MEMORANDUM

DATE: July 20, 2010
TO: House Appropriations Committee, Subcommittee on Economic Development
FROM: Mark Wolf, Fiscal Analyst
RE: Unemployment Insurance Solvency Issues and Interest Liability

This memorandum provides an update on the Unemployment Insurance Agency's receipt of loans from the U.S. Department of Labor under Title 12 of the federal Social Security Act to continue paying regular state UI benefits. The current outstanding loan balance (as of June 10, 2010) is **$3.8 billion.** This was recently reduced by $62.6 million due to the recent increased federal unemployment taxes on Michigan employers, but is not expected to increase (due to additional borrowing) or decrease (due to further repayments) during the remainder of the calendar year.

While the American Recovery and Reinvestment temporarily waived the interest requirements on these loans, states will required to resume paying interest on these loans beginning in 2011, barring some action by Congress to extend the waiver period. The UIA recently estimated that the amount of the interest due in Fiscal Year 2010-11 will be approximately **$150.0 million**, based on advances received to-date and anticipated borrowing in the future.[1] The Michigan Employment Security Act provides for a solvency tax to pay this interest liability. The UIA recently estimated that, on the high end, the solvency tax would generate approximately **$50.0 million – $65.0 million** in revenue, meaning that there is a shortfall between **$75.0 million – $100.0 million** that must be made up from other funding sources. Under federal law, the Unemployment Trust Fund cannot be used to pay interest.

STATE UNEMPLOYMENT TAX STRUCTURE

The state UI system is established in the Michigan Employment Security Act, 1936 (Extra Session) PA 1, MCL 421.1 et seq. The basic structure of the act is dictated by federal law.

Who Pays: There are, essentially, two types of employers that pay into the state unemployment trust fund. Employers that pay quarterly UI taxes to the state are "contributing employers". This covers private sector employers. Employers that do not pay UI taxes but, instead reimburse the state unemployment trust fund, on a dollar-for-dollar basis for benefits paid out to the employer's former employees, are "reimbursing employers." This category includes the state (the various departments), most local units of government and school districts, and many non-profit organizations.

Tax Base: The state UI tax imposed on the first $9,000 in wages for each employee.[2] States are generally free to establish taxable wage base for state tax purposes, subject to a federally-established minimum taxable wage base of $7,000.

Tax Rate: The state UI tax rate varies per employer and ranges from 0.06% to 10.3%, exclusive of any penalties imposed for noncompliance.[3] According to the Unemployment Insurance Agency (UIA), in CY 2009, the average

[1] Based on the earnings yields of the federal Unemployment Trust Fund over the last eight calendar quarters, the interest liability on the current outstanding balance could range from $115.5 million to $135.5 million. Over the course of these last eight calendar quarters, UTF earnings yields have ranged from 4.0476% (2010 Q2) to 4.7433% (2009 Q1), with the earnings rates declining in recent quarters. The ultimate interest rate charged in CY2011 will be the UTF's earnings yield during last quarter of CY2010. The additional interest liability in FY 2011 would depend on the volume of borrowing between January and May 2011.
[2] Section 44 of 1936 (Extra Session) PA 1, MCL 421.44
[3] Section 19 of 1936 (Ex. Session) PA 1, MCL 421.19

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Michigan UI tax rate was 5.3%, which equates to $477 per employee.[4] The tax rate is said to be "experience-rated" meaning that employers that have more former employees collecting UI benefits have higher tax rates than those with fewer former employees collecting UI benefits. The chart below shows the distribution of tax rates among contributing employers.

State UI Tax Rate Distribution

Tax Rate Range	Number of Employers	Percent of Total
0.06 – 0.09%	25,294	12.5%
0.1 – 1.0%	34,841	17.2%
1.1 – 2.0%	32,810	16.2%
2.1 – 3.0%	26,018	12.9%
3.1 – 4.0%	12,214	6.0%
4.1 – 5.0%	7,497	3.7%
5.1 – 6.0%	9,454	4.7%
6.1 – 7.0%	5,046	2.5%
7.1 – 8.0%	4,884	2.4%
8.1 – 9.0%	4,416	2.2%
9.1 – 10.0%	4,585	2.3%
10.1 – 10.3%	34,984	17.3%
Totals	**202,043**	**100.0%**

Source: Unemployment Insurance Agency, *CY 2009 Statistical Highlights for Michigan's Unemployment Tax Program,* UIA Fact Sheet No. 81, Revised June 2010. **Note:** Rates do not include penalties.

The state UI tax is determined by three components.

1. **Chargeable Benefits Component (CBC):** The CBC rate looks at the amount of benefits charges to an employers account over the 60-month (5-year) period ending on the previous June 30th. This amount then divided by the total taxable payroll over that same time period. This amount is then rounded up to the next 0.1%. The CBC rate ranges from zero to 6.3%.

$$\textbf{CBC} = \frac{\textbf{60 months of benefit charges}}{\textbf{60 months of taxable payroll}}$$

2. **Account Building Component (ABC):** The ABC rate aims to ensure the solvency of the UI system, by increasing the tax rate of employers whose UI account do not meet certain solvency standards. The ABC rate divides one-half of the difference between an employer's "actual reserve" and its "required reserve" by the total payroll (not just taxable payroll) for the 12-month period ending the previous June 30th.

$$\textbf{ABC} = \frac{\textbf{[Required Reserve - Actual Reserve] x 0.5}}{\textbf{12 months of total payroll}}$$

   The "required reserve" is 3.75% of an employer's total payroll for the 12-month period ending the previous June 30th. The "actual reserve" is the total amount of state UI taxes the employer has paid (based on the ABC and CBC components), less the total amount of benefits charged against the employer. The amount is rounded up to the next 0.1%, and cannot exceed 3.0%. Employers whose actual reserve is less than the required reserve are known as "negative balance employers". Historically, about 20% of employers are negative balance employers. However, given the prolonged economic decline, the proportion is increasing.

[4] *CY 2009 Statistical Highlights for Michigan's Unemployment Tax Program*, Michigan Unemployment Insurance Agency, Fact Sheet No. 81, revised June 2010, [http://www.michigan.gov/documents/uia_2003_TaxInfoFS81_108966_7.pdf].

3. **Nonchargeable Benefits Component (NBC):** The NBC rate is not experienced rated, and is generally 1.0%, although it can be lower, if the employer has few benefit charges. The NBC rate is generally used to pay the cost of UI benefits that are pooled among employers and not charged directly to a specific employer's experience account. A common example of "non-chargeable benefits" would be benefits that are payable to the former employees of an employer that has gone out of business.

For new employers, the state UI tax rate is set at 2.7% for the first two years. In the third year, the rate is one-third of the CBC rate plus 1.8%, and in year four the rate is two-thirds of the CBC rate plus 1.0%. The construction industry uses a higher (but similar) rate schedule, which is partly the reason why the construction industry has a higher average unemployment tax rate than other industry sectors. The chart below shows the distribution of state UI tax rates among the various industries.

State UI Tax Rate by Industry

Industry	Avg. Rate
Agriculture, Forestry, & Fishing	6.1%
Mining	7.4%
Construction	9.0%
Manufacturing	7.1%
Transportation, Communications, and Utilities	5.3%
Wholesale & Retail Trade	4.0%
Finance, Insurance, and Real Estate	4.6%
Services	5.2%
Government	3.6%

Source: Unemployment Insurance Agency, *CY 2009 Statistical Highlights for Michigan's Unemployment Tax Program,* UIA Fact Sheet No. 81, March 2010

FEDERAL UNEMPLOYMENT TAX STRUCTURE

Provisions in federal law pertaining to unemployment insurance are spelled out in Titles 3, 9, and 12 of the federal Social Security Act, and the Federal Unemployment Tax Act.[5] Title 3 of the SSA provides grants to the states to administer their UI system, and provides the framework for state UI laws necessary to receive federal administrative funding. Title 9 of the SSA pertains to the financial structure of the UI system. Title 12 of the SSA pertains to advances (loans) made to the state UI trust funds. The FUTA imposes the federal UI tax on employers, establishes other requirements on state UI laws, and establishes a joint federal-state program providing extended benefits during periods of high unemployment.

Who Pays: Generally, the same as provided under state law. Employers are either "contributing" employers paying federal UI taxes or reimbursing employers who reimburse the state unemployment trust fund, rather than paying UI taxes.

Tax Base: The tax base is $7,000 in wages per employee. The taxable wage base has remained at $7,000 since January 1, 1983, following the enactment of the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248 (H.R. 4961.)[6]

Tax Rate: The tax rate is fixed at 6.2%.[7] This includes a 0.2% surtax that was enacted in 1976 to repay loans to the federal Unemployment Trust Fund following the mid-1970's recession. The surtax sunsets every few years, and is routinely re-authorized by Congress. Following the enactment of the Worker, Homeownership, and Business Assistance Act of 2009, P.L. 111-92 (H.R. 3548), the surtax now sunsets at the end of June 2011.

[5] See, 42 USC 501 et seq. (SSA Title 3), 42 USC 1101 et seq. (SSA Title 9), and 42 USC 1321 (SSA Title 12), and 26 USC 3301 et seq. (FUTA).
[6] See 26 USC 3306.
[7] See, 26 USC 3301.

The Federal Unemployment Tax Act provides a credit of 5.4% to employers that comply with the act (and are located in states whose UI law conforms to federal requirements), which effectively reduces the federal rate to 0.8%. In effect, then, the federal UI tax equates to $56.00 per employee.

THE UNEMPLOYMENT TRUST FUND

Federal and state unemployment tax receipts are credited to federal unemployment trust fund, and expended pursuant to federal and state 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 states.[8] The most notable of these are the 53 state accounts, more commonly known as the state unemployment trust funds.[9] State unemployment tax revenue is credited to its account within the trust fund.[10] Funds within a state UTF are to only be expended for the payment of regular state unemployment benefits and the state's portion (generally half) of extended unemployment benefits (EB). Federal unemployment taxes are credited to the Employment Security Administration Account (ESAA), [11] the Extended Unemployment Compensation Account (EUCA),[12] and the Federal Unemployment Account.[13] Since 2009, outlays for extended benefits (both EUC08 and EB benefits) and for Title 12 loans to the states have far outstripped available FUTA tax revenue. As a result, the U.S. Department of Labor has had to borrow from the general U.S. Treasury to continue making payments.[14] Recently, the Obama Administration has noted, "[d]ue to the high volume of state loans and increased EB payments, FUA and EUCA are projected to borrow $51 billion from the general fund in FY 2010 and an additional $25 billion in FY 2011. The general fund advances must be repaid with interest. Neither account is projected to return to a net positive balance by 2015."[15]

As evidenced by the Michigan Employment Security Act's declaration of policy[16], the UTF is designed such that it accumulates fund balances during times of economic prosperity, and draws down those reserves during times that aren't so good economically. On this point, the Governmental Accountability Office (GAO) recently noted, "[b]ecause unemployment can vary substantially during a business cycle, it is important that states build sufficient trust funds to remain solvent during recessionary times."[17] This funding structure furthers the objective of the UI program to act as an economic stabilizer.[18]

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[8] For an overview of the flow of unemployment funds see, *Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits*, Congressional Research Service, RS22077 (updated January 31, 2008), available publicly at, [http://file.wikileaks.org/file/crs/RS22077.pdf]. See, also, Mike Miller, "The Role of Federal Financing in the Unemployment Insurance System," in *Unemployment Insurance in the United States: Analysis of Policy Issues*, 1997, W.E. Upjohn Institute for Employment Research.

[9] For the purposes of unemployment insurance, the District of Columbia, Puerto Rico, and the Virgin Islands are considered to be states.

[10] What we know in Michigan as the unemployment trust fund, and what is established in the Michigan Employment Security Act (MCL 421.26) as the unemployment compensation fund, is really the Michigan account within the federal unemployment trust fund.

[11] The ESAA is used to support state and federal UI administrative costs.

[12] The EUCA is used to pay for the federal portion of extended unemployment benefits.

[13] The FUA is used to provide loans, when necessary, to states for the purpose of paying unemployment benefits. State Title 12 interest payments are credited to the FUA.

[14] The federal unemployment trust fund is part of a unified federal budget. When the trust fund runs a surplus, the surplus is invested in government securities, meaning the federal government borrows less. When the trust fund runs a deficit, as is the case now, it must borrow from the general Treasury. On this point, the Congressional Research Service has noted, "[a]ll things being equal, a UTF surplus reduces the federal deficit, lowering the amount the federal government must borrow from the public. Conversely, a UTF deficit increases the overall federal budget deficit and increases federal borrowing needs." See, *Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits*, Congressional Research Service, RS22077 (updated January 31, 2008).

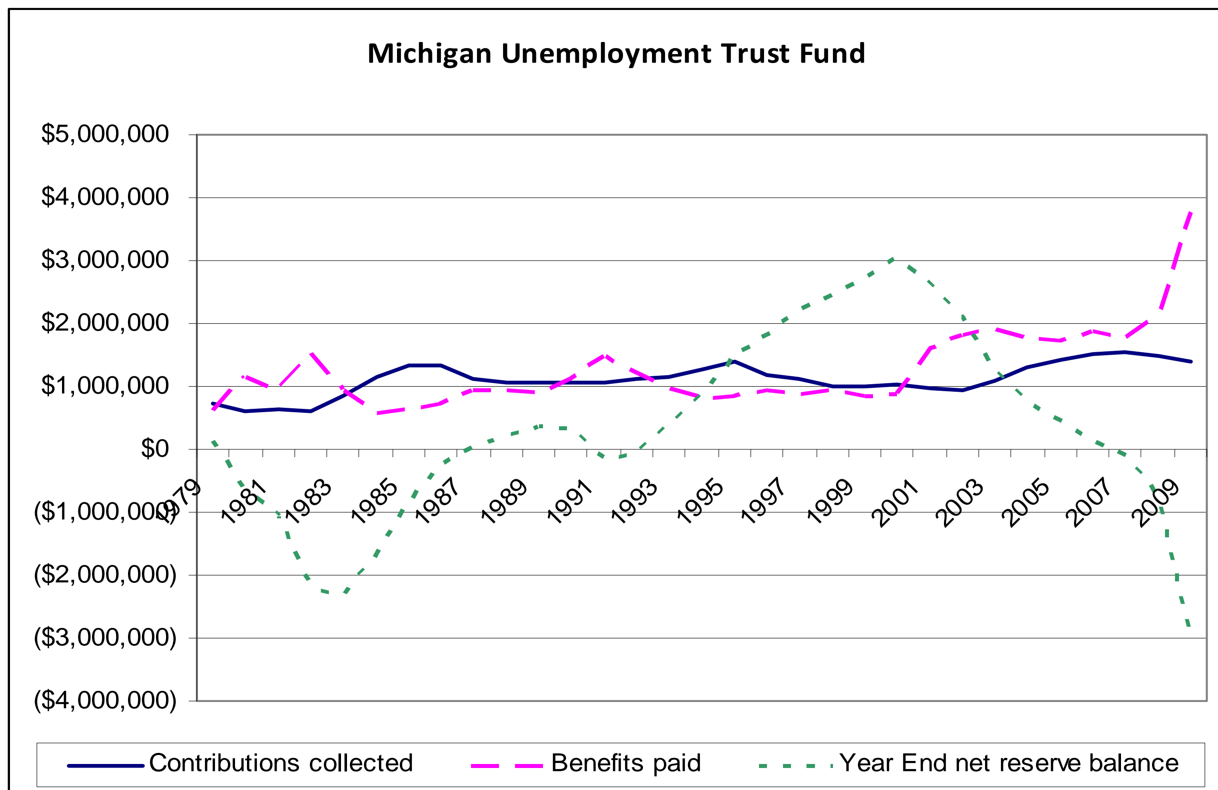
[15] *FY 2011 UI Outlook*, U.S. Department of Labor, [http://www.ows.doleta.gov/unemploy/content/prez_budget.asp].

[16] Section 2 of 1936 (Extra Session) PA 1, MCL 421.2 states, in part, "The 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."

[17] *Unemployment Insurance Trust Funds: Long-standing State Financing Policies Have Increase Risk of Insolvency*, Government Accountability Office, GAO-10-440, April 2010, [http://www.gao.gov/new.items/d10440.pdf],

[18] On this point, the Advisory Council on Unemployment Compensation (ACUC) noted, "[e]conomic stabilization can be achieved most effectively when unemployment benefits are paid out of a trust fund established at an earlier time (that is, under a principle of forward funding)." See, *Unemployment Insurance in the United States: Benefits, Financing, Coverage*, Advisory Council on Unemployment Compensation, February 1995, [http://www.ows.doleta.gov/dmstree/misc_papers/advisory/acuc/February_1995/adv_council_0295.pdf].

The counter-cyclical nature of the UTF is evidenced in the chart below, which shows contributions to, benefits paid from, and the year end balance (net outstanding loans) of the state UTF from 1979-2009. As shown in the chart, the state UTF is insolvent, with a balance, net of outstanding loans, of more than negative $3.0 billion, as of the end of the 2009 calendar year. Ten years ago, the situation was the exact opposite, with the trust fund having a balance of a positive $3.0 billion. For nearly the past decade, benefits have outpaced tax collections.



Source: U.S. Department of Labor, Employment and Training Administration, *ET Financial Handbook 394* and Michigan Unemployment Insurance Agency, *CY 2009 Statistical Highlights for Michigan's Unemployment Tax Program.*

TITLE 12 ADVANCES

Title 12 of the federal Social Security Act, 42 USC 1321 et seq., permits states to receive advances (loans) to pay unemployment benefits when the state unemployment trust fund does not have sufficient resources to pay benefits.[19] On this point, the Congressional Research Service notes, "[i]n budget terms, UC benefits are an entitlement (although the program is financed by a dedicated tax imposed on employers and not be 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."[20]

Title 12 was added to the federal Social Security Act with the enactment of the Employment Security Administrative Financing Act of 1954, P.L. 83-567 (H.R. 5173), commonly referred to as the "Reed Act".[21] Prior to enactment of the Reed Act, a federal loan fund (known as the George Fund) was enacted in 1944, in anticipation of states needing additional funding support to meet the expected increase in UI claims following the end of World War II. In the end, no state depleted its reserve or required assistance from the George Fund. However, in the years following the war, several states maintained fund balances at very low levels, which prompted continued discussion of the need for federal assistance to insolvent states. At the time, discussion centered around the propriety of providing states with direct grants or repayable loans. It was generally believed that a loan fund would continue to provide

[19] See, also, Section 60 of the Michigan Employment Security Act, MCL 421.60, which authorizes the governor to request Title 12 advances.

[20] See, *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States,* Congressional Research Service, Report RS22954 (January 12, 2010), publicly available at, [http://assets.opencrs.com/rpts/RS22954_20100112.pdf].

[21] See, Saul J. Blaustein, Wilbur J. Cohen, and William Haber, *Unemployment Insurance in the United States: The First Half Century*, 1993, W.E. Upjohn Institute for Employment Research. Kalamazoo, MI.

for state responsibility for financing its own UI program, provide states with an incentive to take corrective action to improve the financial viability of its UI program, and would minimize the role of the federal government.[22] Advocates for grant assistance, on the other hand, believed that states (and taxpaying employers) would be placed at a competitive disadvantage when they finally had to repay the loans and, at the same time, replenish the state trust fund.[23]

As enacted in 1954, Title 12 advances (loans) were made available to states, interest-free, if their trust fund balance for a calendar quarter fell below the amount paid for benefits in the prior four quarters. The federal government didn't enforce repayment of the loans until four years after the loans were made by – as is the practice still today – reducing FUTA tax credits available to employers. After a few states (including Michigan) received loans without actually using them, the loan program was tightened a bit in 1960 by requiring that state trust funds actually be insolvent (i.e., insufficient to pay claims), requiring repayment to begin within two years, and increasing reductions in federal tax benefits, thereby speeding up repayment. The loans remained to be interest -free, however.

The current provisions of Title 12 largely came about following the heavy borrowing by states during the recessions of the 1970's and early 1980's. During the 1970's 25 state received Title 12 loans, far outstripping the resources of the Federal Unemployment Account, from which advances were paid. (The FUA had to resort to receiving advances from general revenue of the U.S. Treasury to make the loans.) Given the volume of borrowing and the downturn in the economy, Congress enacted legislation in 1975 (P.L. 94-45) and 1976 (P.L. 95-19) allowing states to defer repayment of the Title 12 loans. The National Commission on Unemployment Compensation noted, "[t]he intent of the deferral was to ease the burden of States in which repayment of loans was scheduled to occur at the same time those States faced extraordinarily high benefit outlays."[24] On the interest-free nature of the Title 12 loans, the NCUC noted, "the Commission finds that interest should be charged on loans as an inducement to follow sensible reserve policies and thereby lessen the probabilities of borrowing. Further, the charging of interest should reduce the present advantages of borrowing and encourage prompt repayment on the part of debtor States."[25] In 1981, Congress carried out the recommendation of the NCUC in attaching interest to Title 12 loans, and making other improvements to the Title 12 loan provisions by enacting the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). This 1981 act largely serves as the basis for that Title 12 loans provisions as they exist today.

Interest Requirements

Under current law, loans made to states bear interest at a rate (not exceeding 10%), 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 2009, this interest rate is 4.6375%.[26] Interest does not accrue on loans made for so-called "cash flow" purposes. These are loans made between January and September of the federal fiscal year, and repaid by the end of the fiscal year (September 30th), provided the state does not take out any other loans for the remainder of the calendar year.[27] If the state does take out any additional loans between October and December, the "cash-flow" loans previously received (and repaid) will be assessed interest. That interest is due the day following the day the later advance is received.

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[22] William Haber and Merrill G. Murray, *Unemployment Insurance in the American Economy*, 1966. Richard D. Irwin, Inc. Homewood, IL.

[23] Ibid. 20 years earlier, at the time the UI system was created, a federally-created system was preferred over a state-by-state approach on the belief that, if states were free choose (or not choose) to enact their own UI laws, states that opted to not enact a UI program would have a competitive advantage over states that opted to create a UI program. See, Saul J. Blaustein, Wilbur J. Cohen, and William Haber, *Unemployment Insurance in the United States: The First Half Century*, 1993, W.E. Upjohn Institute for Employment Research. Kalamazoo, MI. See, also, Daniel Nelson, *Unemployment Insurance: The American Experience, 1915-1935*, 1969, The University of Wisconsin Press, Madison Wisconsin.

[24] *Unemployment Compensation: Final Report,* National Commission on Unemployment Compensation (NCUC), July 1980.

[25] Ibid.

[26] Department of Labor, Employment and Training Administration, *Unemployment Insurance Program Letter 9-09,* January 13, 2009, [http://wdr.doleta.gov/directives/attach/UIPL/UIPL09-09.pdf]. The UTF earnings yield for the quarter ending June 30, 2010 was 4.0476% according to the U.S. Department of Treasury, Bureau of the Public Debt, [http://www.treasurydirect.gov/govt/rates/rates_tfr.htm].

[27] An additional requirement, per Section 1202 of the Social Security Act [42 USC (b)(2)(C)], to receive interest-free loans is that the state comply with certain funding goals prescribed by the Secretary of Labor. This requirement was added with the Balanced Budget Act of 1997 but, to date, has not been implemented by DOL-ETA. In June 2009, the department issued proposed regulations carrying out this provision establishing a goal of having an average high cost multiple (ACHM) of 1.0, meaning the state could pay one year of benefits at recession levels without taking in any additional revenue.

While under Title 12 interest is due no later than September 30th, states are provided with three options enabling them to defer payment:

1. **May/September Delay**

   Under a May/September Delay, states may push back the interest payment on an advanced received during the last five months of the federal fiscal year (May-September) until the December 31st of the following year.[28] Under the May/September delay, interest on the interest will accrue from its original due date (September 30th) until the interest is paid. To delay the interest payment, the governor has to submit a request to the Department of Labor by September 1st prior to the September 30th when interest would normally be due.

2. **High Unemployment Deferral**

   Under a high unemployment deferral, states may spread their interest payment due in one year over a four year period. Each year over the four year period, a state pays one-quarter of the original interest due.[29] Under a high unemployment deferral, the deferred interest does not accrue interest. To receive a high unemployment deferral, the governor must submit an application to the Department of Labor by July 1st, and the state must have had an average insured unemployment rate (IUR) of 7.5% during the first six months of the previous calendar year. The IUR differs considerably from the standard unemployment rates that are reported monthly by state and federal labor market information agencies. The IUR is, essentially, the ratio of (1) the average number of UI claims and (2) number of employees covered under the UI program. It's not likely the state would qualify for this deferral, given the comparatively high threshold.[30]

3. **High Unemployment Delay**

   Under a high unemployment delay, states may push back the interest payment by up to 9 months (by the following June 30th) if the state has an average total (unadjusted) unemployment rate of 13.5% for the most recent 12 month period for which data is available before the interest payment is due.[31] During a high unemployment delay, additional interest on the interest payment will not continue to accrue. To receive the delay, the governor must apply to the Department of Labor by the July 1st before the interest is due. Based on current estimates, this option would be available to the state.

Funding Source of Interest Payments

Title 12 provides, in part, that the 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 and result in the loss of administrative funding.[32] Decertification is also a potential consequence of a state's failure to pay interest as required.[33] Previously, the U.S. Department of Labor has issued guidance letters further clarifying what fund sources may be used by states to pay interest on their Title 12 advances. The department has noted, "interest on Title XII advances from any State fund other than the State unemployment fund is not prohibited by Federal law even if State law requires or permits excess amounts in that fund to be transferred to the unemployment fund.

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[28] See Section 1202(b)(3)(B) of the Social Security Act [42 USC 1322(b)(3)(B)] and 20 CFR 606.40.

[29] See Section 1202(b)(3)(C) of the Social Security Act [42 USC 1322(b)(3)(B)] and 20 CFR 606.41.

[30] The IUR is used as measure to determine whether states "trigger on" for extended benefits (EB). The state's average IUR for the last 13 weeks is 4.08%. The average total unemployment rate (the more common measure) for the same time period was 13.9%, according to the Department of Labor, [http://www.ows.doleta.gov/unemploy/trigger/2010/trig_071810.html].

[31] See Section 1202(b)(9) of the Social Security Act [42 USC 1322(b)(9)] and 20 CFR 606.42.

[32] See Section 1202(b)(5) of the Social Security Act [42 USC 1322(b)(5)]. A similar provision is also included in the Federal Unemployment Tax Act, 26 USC 3304(a)(17). Section 26 of the Michigan Employment Security Act, MCL 421.26, notes, Any interest required to be paid on advances under title XII of the social security act, 42 USC 1321 to 1324, shall be paid in a timely manner and shall not be paid, directly or indirectly by an equivalent reduction in contributions or payments in lieu of contributions, from amounts in this state's account in the federal unemployment trust fund."

[33] See Section 303(c)(3) of the Social Security Act [42 USC 503(c)(3)].

These funds include penalty and interest special funds which have been created solely for the payment of interest on Title XII advances."[34] Additionally, in May 2010, the department issued a guidance letter noting that states could not use ARRA modernization funds to pay interest.[35]

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 (described later) imposed on certain employers for the express purpose of making interest payments. This fund may be used by the UIA to fund administrative expenses. Revenue collected from the solvency tax, however, may only be used for the payment of interest on any outstanding Title 12 loans.[36]

In 2002, the act was amended to require that all funds in the Contingent Fund in excess of $15.0 million lapse to the unemployment trust fund at the close of the fiscal years.[37] In addition, there have been several transfers from this fund to the General Fund, including the FY 2002 transfer of $79.5 million to the General Fund[38] per 2002 PA 192, and the FY 2004 transfer of $10.0 million.[39] Additionally, for FY 2007 and FY 2008, the Contingent Fund was also used to support costs related to the Workers' Compensation Agency. In FY 2009, the WCA was supported with GF/GP to allow the Contingent Fund to be used to support the UIA's Title 12 interest liability.[40]

State Receipt of Title 12 Advances

The charts below show (1) the amount of Title 12 advances made to the state, by month since January 2006, and (2) the amount of Title 12 advances made to the states that are outstanding as of July 8, 2010, based on data from the U.S. Department of Treasury, Bureau of the Public Debt. The current outstanding balance for the state is $3,814,145,999.11. State unemployment taxes are collected on a quarterly basis, with the bulk of the collections occurring in April, which enables the state to repays all or portions of the advances received or, in the case of 2009 and 2010, allowed the UIA to not take out additional loans in the months immediately following the collection of taxes. The UIA currently estimates that no additional borrowing will be need for the remainder of the calendar year.

As the second chart below indicates, in March and April the state received $165.8 million in loans, which were repaid on April 27, 2006.[41] These loans were considered to be for cash-flow purposes, because they were repaid before September 30, 2006, and thus were interest free. From January-April 2007, the state received another $423.5 million in loans, repaying those loans by May 2007. However, because the state received additional loans in December 2007 ($134.6 million), these earlier loans were then subject to interest, at a cost in FY 2007-08 of $3.6 million from the Contingent Fund.[42] Between December 2007 and April 2008 the state received $717.0 million in loans. These loans were repaid in full by May 1, 2008, with interest totaling $7.2 million paid from the Contingent

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[34] See, *Unemployment Insurance Program Letter 05-93*, November 12, 1992, [http://wdr.doleta.gov/directives/attach/UIPL5-93.cfm].

[35] See *Unemployment Insurance Program Letter 7-04, Change 1*, May 11, 2010. Under the ARRA the state is eligible for $207.9 million in funding from for the payment of UI administrative costs and benefits, if the state enacts certain provisions expanding eligibility for UI benefits. The state received one-third of this amount ($69.4 million) because it already had in place an alternate base period used to determine financial eligibility for benefits. The remaining two-thirds ($138.5 million) is available if the state enacts certain changes expanding eligibility. See, House Bill 4785 and House Bill 4786, which are pending before the Senate.

[36] See Section 10 of the Michigan Employment Security Act, MCL 421.10.

[37] Public Act 192 of 2002 (HB 5763).

[38] Public Act 192 of 2002 (HB 5763). This transfer was originally part of the FY 2002-03 Executive (Engler) Budget Recommendation, and was intended to prop-up the General Fund contribution to the School Aid Fund, given the decline in General Fund revenue, [http://www.michigan.gov/documents/FY03budgetdocument_35344_7.pdf].

[39] Public Act 84 of 2003 (SB 370). This transfer was originally part of the FY 2003-04 Executive (Granholm) Budget Recommendation to, again, support the General Fund, [http://www.michigan.gov/documents/budgetpr_58980_7_96414_7.pdf].

[40] After being partially supported by the General Fund, funding for the WCA shifted to Corporations and Securities Fees in FY 2002. Also, in 2002, Governor Engler issued Executive Order 2002-1 (ERO 2002-1, MCL 445.2004) combining the UIA and WCA into a single bureau.

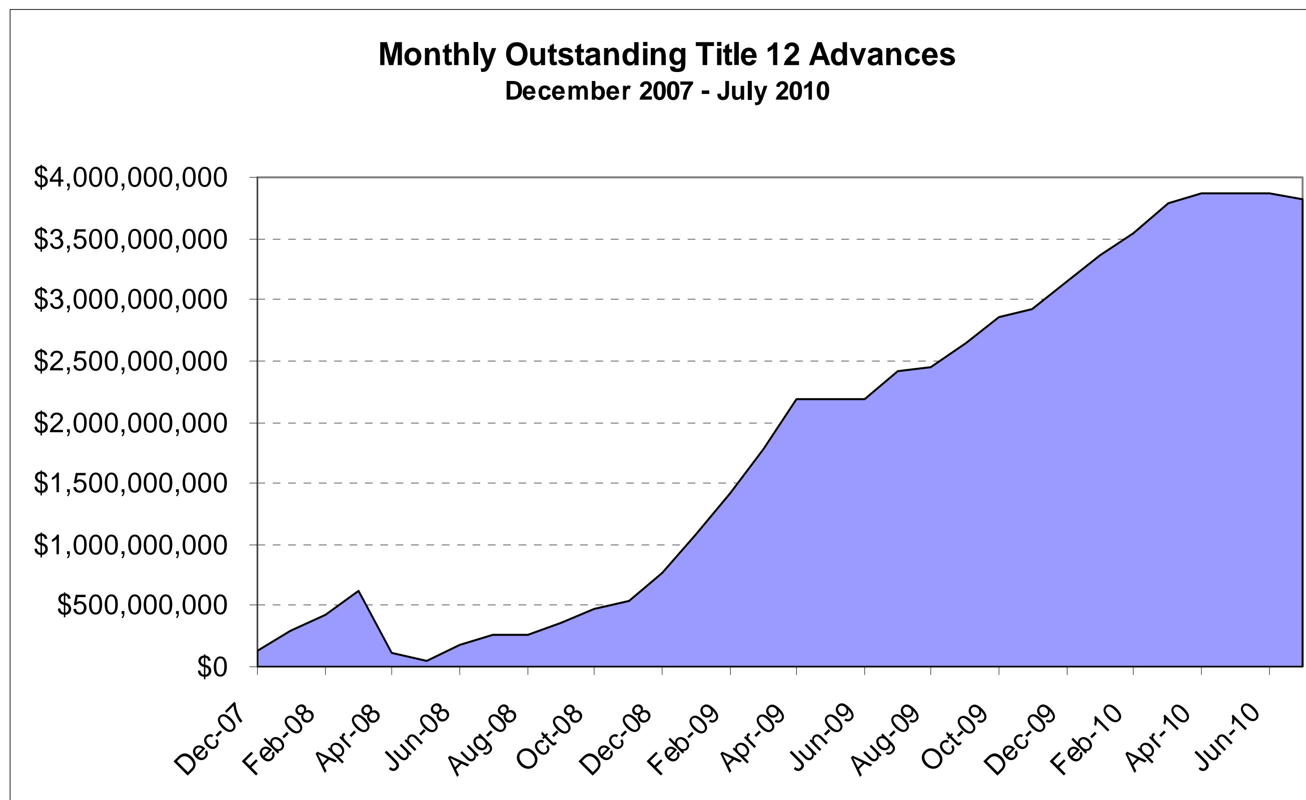
[41] This $165.8 million includes $91.9 million in loans received in March 2006 and an additional $73.9 million in loans received in April 2006.

[42] The interest rate on the 2007 loans was 4.6433%, per Unemployment Insurance Program Letter 13-07 (March 8, 2007), [http://wdr.doleta.gov/directives/attach/UIPL/UIPL13-07.pdf].

Fund.[43] The $3.8 billion in loans has accumulated since May 2008. The loans taken from May-September 2008 ($362.4 million) were subject to the May/September delay, allowing the interest payment to be pushed back to December 31, 2009.[44] The interest payment on the loans taken in the last quarter of 2008 ($410.1 million) wasn't due until September 30, 2009.

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) until December 31, 2010.[45] Under the normal provisions in the Title 12 and related regulations, this means that interest will be payable not later than September 30, 2011. Additionally, interest on all loans, whether received prior to the ARRA or during this waiver period, does not accrue.[46]

Under Title 12, there are essentially two types of loan repayments: (1) voluntary repayments and (2) other repayments. Voluntary repayments are made by the state when it has sufficient resources in its UTF to repay all or a portion of the loans received. When a state makes a voluntary payment, it repays the loans it most recently received. When a state makes a repayment via the "other" method, e.g. in the form a reduced federal credits (discussed later), it repays longest outstanding loans. For instance, when the state voluntarily repaid its loans in April and May 2008, the May payment paid of a portion of the loans it received in late April and the April payment paid off the loans it received in early April, March, February, January, and December (in that order). The recent collection of revenue from FUTA credit reduction ($62.6 million) paid off loans received at the end of May 2008 and early June 2008.



Source: U.S. Department of Treasury, Bureau of the Public Debt.

[43] As of May 1, 2008, the state had no outstanding loan balance. In 2008, interest accrued at a rate of 4.8078%, per Unemployment Insurance Program Letter 8-08 (January 28, 2008), [http://wdr.doleta.gov/directives/attach/UIPL/UIPL8-08.pdf].

[44] This interest payment would have totaled $3.6 million, and accrued interest, but because of the ARRA, this payment was waived (considered to be paid).

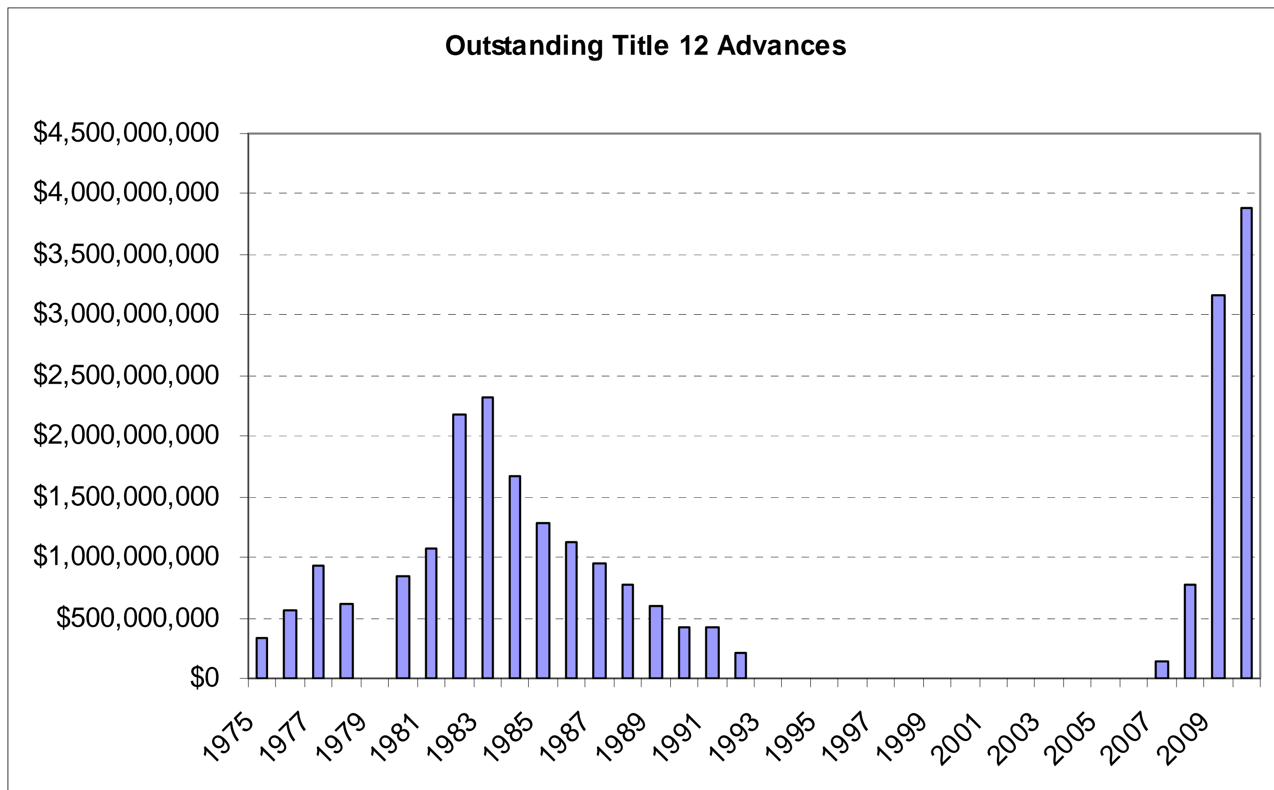
[45] See Subtitle A (Unemployment Insurance) of Title II (Assistance for Unemployed Workers and Struggling Families of Division B (Tax, Unemployment, Health, State Fiscal Relief, and Other Provisions) of the American Recovery and Reinvestment Act. See, also, the Joint Explanatory Statement of the Committee on Conference, [http://thomas.loc.gov/home/h1/Recovery_JS_DivB.pdf].

[46] See, Unemployment Insurance Program Letter 14-09 (February 26, 2009),[http://wdr.doleta.gov/directives/attach/UIPL/UIPL14-09.pdf] and Unemployment Insurance Program Letter 14-09, Change 1 (March 19, 2009), [http://wdr.doleta.gov/directives/attach/UIPL/UIPL14-09c1.pdf].

Monthly Title 12 Advances to Michigan
(As of July 8, 2010)

	2006	2007	2008	2009	2010
January	$0.00	$95,700,000.00	$166,000,000.00	$303,400,000.00	$212,300,000.00
February	$0.00	$119,900,000.00	$125,000,000.00	$336,500,000.00	$174,000,000.00
March	$91,900,000.00	$207,900,000.00	$196,800,000.00	$367,400,000.00	$237,600,000.00
April	($91,900,000.00)	($246,100,000.00)	($510,859,538.79)	$404,400,000.00	$93,800,000.00
May	$0.00	($177,400,000.00)	($60,840,461.21)	$0.00	$0.00
June	$0.00	$0.00	$126,300,000.00	$0.00	$0.00
July	$0.00	$0.00	$78,300,000.00	$234,000,000.00	($62,636,334.21)
August	$0.00	$0.00	$0.00	$36,960,000.00	
September	$0.00	$0.00	$107,100,000.00	$189,100,000.00	
October	$0.00	$0.00	$110,400,000.00	$208,300,000.00	
November	$0.00	$0.00	$59,400,000.00	$69,522,333.32	
December	$0.00	$134,600,000.00	$240,300,000.00	$237,000,000.00	
Yearly Total	**$0.00**	**$134,600,000.00**	**$637,900,000.00**	**$2,386,582,333.32**	**$655,063,665.79**
Year End Balance	**$0.00**	**$134,600,000.00**	**$772,500,000.00**	**$3,159,082,333.32**	**$3,814,145,999.11**

Source: HFA Calculations based on Unemployment Trust Fund - Federal Unemployment Account monthly transaction statements prepared by the U.S. Department of Treasury, Bureau of the Public Debt. **Note:** The amounts shown above include any repayments made in that month. The repayment made in July 2010 reflects the FUTA credit increased (increased federal UI taxes) Michigan employers paid in January. Positive amounts reflect loans received by the state, and negative amounts reflect the repayment of those loans.



Source: National Association of State Workforce Agencies and U.S. Department of Labor, Employment and Training Administration

Outstanding Title 12 Advances to States
(As of July 16, 2010)

State	Loan Balance	State	Loan Balance
Alabama	$283,001,164.19	MICHIGAN	$3,814,145,999.11
Arizona	$33,289,228.12	Minnesota	$634,608,599.19
Arkansas	$330,853,383.31	Missouri	$722,116,933.16
California	$7,534,038,172.43	Nevada	$465,045,635.83
Colorado	$202,965,185.05	New Jersey	$1,749,563,533.38
Connecticut	$498,452,705.05	New York	$3,176,873,427.71
Delaware	$12,901,505.48	North Carolina	$2,363,980,615.25
Florida	$1,612,500,000.00	Ohio	$2,314,186,799.00
Georgia	$416,000,000.00	Pennsylvania	$3,008,614,960.83
Idaho	$202,401,700.22	Rhode Island	$225,472,937.00
Illinois	$2,239,582,343.13	South Carolina	$886,662,351.97
Indiana	$1,739,415,133.42	Texas	$1,417,124,596.69
Kansas	$88,159,421.40	Vermont	$32,657,064.94
Kentucky	$795,100,000.00	Virginia	$346,876,000.00
Maryland	$133,840,764.71	Virgin Islands	$15,289,406.98
Massachusetts	$387,313,005.04	Wisconsin	$1,424,768,541.29
		Totals	**$39,107,801,113.88**

Source: U.S. Department of Treasury, Bureau of the Public Debt

Recently, the Obama Administration estimated that, "[v]ery large amounts of borrowing from the Federal Unemployment Account (FUA) are projected over the next few years. The balance of outstanding loans is projected to increase from $17.4 billion at the end of FY 2009 to a peak end-of-year balance of $93 billion in FY 2013. A total of 35-40 states are projected to borrow.[47]

IMPACT ON MICHIGAN BUSINESS

Solvency Issues: There are essentially two major consequences of the continued receipt of Title 12 advances on Michigan employers:

1. The imposition of the state solvency tax on negative-balance employers.

   Under the Michigan Employment Security Act, MCL 421.19a, 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 (e.g. those that have paid less in unemployment taxes than their former employees have received in benefits) are subject to an additional "solvency tax" beginning at the state of the next calendar year.

   Generally speaking, the state solvency tax is calculated in the same manner as the account building component (ABC) of the contributing employer's state unemployment tax rate. Under the act, MCL 421.19(a)(4), the maximum ABC rate is 3.0%. Further, the act, MCL 421.19a, provides that the solvency tax is the lesser of 1/4 of the ABC rate, or 2%. These provisions effectively provide that the maximum solvency tax rate is 0.75% (1/4 of 3.0%). With a taxable wage base of $9,000 per employee, the maximum solvency tax equates to an additional tax of $67.50 [$9,000 × 0.75%] for each employee for the tax year. Employers with an ABC rate below the maximum would have a solvency tax rate of less than 0.75% and a per-employee cost of less than $67.50.

   Revenue generated from the solvency tax is credited to the Contingent Fund, and may only be expended to pay interest on Title 12 Advances. Because the state has an outstanding loan balance as of June 30, 2008 of $177.0 million – see Chart 1 above – the solvency tax was to go into effect on January 1, 2009. However, the American Recovery and Reinvestment Act waived any interest payments otherwise due through the end of the 2010 calendar year. This is a complete waiver, where interest is considered to have been paid,

[47] *FY 2011 UI Outlook*, U.S. Department of Labor, [http://www.ows.doleta.gov/unemploy/content/prez_budget.asp].

with additional interest not accruing. As such there is no interest costs associated with the receipt of Title 12 advances in the near term. Because interest was no longer due in CY 2009 or CY 2010 under the Recovery Act, the Legislature and the Governor enacted 2009 PA 1 (HB 4239) suspending the imposition of the solvency tax when any interest otherwise due in the year is suspended or forgiven under federal law. This action saved employers an estimated $35.0 million in CY 2009. The solvency tax was last in effect between 1983 and 1989, generated $188.6 million. Because the state had an outstanding loan balance as of June 30, 2010 ($3.9 billion), the solvency tax will be re-instated on January 1, 2011, barring any additional action by the Congress to extend the interest-waiver period. The UIIA recently issued two "fact sheets" on the solvency tax, which are available on the UIA website.[48]

2. The reduction of the FUTA credit for all contributing employers.

   To reiterate, under the Federal Unemployment Tax Act, contributing employers pay a tax of 6.2% on a taxable wage base of $7,000 per employee.[49] However, employers who comply with the law receive a credit equal to 5.4%, which reduces the effect FUTA tax rate to 0.8% of taxable wages.[50] The UIA notes that the credit reduction became effective on January 1, 2009 and is payable to the IRS (Form 940) by January 31, 2010.[51]

   Under federal law, 26 USC 3302, the amount of the credit is reduced for contributing employers in a state that has an outstanding advance balance on January 1st for two consecutive years and that has not paid off the balance prior to November 10 of the second year. The credit is reduced in increments of 0.3% (increasing the effective tax rate to 1.1%) and is reduced an additional 0.3% on each subsequent year when there is an outstanding loan balance. Each 0.3% increase in the rate equates to $21 per employee.

   In addition to the incremental FUTA reductions, the credit is further reduced in years three and four, and further reduced beginning in year five and beyond based on the state average tax rate and the 5-year benefit cost rate. However, federal law provide that the amount of the credit reduction is limited – if states meet certain conditions – to the higher of (1) 0.6% of the wages paid by the taxpayer or (2) the reduction that was in effect in the prior year. In order to the reduction limit to apply, the state must meet the following criteria:

   a. No action was taken during the prior fiscal year that resulted in, or will result in, a reduction of the state's unemployment tax effort.

   b. No action was taken during the prior fiscal year that resulted in, or will result in, a decrease in the solvency of the state's unemployment trust fund.

   c. The state UI tax rate is at least equal to the average benefit cost ratio for the previous five years. The benefit cost ratio for a calendar year is all compensation paid in the year (including extended compensation), less amounts that are reimbursed by reimbursing employers, divided by the total wages paid by contributing employers.

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[48] See, *Solvency Tax*, Michigan Unemployment Insurance Agency, Fact Sheet No. 121, October 2008, [http://www.michigan.gov/documents/uia/121-Solvency_Taxes_253530_7.pdf]. See, also, *Solvency Tax is Temporarily Suspended,* Michigan Unemployment Insurance Agency, Fact Sheet No. 123, March 2009, [http://www.michigan.gov/documents/uia/123_-_Solvency_Tax_Waiver_03_2009_271028_7.pdf].

[49] See, the FUTA Return for the 2009 tax year (IRS Form 940), [http://www.irs.gov/pub/irs-pdf/f940.pdf], the accompanying instructions, [http://www.irs.gov/pub/irs-pdf/i940.pdf], and Schedule A, [http://www.irs.gov/pub/irs-pdf/f940sa.pdf].

[50] Again, federal law also requires that state UI laws conform to certain requirements. If a stat law is not inconformity with these requirements, employers are not eligible to receive the credit. In addition to suspending the solvency tax, 2009 PA 1, made a number of changes to the Michigan Employment Security Act so that the act conformed to federal requirements. By enacting these changes, the act continued to allow Michigan employers to receive the FUTA credit. The Department of Labor has also informed the Unemployment Insurance Agency that there are conformity issues with the SUTA dumping provisions in the Michigan Employment Security Act, which are required under the federal SUTA Dumping Prevention Act of 2004, P.L. 108-295, 42 USC 503(k). See, House Bill 4238, introduced by Rep. Bob Constan. See, also, House Bill 6386 from the 2007-08 Legislative Session.

[51] *Changes to Federal Unemployment Taxes*, Michigan, Unemployment Insurance Agency, Fact Sheet No. 126, June 2009, [http://www.michigan.gov/documents/uia/126_-_ChangesTo_FUTA_280302_7.pdf].

d. The outstanding loan balance on September 30 of the tax year is less than or equal to the outstanding loan balance prior to the third year.

States can avoid the credit reduction if (1) prior to November 9, the state repays all loans made during the 12-month period ending on that November 9th, plus the amount of potential additional tax due because of the credit reduction; (2) the state trust fund has sufficient resources to pay benefits for the balance of the year without needing an advance; and (3) the state takes some action that increases the solvency of the trust fund so that the increase is at least equal to the potential additional taxes that would otherwise by payable because of the credit reduction.[52]

Under Section 19(a)(5) of the Michigan Employment Security Act, MCL 421.19(a)(5), "positive balance" employers may receive a credit against the state unemployment tax for a portion of the amount of any additional FUTA taxes paid as a result of the FUTA credit reduction. The credit is generally equal to one-half of the amount of additional FUTA taxes paid as a result of the credit reduction, but cannot exceed the state UI tax non-chargeable benefits component rate (generally 1%) multiplied by taxable payroll. [On a per employee basis, the half of the FUTA credit reduction is $10.50, while the NBC calculation is $90.]

On this point, the UIA notes, "The extra federal unemployment tax will become due on January 31, 2010. The first Michigan tax credit will be applied to an employer's account in mid 2010. Thereafter, the credit will be applied for the calendar year that follows a year in Michigan a credit reduction was in effect. For example, if the credit reduction is still in effect in 2010, due January 31, 2011, the credit for that year will be applied in the 2011 tax year."[53]

According to the National Association of State Workforce Agencies, Indiana and South Carolina employers will be subject to the FUTA credit reduction this year (being reflected in FUTA tax returns due January 2011), with employers in another 23 states seeing a FUTA credit reduction in 2011 (January 2012 returns), and employers in 9 states seeing a FUTA credit reduction in 2012 (January 2013 returns).[54]

Per-Employee Costs of Solvency Required Taxes

	Date	Calculation	Negative Balance Employers	Positive Balance Employers
Solvency Tax	April 2011	0.75% x $9,000	$67.50	$0.00
FUTA Yearly Increase	January 2010	0.3% x $7,000	$21.00	$10.50

Note: Positive-balance employers receive a 50% credit for the additional FUTA taxes, taken against their state unemployment taxes. State unemployment taxes are paid quarterly, with the first payment in a year made in April.

IMMEDIATE OPTIONS FOR THE LEGISLATURE

The immediate issue facing legislators is the requirement that the state resume paying the interest on the $3.9 billion in federal loans the state has received (to-date) in order to provide benefits over the past several years.

1. **Budget for it:** Given the apparent shortfall in solvency tax revenue, the shortfall will have to be added to the list of budgetary GF/GP issues facing leadership when crafting a solution to the FY 2011 budget. Based on actual solvency tax collections, this amount could vary between $75.0 million and $90.0 million. In

[52] For further information see, 26 USC 3302, Title 20 Part 606 of the Code of Federal Regulations, and DOL-ETA Unemployment Insurance Program Letter (UIPL) 03-91, [http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=2398]. See, also, the presentation of Tom McHugh, of the Wisconsin Department of Workforce Development, Division of Unemployment Insurance before the 2009 National Conference on Unemployment Tax Administration, August 2009, http://www.dol.state.ga.us/taxconf/files/panel_1_mchugh.pdf

[53] *Michigan Tax Credit Coming in Mid 2010 For Positive Reserve Balance Employers,* Michigan Unemployment Insurance Agency, Fact Sheet No. 130, July 2009, [http://www.michigan.gov/documents/uia/130_-_MI_UI_tax_credit_07_09_292795_7.pdf].

[54] Statement of Karen Lee, President, National Association of State Workforce Agencies, before the U.S. Senate, Committee on Finance, April 14, 2010, [http://finance.senate.gov/imo/media/doc/041410kltest.pdf].

addition, the Legislature may have to revisit the $15.0 million cap placed in statute on the year-end balance of the Contingent Fund.

2. **Increase Solvency Tax:** The Michigan Employment Security Act provides that the solvency tax is the lesser of 1/4 of the ABC rate (i.e. 1/4 of 3%), or 2%. Increasing the solvency tax to the maximum rate of 2% may generate sufficient revenue to avoid having to resort to other funds to pay the interest liability. At 2%, the solvency tax would equate to $180.00 per employee (an increase of $112.50), generating approximately $97 million in revenue, according to the Unemployment Insurance Agency. However, at $180/employee, the tax may present the UIA with certain non-collection difficulties. Further, at the rate, some employers may find it more cost effective to simply make a lump sum payment bringing the account in balance, thus avoiding the imposition of the solvency tax, and further reducing solvency tax collections.

3. **Delay the Payment:** Title 12 permits states with an unemployment rate of 13.5% to delay the interest payment by 9 months. By the time a decision to delay the payment has to be made, the unemployment rate may be high enough allowing for a delayed payment. It isn't currently, however.[55] Simply delaying the interest payment under this provision wouldn't diminish (or increase) the amount due, but would allow for the payment to be pushed off into the FY 2012 budget. That, of course, would only add to the interest liability due the following year.

Of course, all of this may be a moot point, if Congress acts to extend the interest waiver period. The interest waiver in the ARRA is a clear indication that Congress is aware of the impact the interest requirements have on state budgets and state unemployment programs. On the other hand, the recent discussions on extending benefits indicates that there are members of Congress who are concerned about the solvency of the UI system and its impact on the budget deficit. However, in recent Congressional testimony, various interest groups with differing viewpoints on the UI system have implored Congress to extend the waiver, as indicated below:

→ **"Extending this provision will assist borrowing states while they are adjusting their programs and might relieve some immediate pressure to increase employer taxes in the short run."** Karen Lee, National Association of State Workforce Agencies.[56]

→ **"To reduce the pressure on states to cut workers' benefits and enact steep tax increases, Congress should continue the waiver of federal interest on trust fund loans through 2011. This continued relief should be tied to an explicit maintenance of effort requirement that ensures the UI program will continue to deliver support jobless workers and their families need, especially now at a time of such high unemployment."** Andrew Stettner, National Employment Law Project.[57]

→ **"The status of the slowly recovering economy and the need for jobs dictates that we must first do no harm to discourage job creation and economic recovery. The federal penalties that would otherwise be imposed in the form of Title XII loan interest and the FUTA offset credit penalty should be waived for two years to avoid dampening the creation of jobs and the economic recovery."** Douglas J. Holmes, UWC-Strategic Services on Unemployment and Worker's Compensation.[58]

[55] According to the DELEG Bureau of Labor Market Information and Strategic Initiatives, the June 2010 seasonally unadjusted state unemployment rate was 13.1%.

[56] Statement of Karen Lee, President of the National Association of State Workforce Agencies and Commission of the Washington State Employment Security Department, before the U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Income Security and Family Support, May 6, 2010, [http://waysandmeans.house.gov/media/pdf/111/2010May06_Lee_Testimony.pdf]. The NASWA is an association representing the interest of administrators of state UI programs, workforce development programs, and labor market information programs.

[57] Statement of Andrew Stettner, Deputy Director, National Employment Law Project, before the U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Income Security and Family Support, May 6, 2010, [http://waysandmeans.house.gov/media/pdf/111/2010May06_Stettner_Testimony.pdf]. The NELP is an organization advocating for worker interests in various employment law programs.

[58] Statement of Douglas J. Holmes, President, UWC-Strategic Services on Unemployment and Worker's Compensation, , before the U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Income Security and Family Support, May 6, 2010,

LONG-TERM ISSUES FOR THE LEGISLATURE

In addition to the immediate issue of the state's Title 12 interest liability, it is clear that there are long-term solvency issues with the unemployment insurance system, at the national level, among the several state UI programs, and here in Michigan. In recent testimony before the U.S. Senate Finance Committee, Gary Burtless, of the Brookings Institution, stated,

> I think our experience in this recession points to a number of areas in which long-term reform of UI is needed.
>
> * * *
>
> Many states entered the recession with UI trust fund reserves that were plainly inadequate, notwithstanding the fact that the job market had been comparatively healthy for a number of years. By providing state trust funds with interest-free loans during the current recession, the federal government has unintentionally rewarded states for this short-sighted behavior. Sensible federal policy should encourage state legislatures to build up prudent trust fund reserves during economic expansions.
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> * * *
>
> The basic system of financing UI is scandalously out of date. The federal unemployment tax is only assessed on the first $7,000 of a worker's annual wages. This is equivalent to the annual earnings of a part-time, minimum-wage worker. In more than half of the states the tax base is less than $10,000. For the country as a whole, unemployment insurance taxes are assessed only about a quarter of wages. This system means that the maximum UI tax is assessed on the earnings of low-wage workers. In many states the unemployment tax is essentially a flat tax per person added to a company's payroll. It is hard to see why this tax structure is in the best interest of employers, of low-and average-wage workers, or of the nation as a whole. Congress should consider a basic overhaul of the financing system.[59]

Given the basic objectives of the unemployment system — wage replacement, economic stabilization, promoting reemployment, preventing unemployment — whatever direction the long-term solvency solutions take,they must balance these sometimes competing purposes. On this point, the Advisory Council on Unemployment Compensation noted,

> To a significant extent, all of the objectives discussed are positive outcomes. Nevertheless, for two reasons, they cannot all be fully pursued simultaneously within one unemployment insurance system. First, because some of the objectives require a commitment of scare resources, they must be weighted according to their relative priority in a given system. Second, the pursuit of some objectives can have a negative impact on others. For example, generous wage replacement provisions may hamper efforts to facilitate reemployment by reducing the costs of unemployment to individuals. Similarly, the desire for an extremely limited wage replacement program is likely to reduce the capacity of unemployment insurance to serve as a significant toll for economic stabilization during periods of recession. Because of these tensions, the design of an unemployment insurance system often requires a subtle balancing of competing objects.
>
> Thus, in determining the structure of an unemployment insurance program, the identification and prioritization of objectives, as well as the intrinsic tensions among those objectives, must be taken

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[http://waysandmeans.house.gov/media/pdf/111/2010May06_Holmes_Testimony.pdf]. The UWC is an organization advocating business interests.

[59] Gary Burtless, *Unemployment Insurance for the Great Recession,* testimony before the U.S. Senate Committee on Finance, September 15, 2009, [http://finance.senate.gov/hearings/testimony/2009test/091509gbtest.pdf]. See, also, Marc Baldwin, *Beyond Boom and Bust: Financing Unemployment Insurance in a Changing Economy,* National Employment Law Project, April 2001, [http://nelp.3cdn.net/e252e86c94c15dd1ca_5km6iv50f.pdf]. See, also, *Trust Fund Report,* New Hampshire, Department of Employment Security, May 21, 2009, [http://nelp.3cdn.net/e252e86c94c15dd1ca_5km6iv50f.pdf]. See, also, Rick McHugh, National Employment Law Project, *Response to Questions for Interested Parties,* State of Vermont, Unemployment Trust Fund Reform Study, September 22, 2009, [http://nelp.3cdn.net/12e60f2af629004e7b_5gm6bn47f.pdf]. See, also, *Unemployment Insurance Reform Proposal*, Vermont Department of Labor, April 2009, [http://www.labor.vermont.gov/Portals/0/UI/UI%20Brief.pdf].

> into consideration. To a great extent, the appropriate balance among the objectives must ultimately depend on value judgments, which will inevitable vary across (and within) societies and cultures.[60]

Recent Congressional hearings have provided a brief overview of some of the actions that may be taken by State Legislatures and Congress to address the long-term solvency issues of the UI system.[61] The first of these, however, may simply be convening a commission or task force to review and study this issue, and make the appropriate policy recommendations. Over the years there have been a number of commissions looking at this at a national level (in 1980 and 1995), and state level, including recent activities in Vermont,[62] Kentucky,[63] and New Hampshire.[64]

On this point, the National Employment Law Project, an organization advocating for employee interests, recommends that states undertake expert studies assessing the causes of trust fund insolvency and the long-term solutions to restore financial stability to the system, stating:

> In most states, trust fund insolvency has two primary causes: (1) failure to adequately finance the system prior to the recession, and (2) unprecedented rates of unemployment and record levels of long-term unemployment. States that are borrowing heavily from the federal government will be under political pressure to institute measures that will prevent unwanted tax consequences like FUTA credit reductions. At the same time, it is more important than ever to build a plan that not only restores solvency but also commits to forward-financing in order to avert future insolvency. A good plan should keep a state out of trouble for at least ten years.
>
> By examining the origins of the state's insolvency, a financing study can identify needed corrective measures. This process could delay legislative action, but it is more important to take the time to develop a well-constructed plan with fairly predictable revenue streams over a number of years than it is to avoid the first FUTA credit reduction ($21 per year per employee).[65]

Indeed, the Michigan Employment Security Act establishes the Michigan Employment Security Advisory Council and charges the council with making recommendations to the UIA on policy, and to the governor, the Legislature, and the UIA on proposed amendments to the act that are "deemed advisable to carry out the purposes of this act and to provide more effective administration of this act."[66] The council consisted of 11 members representing the interests of public and private employers, public and private employees, and the public. The advisory council was abolished in 1994 by Governor Engler[67], but could be reconstituted to provide recommendations to the Legislature on long-term solutions on the solvency of the unemployment trust fund.

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[60] *Unemployment Insurance in the United States: Benefits, Financing, Coverage*, Advisory Council on Unemployment Compensation, February 1995, [http://www.ows.doleta.gov/dmstree/misc_papers/advisory/acuc/February_1995/adv_council_0295.pdf].

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