interest when due. Failure to do so can lead to conformity/substantial compliance proceedings which could result in loss of FUTA tax credits for employers in the state for the year the interest payment is not made timely, and loss of unemployment compensation (UC) administrative funding under Title III [of the federal Social Security Act] for the time period during which interest is outstanding. Interest will be charged on the outstanding interest at the rate paid on deposits in the UTF until payment is made."[9]

Going Forward

Looking ahead to FY 2011-12, it's currently estimated that the UIA's interest obligation will total approximately $136.4 million, with the solvency tax generating an estimated $57.0 million, leaving a shortfall of $79.4 million. Total interest costs and solvency tax revenue are estimated to be higher in FY 2011-12 than the current year because, in part, they will accumulate for a full-year, rather than the 9 months they have accumulated during FY 2010-11. Available Contingent Fund revenue will be reduced given the FY 2010-11 payment.[10] The fund receives approximately $12 million in revenue annually, with annual appropriations from the fund to support administration of the UIA totaling approximately $5.0 million.

[9] U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Program Letter 29-11, September 7, 2011, http://wdr.doleta.gov/directives/attach/UIPL/UIPL29-11.pdf.
[10] Under the Michigan Employment Security Act, the Contingent Fund was allowed to carry forward $15.0 million at the end of each fiscal year. Additionally, penalties for certain violations of the act are now credited to the Special Fraud Control Fund created by 2011 PA 14 (HB 4408), rather than the Contingent Fund.