

Unemployment Insurance Financing in Crisis: How Should States Respond to Trust Fund Insolvency?

EXECUTIVE SUMMARYⁱ

State unemployment insurance programs are experiencing a financing crisis of historic proportions. As of April 30, 2010, 35 statesⁱⁱ had outstanding federal loans in excess of \$40 billion with loan balances projected to reach \$90 billion by FY 2013. As described in NELP's recent paper, *Understanding the Unemployment Trust Fund Crisis of 2010*, today's solvency problems have their roots in years of short-sighted funding decisions by state programs. Today's crisis gives states the opportunity to revisit their unemployment trust fund philosophy and set a course for a more responsible future. This paper outlines state responses available for the immediate and long-term challenges facing state unemployment insurance (UI) trust funds.

Immediate Issues Facing States

- States with federal debts will start facing consequences in September 2011, when they will owe approximately \$2 billion in interest on trust fund loans. This paper recommends that states follow the historical practice of making these payments with a

special interest assessment on their employers.

- Employers in 23 states will face a \$21-per-worker reduction of the Federal Unemployment Tax Act (FUTA) tax credit if state trust funds are not solvent by November 10, 2011 (employers will pay for the credit reduction on January 31, 2012). Michigan employers paid for the credit reduction this year, and South Carolina and Indiana will be hit in 2011 if they are not solvent by November 10 of this year. For state policy makers, there are pros and cons to these FUTA penalties. In many cases, letting these surcharges kick in can serve as a first step toward restoring state solvency.
- States with larger debts cannot be expected to raise their UI tax rates high enough to pay back their trust fund debt in a matter of a few years.
- Despite the serious recession, state UI taxes in many states remain low, with 20 states charging a minimum tax of \$15 or less in 2009. (See Figure 1.)

Summary of Key Recommendations

- State policy makers should resist reverting to the "equality of sacrifice" model in which roughly equivalent benefit cuts and tax in-

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ⁱⁱ Throughout the report, the term "states" refers to the 53 unemployment insurance jurisdictions (the 50 states plus the District of Columbia, Puerto Rico and the Virgin Islands).

creases are used to restore solvency. Overly generous benefits did not cause today's crisis, and taking money out of the hands of jobless workers in today's slowly recovering economy would do more harm than good.

- Employers in states that have adopted a “pay-as-you-go” approach to UI financing are now facing major costs that are a direct consequence of this philosophy. As they move out of the current solvency crisis, these states need to turn the corner and adopt forward-financing principles.
- Insolvent states should conduct expert examinations of their UI financing mechanisms and consider features that are recognized for promoting UI solvency. The most effective of these measures is indexing the taxable wage base. Other measures that should be considered include (a) ensuring adequate minimum and maximum tax rates, (b) establishing a fund solvency goal that enables the state to pay a year of benefits at a historically high recessionary level, (c) adopting social tax rates to recoup costs that are not individually charged and (d) establishing more responsive tax table triggers.
- In those instances where states with sound financing systems have become insolvent, the cause has almost always been a history of legislative intervention in the setting of tax rates. As an insurance program for the nation's workers, UI financing and actuarial principles must be insulated from political efforts to utilize low UI tax rates as economic development strategies.
- While there will be calls for Congressional responses to widespread state trust fund insolvency, states should not assume that federal debt relief will happen and should begin framing their actions in ways that demonstrate fiscal responsibility.

BACKGROUND

After more than two years of recession, the first signs of recovery for the U.S. economy are not signaling corresponding optimism about job growth. Most economists expect unemployment rates to remain near 10 percent throughout 2010 and the administration forecasts that unemployment will continue to average over 9 percent in 2011 and over 8 percent in 2012.¹ Long-term unemployment is at record levels with the average duration of unemployment lasting over six months. Nearly one-quarter of unemployed workers have been out of work for a year or more. One result of this distressed labor market is unprecedented federal borrowing by state UI trust funds to maintain payment of state UI benefits.

As of April 30, 2010, 35 states had drained their UI trust funds and been forced to borrow over \$40.0 billion from the federal government in order to continue paying state UI benefits. This borrowing will rise as weak labor markets persist in coming years. Actuaries at the U.S. Department of Labor are projecting that as many as 40 of the 53 UI jurisdictions could borrow over \$90 billion in federal loans for state trust funds by FY 2013.²

The Federal Unemployment Account (FUA), which funds loans to the state trust funds, has itself become insolvent and is borrowing from general revenues.

The crisis in UI Trust Fund solvency should be a national and state policy priority. The magnitude of state debt has already drawn the attention of policy makers in Washington, including the Government Accountability Office:

Long-standing UI tax policies and practices in many states over 3 decades have eroded trust fund reserves, leaving states in a weak position prior to the recent recession. While benefits over this period have remained largely flat relative to wages, employer tax rates have declined. Specifically, most state

taxable wage bases have not kept up with increases in wages, and many employers pay very low tax rates on these wage bases.³

However, there is no assurance that timely federal action will happen. Meantime, stakeholders in the states are faced with an immediate set of hard decisions. This paper contains recommendations for state policy makers and advocates facing solvency debates in the states.

State Reactions to the Insolvency Crisis

All state unemployment insurance programs include some features to increase revenues when their trust funds become less solvent. First and foremost, experience rating of employer taxes generally increases tax rates based on higher UI claims activity. Furthermore, the majority of states have additional taxes that are triggered when trust fund balances begin to fall below specified levels. These two factors have generally been operating to automatically increase employer taxes in 2010.⁴ In addition, the taxable wage base increased in 2010 for employers in eight states.⁵ Altogether, employers in 36 states faced UI tax increases in 2010.⁶ However, such increases alone will not be sufficient to restore solvency in most states for years because of the level of debts and limitations built into states' UI financing mechanisms.

In the first four months of 2010, state legislatures have reacted to insolvency in a variety of different ways. The vast majority of states – including all of the dozen states that have borrowed \$1 billion or more – have made no major structural changes to improve financing of their systems. In fact, two of those states – Florida and Indiana – repealed employer tax increases enacted last year before they could take effect in 2010. A third major borrowing state (New Jersey) is seriously considering a proposal to peel back the size of a scheduled statutory tax increase. Generally, without the threat of an immediate demand for repayment of principal or accrual of interest, the largest

borrowing states have taken a wait-and-see approach to mounting debt.

Among lower level borrowers, Kansas enacted legislation that reduced UI tax rates for about 38,000 employers. Meanwhile, Vermont recently passed legislation that will increase the taxable wage base from \$10,000 in 2010 to \$16,000 by 2012, but will also freeze maximum benefit payments until the fund is solvent, add a one-week waiting period, and introduce tougher eligibility guidelines for unemployed workers.

A small number of legislatures in insolvent states are still considering bills that would either increase the taxable wage base or make an adjustment to solvency tax rates in their current sessions. New Jersey, Mississippi and South Carolina are all considering additional increases in the taxable wage base coupled with proposals to cut benefit rates and eligibility. Massachusetts is considering an administration proposal to substantially increase and index its taxable wage base. In 2010, Maryland, Nebraska, South Dakota and Utah have all enacted UI benefit expansions under the Unemployment Insurance Modernization Act (UIMA) provisions of the Recovery Act that have resulted in the distribution of federal incentive funds to their UI trust funds. Finally, Hawaii has enacted legislation to reduce the size of a scheduled tax increase.

NELP's recommendations for federal policy regarding solvency are beyond the scope of this paper, but can be found in recent testimony to Congress.⁷

Dealing with the Immediate Consequences of Federal Borrowing

States will have several important decisions related to federal loan repayment rules.

Interest: In general, federal UI loans are interest free only if made and repaid between January 1 and September 30 of the same calendar year.

These interest-free loans are known as “cash flow” borrowing. However, early in 2009 Congress (as part of the Recovery Act) waived interest on trust fund loans through CY 2010. Because of the rule described above, interest on most recession-related UI loans will be due on October 1, 2011. Thus if a state was able to bring its loan balance down to zero by September 30, 2011, the state would face no interest payment on borrowing in 2009 and 2010.⁸ Interest payments are expected to total just under \$2 billion nationally in FY 2011.

States cannot pay back this federal interest from their regular state UI tax collections — which can only be used for the payment of benefits or the repayment of the principal of federal loans that were used to pay benefits.⁹ In today’s tight general revenue environment, the wisest move for the states is to enact a special interest assessment on employers. Twenty-one states already have an interest assessment in their law. Such funds are segregated from the UI trust fund and then used to repay federal interest, and are sometimes known as solvency or interest surcharges. States should be prepared to enact this assessment at the start of their 2011 session so funds will be available by early October. Since financing of the unemployment trust fund is an employer responsibility, it is logical for the employer community to be responsible for payment of interest on trust fund borrowing as well. States should not look upon federal UI interest as a general fund obligation.

FUTA Credit Reductions: While states are not required to pay back the principal on their loans in any specified time, the federal government does have automatic mechanisms to ensure repayment of loan principal. If a state has a loan balance on January 1 during two consecutive years, and cannot pay back its balance by November 1 of the second year, its employers face a tax penalty. This penalty, known as the FUTA (Federal Unemployment Tax Act) tax credit reduction, increases the effective federal UI tax on employers in insolvent states by \$21

per employee per year (\$21 per employee in year one, \$42 per employee in year two, etc.). These extra revenues are used to pay back principal on the loan. Already, Michigan has experienced this penalty, and as of November 1, 2010, employers in Indiana and South Carolina will incur the same penalty and have to contribute extra federal taxes by January 31, 2011. As many as 23 states could face these reductions as of the end of 2011, with the extra federal tax payment due on January 31, 2012. **(See Table 1.)** Extra FUTA payments are applied directly to a state’s loan principal.

FUTA credit reductions raise many concerns for employers and state officials. The increase in the FUTA tax is confusing for employers, and requires them to file extra paperwork with their tax returns. Moreover, the FUTA credit applies equally to every employer in the state — and many low-layoff employers argue that high-layoff employers should pay a greater share of trust fund debt repayments. Nonetheless, when assessing the costs and benefits of solvency efforts, the extent of potential FUTA surcharges should be taken into account in determining how state UI tax increases under consideration compare to FUTA surcharges that will apply automatically under federal law.

NELP does not recommend a strategy of avoiding FUTA credit reductions at all costs. FUTA credit reductions will reduce the UI debt principal and have the advantage of not requiring contentious state legislative debates. Still, states with large trust fund debts will not get much immediate help from FUTA credit reductions.

RECOMMENDATIONS

A. A renewed national commitment by stakeholders to restoring adequate forward financing of UI programs is vital to the nation’s economic health.

The importance of a strong UI program has never been more evident than in the current

recession. The primary goals of the UI program are to partially replace the wages of unemployed workers between jobs and to help stabilize local economies when communities experience major worker dislocations. The number of American workers who rely each week on UI benefits to pay for mortgages, rent, food and other essentials has never been higher (currently near 11 million). The UI program has prevented millions of middle-class Americans from falling into poverty, and it has mitigated financial harm for thousands of small businesses, particularly in the communities hit hardest by plant closings and other major industry dislocation. The Congressional Budget Office has found that each dollar in UI benefits paid translates into an increase of up to \$1.90 in the Gross Domestic Product (GDP).¹⁰

The UI program has largely succeeded in meeting these goals, but for most states, it has come at the cost of insolvency. To make matters worse, trust fund insolvency comes at a time when families and economies are still continuing to depend on the safety net. Unlike most prior recessions, UI claims will remain elevated as the job market slowly recovers over the next several years.

As pointed out in NELP's recently released paper "Understanding the Unemployment Trust Fund Crisis of 2010," the roots of the trust fund crisis lay in short-sighted financing decisions in the years leading up to the recession.¹¹ If state policy makers do not take responsibility for setting their unemployment trust fund financing on a more responsible course now, the political will to maintain a program that provides meaningful economic support to unemployed workers will erode in many states.

Nearly every state must now face a difficult two-part challenge. They must look at the long-term structure of their UI financing and develop plans for rebuilding solvency in order to be better positioned for future recessions. At the same time, they have a set of short-term financing and benefit decisions to navigate

through an economic recovery that still includes high jobless rates.

B. Given the degree of debt and persistence of high unemployment, the usual self-correcting UI experience rating mechanisms will – for some states – be inadequate to restore UI solvency. Despite this challenging situation, policy makers should resist reverting to the “equality of sacrifice” model in which benefits are cut and taxes raised to generate roughly equivalent savings and revenues.

Every state financing system is required by federal law to experience-rate its UI taxes, so that those employers who lay off the most workers pay a greater share of benefit costs. Thus, experience rating is one of the key self-correcting mechanisms for UI financing, because it automatically raises revenue after a period of high claims. The experience rating principle means that many employers can already expect to see their UI taxes rise over the next couple of years, even if a state takes no legislative action. This is because experience rates generally increase in the two to three years following higher claims activity. However, given the size of the trust fund debt and low tax bases for UI payroll taxes in most states, experience rating alone will not be enough to repay trust fund debts.

In addition, nearly all states have some mechanism for adjusting tax rates across the board when increases in benefit payouts stress the trust fund. A few states accompany these tax increases with automatic benefit reductions. There are several problems associated with these funding mechanisms.

- Many states have adopted pay-as-you-go financing mechanisms. In these states, UI taxes are set up to stay just as high as benefit payments in the previous year or two. While this keeps taxes low during good times, it requires major tax increases in the years immediately after a spike in UI benefit

claims. Employers in some of these states are facing significant tax increases. Even though these tax increases are part of statutory schemes that employers agreed to and designed, state policy makers are now wary of letting them go into effect as written during economic hard times.

- Because this recession has been longer than usual, significant and sometimes steep tax increases are hitting businesses in the spring of 2010. These increases come at a time when business bottom lines have certainly improved, but when economic recovery is just in its early stages.
- State UI financing mechanisms contain significant limitations that will make a return to solvency take years in many cases. Overall, the actuarial reality of state trust financing mechanisms will not get them out from under the weight of the current insolvency problem. The U.S. Department of Labor predicts that in FY 2011, state UI collections will increase to \$52 billion in revenue (from \$31.4 billion in FY 2009), but that state benefits will still be at the elevated level of \$77.7 billion. The U.S. Department of Labor's projections do not project net savings by state trust funds until FY 2015.

Because of these structural flaws, most states will be forced to re-examine their trust fund financing systems to resolve financing shortfalls. As they try to craft remedies for a problem that is still very much ongoing, states have to take a long-term view.

NELP offers several key observations:

- States with large trust fund debts cannot be expected to raise taxes so high as to pay trust fund loans back in just a few years. On the other hand, substantial tax increases are the only responsible course of action in states where employers have been paying very low taxes for years. There is evidence that policy makers do not have the stomach

to raise taxes. For example, the Florida legislature recently repealed a 2009 law, crafted by business leaders just months earlier, that would have raised the minimum tax on employers from \$8.40 to \$100. This law was repealed before it could take effect because of employer protests about the impact on job creation. This action was taken despite the fact that Florida had already borrowed approximately \$1.2 billion and the average UI tax rate nationally is about \$275 per worker.

- In this kind of anti-tax environment, there will be calls to cut benefit levels or enact more restrictive eligibility requirements. This so-called "equality of sacrifice" model is not the appropriate remedy for insolvency problems that were not caused by overly generous benefits. Reducing the size of a benefit that – on average – only replaces about 36 percent of the worker's pre-layoff wages clearly undercuts the program's twin goals of helping unemployed Americans get through to their next job and stimulating local economies. As an insurance program, UI benefits are intended to protect against the detrimental consequences of an adverse economic event – job loss – by insuring previous wages. Reducing benefit levels that already replace only a portion of prior wages simply undermines the program's economic goals.
- Trying to dig out of insolvency without rejecting the pay-as-you-go philosophy that has contributed to insolvency in several states will foreclose the possibility of addressing UI solvency responsibly. Over the long term, UI benefits cannot keep pace with wage growth in the absence of forward financing of UI trust funds. The evidence is clear that by far the leading contributor to most states' insolvency is a long-standing failure to adequately finance trust funds, leaving them unprepared for the current recession.

C. States with insolvent trust funds should conduct an expert examination of the causes of insolvency and craft long-term solvency plans aiming to correct tax features that are inconsistent with forward-financing principles.

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).

While a commitment to forward-financing must be the single unifying principle of any solvency plan, it is important to consider those tax structure features that have been identified by the U.S. Department of Labor as promoting solvency. These features are found in better-designed financing mechanisms and include:

- **Indexing the taxable wage base to growth in average annual wages to ensure the percentage of wages subject to UI payroll taxes remains consistent as wages rise.** Because average wages continually rise, average weekly UI benefits – which are a percentage of wages – will also increase

from year to year. The most effective way to recapture increasing costs associated with rising benefits is to index the wages that are subject to UI taxes to the level of average wages in each state. This is by far the most important recommendation for states and is explained in depth in Section D below.

- **Ensuring that tax rates are set at adequate levels to generate sufficient revenues to pay benefits attributable to employer experience.** Experience rating systems are designed to ensure that UI tax rates rise for employers as they lay off more workers. To function effectively, the tax rates that correspond to increased benefit charges must be set at levels high enough to recover the resultant rise in costs to the UI trust fund. The maximum tax rate must be set high enough that high-layoff employers pay a fair share of their benefit charges, but not so high as to put an unrealistic tax burden on these employers. Federal law requires that the maximum tax rate be set at least 5.4 percent of \$7000 or \$378 per employer per year – a federal minimum too low for experience rating to effectively work. For example, in 2009, seven insolvent states (Alabama, Arizona, California, Florida, Georgia, Indiana, and South Carolina) had effective maximum tax rates below \$500 per employee per year. These states, and others with low maximum tax rates, will have to revisit their maximum ceilings as part of their solvency plans.
- **Ensuring that the minimum tax rate for all employers is adequate.** Even though a majority of employers may have little or no layoff activity during a given period, sound trust fund management requires that there be a minimum annual contribution by all employers. As any insurance pool, the risk that is being insured needs to be borne by all who are being provided coverage. Since all wages are insured, all employers should pay a premium. Many states have ignored

this principle by affording tax holidays or zero tax rates during good economic times for employers with little or no layoff activity, leaving the system underfunded when the economy makes a downturn. **Figure 1** shows that 20 states have a minimum UI payroll tax of less than \$15 per employee per year. Even in 2009 (a second year of recession), 11 states (Colorado, Kansas, Hawaii, Iowa, Missouri, Montana, Nebraska, North Carolina, South Dakota, Washington and Wisconsin) reported to the U.S. Department of Labor that some employers were allowed to pay no UI taxes and another six states (Arizona, Florida, Georgia, Louisiana, New Hampshire and New Mexico) had UI minimum tax rates of less than \$10 per employee per year. While many of these states raised UI tax rates on these employers in 2010, adopting respectable levels of minimum tax rates represents a commitment by all employers to build up the UI trust funds in the coming years.

- **Reliance on a social charge rate to assess all employers equitably for costs that are not individually charged.** As a matter of public policy, every state has some benefits that are not charged back to employers. Sometimes these are intentional policy choices such as not charging employers for benefits paid to workers who leave jobs for compelling personal or family reasons because these separations are not considered to be attributable to the employer (“non-charge”). In other instances, the tax structure may be ineffective in charging back costs to an employer that is at the maximum tax rate or that has closed its doors and thus no longer pays wages that will be subject to taxation (“ineffective charges”). Some states have added a “social tax” to the basic tax rate to recoup costs that were not individually charged to employers in the

previous year. A typical social tax rate adds up all of the ineffective charges in the state, divides them by the total amount of taxable wages and then assesses this rate across the board.¹²

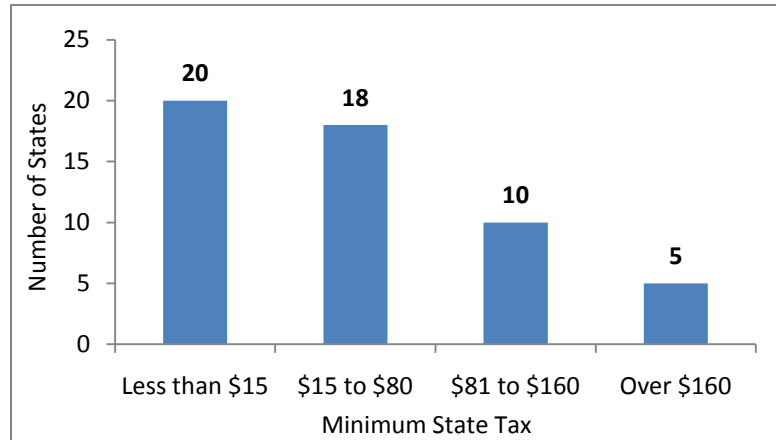


Figure 1. Minimum State Unemployment Insurance Tax per Employee, 2009

- **Preventing legislative rate-setting.** The most effective experience rating systems are those that are directly responsive to changing levels of employer layoff activity and will automatically recover costs associated with increased benefit payouts. States that design their tax systems in a way that allows for frequent intervention by the legislative branch in setting rates often have major solvency problems. Like any insurance system, funding decisions should be based on sound actuarial principles; regular legislative intervention undermines the effective operation of a well-designed experience rating system.
- **Establishing triggers for tax tables that are responsive to increases and decreases in payouts and revenues.** In order to avert trends toward insolvency, many states have made their tax tables more sensitive by raising the fund balance triggers that either activate the highest tax rates or a separate fund solvency tax. Generally, this approach relies on setting a solvency goal that factors

in the fund's highest historical costs over the previous 20 years, relying on either the High Cost Multiple (HCM) or the Average High Cost Multiple (AHCM). (See Section E below.)

The U.S. Department of Labor, Employment & Training Administration (ETA) will consult with state UI agencies that request assistance in the development of solvency legislation. ETA maintains statistical data on all state UI financing systems and can provide analysis of deficiencies in a state's existing tax structure. Finally, because of high UI workloads in almost every state, there are federal UI administrative grant dollars potentially available to fund expert solvency studies.

D. Indexing the taxable wage base to the state's annual average wage should be the cornerstone of any legislative solvency plan.

Most states have a fixed level of wages subject to UI payroll taxes (called the "taxable wage base"). The consensus view of all leading UI financing experts is that indexing the taxable wage base to the state's average annual wage is the most effective method to achieve and maintain solvency. In an April 2010 report to Congress, the Government Accountability Office recommended raising and indexing the FUTA taxable wage base as one of its six policy options.¹³ This would force many states to raise their state taxable wage bases as well.

Under indexing, a state's taxable wage base is raised automatically to keep pace with growth in wage levels. Only 17 states have taken this approach but with a few exceptions, these states have managed to avoid the need for federal borrowing during the current recession. Indexing has a proven record of success which is premised on a basic and understandable insurance principle. Indeed those states that took responsible steps to finance their programs by indexing taxable wages were four

times less likely to borrow from the federal Treasury to pay state unemployment benefits.

For nearly every state that has seen its UI trust fund run dry, a major piece of the underlying insolvency relates to a disconnect between taxable wage levels and overall wages. In fact 29 of the 35 states that are insolvent fail to index their taxable wage bases. On the other hand, 11 of the 18 states that are still solvent as of April 23, 2010 are states that do index their taxable wage bases. (See Table 2.)

It is a matter of basic math that programs will not be able to finance adequate benefit levels over the years if they are levying UI taxes on a fixed wage base. Since benefits increase along with wages and the cost of living, over a number of years states with fixed taxable wage bases simply lose the ability to raise sufficient revenue.

States with fixed taxable wage bases are acting like a car insurance company that would set 2010 rates based on the cost of 1982 Ford Escort, when in fact they are insuring a more expensive 2010 Ford Fusion. If there were a rash of accidents, a firm that set rates in this way would simply go out of business; this is essentially the story of what has happened to many state trust funds.

Given the duration of the current recession, it may be more politically feasible to implement a graduated series of increases in the taxable wage base by adopting an indexing formula, but capping the annual increase. (In addition, many states will be in a position to concurrently adjust tax rates to mitigate increased costs in the transition to a higher wage base.) This will limit the impact of the solvency plan in the short term, but will make implementation less painful, not only because of the caps but also because the increases will be spread out over years in which the state and nation will likely be in a period of economic recovery and growth by the time full implementation takes place.

E. A key component in building a long-term solvency plan is to establish a fund solvency goal. An adequately solvent trust fund should be able to pay benefits (without any additional revenues) for up to one year at unemployment levels comparable to recent recessionary periods.

The measure most commonly used to evaluate the solvency of state unemployment trust funds is called the Average High Cost Multiple (AHCM). This measure is based on the idea that states should be encouraged to accumulate reserves sufficient to pay at least one year of benefits at levels comparable to the state's previous high cost. "High cost" is defined as the average of the three highest annual levels of UI benefits that the state paid in any of the last three recessions.

The AHCM measure was recommended in 1995 by the national Advisory Council on Unemployment Compensation and it is used by the U.S. Department of Labor to measure state solvency. A state with an AHCM of 1.0 is able to pay out UI benefits at predictable recession levels for one year without taking in any additional tax revenues. A state with an AHCM of 1.0 is generally considered to be doing well in terms of solvency.

States that establish a solvency goal normally keep tax rates at a healthy level until the solvency goal is reached. States without a solvency goal are likely to drop their tax rates as soon as the state trust fund debt is paid off. States should establish a responsible fund solvency goal for a couple of reasons. First, a solvency goal can be calibrated to respond automatically to increasing benefit costs or declining revenues with necessary corrective measures. Second, adopting a federally accepted standard like the AHCM of 1.0 will position the state well in terms of any potential federal response to the national solvency crisis. While it is far from clear what kind of remedies Congress will consider, states that have taken steps to institute long-term solvency plans

should expect to receive more favorable treatment under any federal plan than states that have not taken action.

F. The UI trust fund solvency crisis will likely be addressed at some point by Congress. Meanwhile, states should not assume that there will be any wholesale relief of federal debt. States should begin now to frame their actions in accordance with existing federal standards in order to put themselves in the best possible position to benefit from any future federal solvency legislation.

The U.S. Department of Labor is projecting that 40 or more states will owe the federal government \$90 billion by the end of CY 2012 as a result of trust fund borrowing. Michigan employers already experienced a \$21-per-employee FUTA tax increase in 2010, while employers in South Carolina and Indiana could be in a similar situation if federal loans are not repaid by November 1, 2010. Employers in an additional 23 states will experience FUTA tax increases in 2012, unless state trust funds achieve solvency by November 1, 2011. As state legislatures begin to grapple with difficult solvency issues while unemployment remains high, it is appropriate to question whether the national economic emergency of the past two years justifies a UI financing solution that is jointly state and federal.

To the extent that there is pressure from states on Congress to address the solvency crisis as a national issue, any remedies should be premised on giving states incentives to plan responsibly going forward. Interest on federal borrowing has already been waived through the end of CY 2010 and there will be efforts to extend that deadline. Similarly, employers may look for delays on the FUTA credit reduction that will affect many states by the fall of 2011. These kinds of waiver and delay measures can only be justified if states use the breathing room being provided to examine and reform their financing systems.

In the context of the current federal budget deficit, \$90 billion is too large a debt to be forgiven and states are too culpable to justify wholesale debt relief. In addition, employers and states that have acted responsibly and maintained strong UI financing systems are ill served if Congress bails out irresponsible states without assurances that states will prepare for the next recession.

When and if Congress addresses UI financing, states that have taken responsible action should benefit as well as states that are not insolvent. At a minimum, a significant increase in the current federal taxable wage base of \$7000 is long overdue and would almost certainly be a major element in any reasonable Congressional solution. Incentives like interest premiums for states that have managed to achieve solvency goals and less favorable borrowing rules for states that do not make financing improvements are other options. Solvency standards proposed by the U.S. Department of Labor last

year for short-term borrowing provide useful insight into the kinds of federal expectations that would come with any partial federal debt relief. Finally, Congress will likely look to ensure that the worker protections of state UI programs are not eviscerated in a one-sided march toward solvency.

It is still too early to assess how – or even if – there will be a federal legislative solvency solution. Nonetheless, states can look ahead at the range of federal options and frame their actions in a manner that offers the best prospects for future assistance. Many states will find it extremely difficult to concurrently reform their financing systems and repay their federal loans before another economic downturn. But by demonstrating a commitment to restoring trust fund solvency, states can make the strongest possible argument for a federal role in the solution to the ongoing UI financing crisis.

ENDNOTES

¹ *Annual Economic Report of the President*, Council of Economic Advisers, February 2010.

² *UI Outlook, Overview* U.S. Department of Labor, Employment and Training Administration, Office of Unemployment Insurance, Division of Fiscal and Actuarial Services (February 2010).

³ Government Accountability Office, "UNEMPLOYMENT INSURANCE TRUST FUNDS: Long-standing State Financing Policies Have Increased Risk of Insolvency," report to the U.S. House Ways and Means Committee, Subcommittee on Income Security and Family Support, Apr. 2010, <http://www.gao.gov/new.items/d10440.pdf>.

⁴ Tax schedules in 28 states increased in 2010, while another 10 states were already at the highest tax rate schedule allowed by statute. *National Association of State Workforce Agencies (NASWA) UI Trust Fund Solvency Survey*. (December, 2009).

⁵ Id. The states are Arkansas, Hawaii, Louisiana, New Hampshire, Rhode Island, Tennessee, Vermont and West Virginia. Indiana and Florida also enacted wage base increases but repealed them in 2010.

⁶ *Unemployment Program Changes by State in 2010*. ProPublica, Pierce & Larson. (2010).

⁷ U.S. House Ways and Means Committee, Subcommittee on Income Security and Family Support, Hearing on the Solvency of the Unemployment Insurance System, testimony of Andrew Stettner, Deputy Director of the National Employment Law Project, May 6, 2010, http://waysandmeans.house.gov/media/pdf/111/2010May06_Stettner_Testimony.pdf, accessed May 2010.

⁸ The federal interest rate is set at the rate that is paid to unemployment trust fund reserves in the fourth quarter of the previous year. Had interest not been waived, this interest rate would have been 4.36 percent in 2010.

⁹ 42 U.S.C. 1322(b)(5).

¹⁰ See Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011* (February, 2010), pp. 17-18.

¹¹ *Understanding the Unemployment Trust Fund Crisis of 2010*, (April 2010), Available at <http://www.nelp.org>.

¹² Miller, Pavosevich & Vroman, "Trends in Unemployment Benefit Financing", *Unemployment Insurance in the United States: Analysis of Policy Issues*, (1997), p.400.

¹³ Government Accountability Office, p. 26.

Table 1. National Employment Law Project Solvency Update, April 2010

State	Solvency status	Date of borrowing	Year Employers Pay for Reduced FUTA Tax Credit ¹	State taxable wage base	Indexed wage base
Alabama	Insolvent	Sep 2009	2012	\$8,000	No
Alaska	Solvent	---	---	\$34,100	Yes
Arizona	Insolvent	Mar 2010	2013	\$7,000	No
Arkansas	Insolvent	Mar 2009	2012	\$12,000	No
California	Insolvent	Jan 2009	2012	\$7,000	No
Colorado	Insolvent	Jan 2010	2013	\$10,000	No
Connecticut	Insolvent	Oct 2009	2012	\$15,000	No
Delaware	Insolvent	Mar 2010	2013	\$10,500	No
District of Columbia	Solvent	---	---	\$9,000	No
Florida	Insolvent	Aug 2009	2012	\$7,000	No
Georgia	Insolvent	Dec 2009	2012	\$8,500	No
Hawaii	Solvent	---	---	\$38,800	Yes
Idaho	Insolvent	Jun 2009	2012	\$33,300	Yes
Illinois	Insolvent	Jul 2009	2012	\$12,520	No
Indiana	Insolvent	Nov 2008	2011	\$9,500	No
Iowa	Solvent	---	---	\$24,500	Yes
Kansas	Insolvent	Feb 2010	2013	\$8,000	No
Kentucky	Insolvent	Jan 2009	2012	\$8,000	No
Louisiana	Solvent	---	---	\$7,700	No
Maine	Solvent	---	---	\$12,000	No
Maryland	Insolvent	Feb 2010	2013	\$8,500	No
Massachusetts	Insolvent	Feb 2010	2013	\$14,000	No
Michigan ²	Insolvent	Sep 2006	2010	\$9,000	No
Minnesota	Insolvent	Sep 2009	2012	\$27,000	Yes
Mississippi	Solvent	---	---	\$7,000	No
Missouri	Insolvent	Feb 2009	2012	\$13,000	No
Montana	Solvent	---	---	\$26,000	Yes
Nebraska	Solvent	---	---	\$9,000	No
Nevada	Insolvent	Oct 2009	2012	\$27,000	Yes
New Hampshire	Insolvent	Mar 2010	2013	\$10,000	No
New Jersey	Insolvent	Mar 2009	2012	\$29,700	Yes
New Mexico	Solvent	---	---	\$20,800	Yes
New York	Insolvent	Jan 2009	2012	\$8,500	No
North Carolina	Insolvent	Feb 2009	2012	\$19,700	Yes
North Dakota	Solvent	---	---	\$24,700	Yes
Ohio	Insolvent	Jan 2009	2012	\$9,000	No
Oklahoma	Solvent	---	---	\$14,900	Yes
Oregon	Solvent	---	---	\$32,100	Yes
Pennsylvania	Insolvent	Mar 2009	2012	\$8,000	No
Puerto Rico	Solvent	---	---	\$7,000	No
Rhode Island	Insolvent	Mar 2009	2012	\$19,000	No
South Carolina	Insolvent	Dec 2008	2011	\$7,000	No
South Dakota	Insolvent	Oct 2009	2012	\$10,000	No
Tennessee	Insolvent	Apr 2010	2013	\$9,000	No
Texas	Insolvent	Jul 2009	2012	\$9,000	No
Utah	Solvent	---	---	\$28,300	Yes
Vermont	Insolvent	Feb 2010	2013	\$10,000	No
Virginia	Insolvent	Oct 2009	2012	\$8,000	No
Virgin Islands	Insolvent	Aug 2009	2012	\$22,200	Yes
Washington	Solvent	---	---	\$36,800	Yes
West Virginia	Solvent	---	---	\$12,000	No
Wisconsin	Insolvent	Feb 2009	2012	\$12,000	No
Wyoming	Solvent	---	---	\$22,800	Yes

Source: U.S. Department of Labor.

¹ Employers in a state with a trust fund loan balance on January 1 of two consecutive years will face a Federal Unemployment Tax Act (FUTA) tax credit reduction, unless the state pays its loan balance by November 1 of the second year. The FUTA tax credit reduction (\$21 per employee per year) will apply to wages earned during the second of the two consecutive years, but will not be paid by employers until January 31 of the following year. The credit will continue to be reduced by an additional \$21 in each subsequent year the loan balance is not repaid.

² Michigan did not have an outstanding balance on January 1, 2007, but did have an outstanding balance on January 1, 2008. Michigan paid the outstanding balance on May 1, 2008, but then borrowed later in the month. The state had an outstanding balance on January 1, 2009 that was not repaid by November 10, 2009; therefore, Michigan employers faced a credit reduction that applied to 2009 FUTA wages and was paid on January 31, 2010.

Table 2. States with Indexed Taxable Wage Bases, 2010

Indexing a state's taxable wage base to that state's average wages provides for increased trust fund solvency and more effective financing of unemployment insurance (UI) programs. This table shows the 16 states with indexed UI taxable wage bases and their solvency status in April 2010.

State	Taxable Wage Base	Solvency Status	Indexing Criterion
Alaska	\$34,100	Solvent	75% SAAW
Hawaii	\$38,800	Solvent	100% SAAW (effective 2012)
Idaho	\$33,300	Insolvent	100% SAAW
Iowa	\$24,500	Solvent	66.7% AWW times 52
Minnesota	\$27,000	Insolvent	60% SAAW
Montana	\$26,000	Solvent	80% SAAW
Nevada	\$27,000	Insolvent	66.7% SAAW
New Jersey	\$29,700	Insolvent	28 times AWW
New Mexico	\$20,800	Solvent	65% SAAW
North Carolina	\$19,700	Insolvent	50% SAAW
North Dakota	\$22,100	Solvent	70% SAAW
Oklahoma	\$14,900	Solvent	50% SAAW
Oregon	\$32,100	Solvent	80% SAAW
Utah	\$28,300	Solvent	75% prior fiscal year wage
Virgin Islands	\$22,200	Insolvent	60% SAAW
Washington	\$36,800	Solvent	115% of prior TWB but not more than 80% SAAW
Wyoming	\$22,800	Solvent	55% SAAW

Note: SAAW is the state average annual wage. AWW is the state average weekly wage.

Source: Indexing, U.S. Department of Labor U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws* (July 2008), Table 2.2; for levels, U.S. Department of Labor, *Significant Provisions of State Unemployment Insurance Laws* (January 2010, revised March 2010). Available at U.S. Department of Labor, Office of Workforce Security website.