

Can't Get There From Here: Facing Reality in Financing Michigan's Unemployment Insurance Program

By Mike Evangelist and Rick McHugh

Michigan's unemployment insurance (UI) trust fund has borrowed \$3.2 billion in federal loans to finance state benefit payments.¹ As a result, both federal (FUTA) and state UI payroll taxes on employers are rising in Michigan, and a federal interest payment of \$117 million is due at the end of September 2011. These UI tax increases have produced a one-sided, ill-conceived legislative effort to avoid future UI tax increases on employers by cutting state UI benefits. For the sake of Michigan's economy, its jobless workers, and our communities, a more balanced approach that recognizes a significant role for UI taxes in financing UI is required.

Michigan's most recent round of benefit cutting began in March 2011, when Michigan lawmakers enacted legislation to reduce UI benefits by six weeks (from a maximum of 26 weeks to 20 weeks for a regular state claim). This change will take effect for new UI claims filed after January 15, 2012. New bills (House Bills 4781 and 4782) will further reduce UI payments for low- and moderate-wage employees through an across-the-board benefit cut while excluding more workers from UI eligibility. These benefit-cutting bills moved out of a House committee in June and can move toward passage at any point after the legislature returns from its 2011 summer legislative recess.

Those who would further erode Michigan's UI program fail to acknowledge that today's financing problems are rooted in a history of irresponsible employer UI tax breaks starting in the 1990s. And, proponents of UI cuts wrongly promise that today's benefit cuts will result in significant reductions in future UI payroll tax increases on Michigan employers. In fact, there is no reasonable hope that significant payroll tax savings will arise from UI benefit cuts, because we simply cannot cut UI benefits enough to avoid years of future UI tax increases on Michigan employers.

As we explain in this paper, six weeks fewer benefits for state UI claimants in 2012 will have an immediate impact on unemployed workers and Michigan's economy. Unfortunately, benefit cuts will do little to lower upcoming federal interest payments and nothing to stop future federal UI tax payroll increases on Michigan's employers. In short, you cannot get substantial UI payroll tax relief by cutting UI benefits in Michigan. After years of worsening UI solvency and

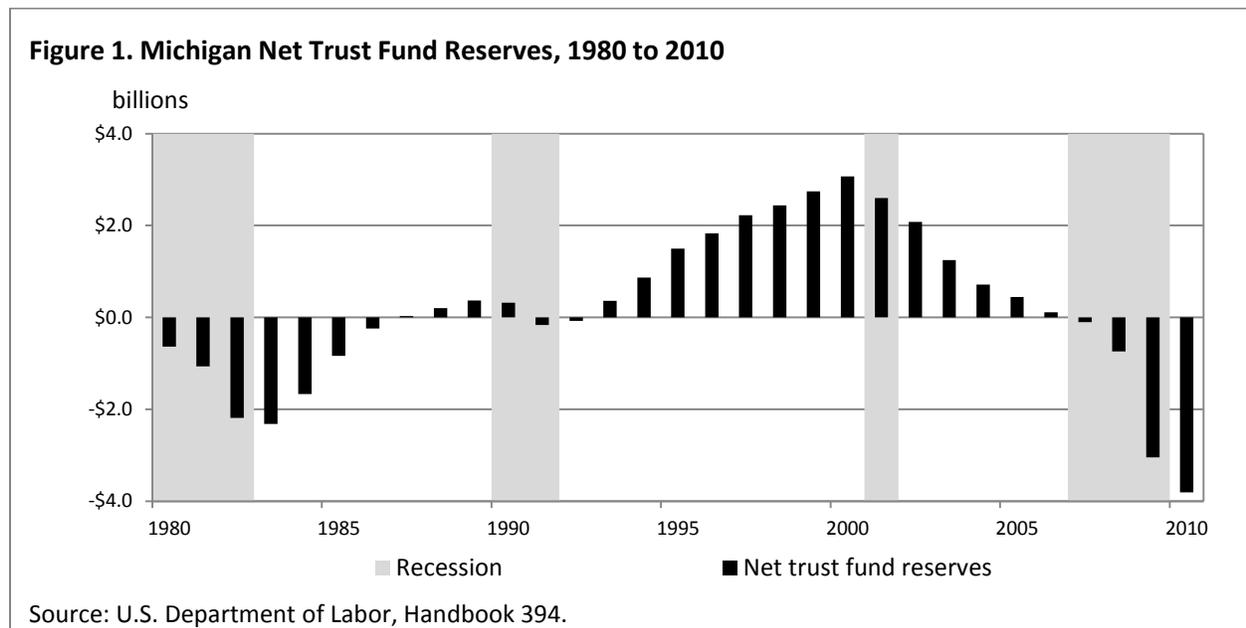
ill-conceived legislation “protecting” employers from modest tax increases, Michigan’s UI insolvency has reached the point at which employers are going to pay higher UI taxes. In short, rather than considering futile benefit cuts as a response to UI insolvency, Michigan should face the reality that higher UI taxes are the main ingredient of any path to solvency.

MICHIGAN UNEMPLOYMENT INSURANCE FINANCING OVERVIEW

Michigan Trust Fund Borrowing Today

Michigan is currently borrowing \$3.2 billion from the federal government to pay unemployment insurance claims. For ten straight years, the state unemployment insurance fund paid out more than it took in, leaving the state ill-prepared to cope with the Great Recession.² Unable to pay rising unemployment claims out of trust fund reserves, in December 2007 Michigan became the first state in this most recent downturn to borrow from the federal government. Michigan now owes the largest loan balance relative to the size of its workforce.

Michigan’s track record concerning UI financing is among the nation’s worst. As shown in the figure below, Michigan borrowed significantly in the 1980s, returning to solvency in the early 1990s and peaking in 2000. Meanwhile, the legislature passed major tax cuts in 1995 and 2002, while holding maximum UI benefit levels frozen from 1995 until 2002, and from 2003 to the present.



Michigan’s UI trust fund has not met generally accepted standards of UI solvency since the early 1970s. The non-partisan, federal Advisory Council on Unemployment Compensation recommended in the early 1990s that states accumulate trust fund reserves sufficient to pay

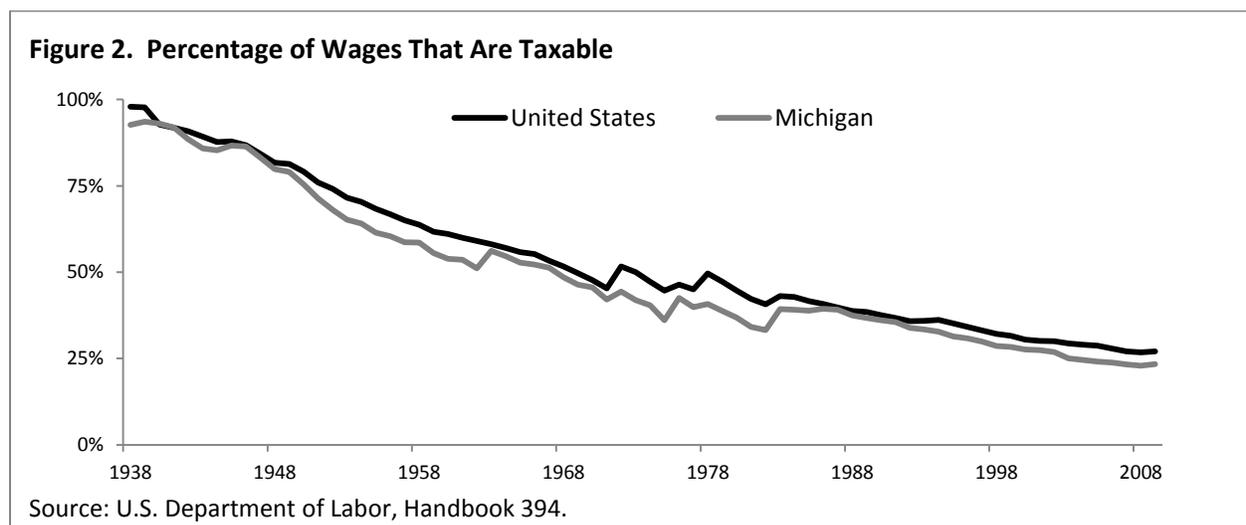
one year's worth of UI claims at recession-level benefit payment levels.³ (Consisting of eleven members from business, labor and state governments, the Advisory Council issued three comprehensive reports outlining recommendations on unemployment insurance reforms.) This benchmark is known as the Average High Cost Multiple (AHCM).

Back in 2000, when Michigan's UI trust fund peaked at just over \$3.0 billion (**Figure 1**), the state still fell \$1 billion short of meeting the recommended solvency benchmark.⁴ That year, 30 other states met the recommended solvency benchmark, while a total of 41 states had a higher AHCM than Michigan.⁵ In short, even at its most recent historic peak in 2000, Michigan's trust fund was among the least prepared to face a recession.

On the eve of the Great Recession in late 2007, Michigan would have required \$3.8 billion in reserves to meet the federal solvency benchmark.⁶ Instead, the trust fund was already borrowing \$134.6 million in federal loans to pay benefits.⁷ So, Michigan became the first state to borrow during the recession, and, depending upon future economic conditions, additional federal loans may be required to pay state UI benefits in coming years.

WHAT STEPS KEEP UI PROGRAMS SOLVENT?

A minority of states have a philosophy of forward funding of UI, striving to keep their UI trust fund levels sufficient to meet expected future demands. Nearly three-quarters of the 19 states that met the recommended solvency benchmark (AHCM = 1.0) in 2007 are solvent today despite the worst recession in UI program history (**Table 1**). In other words, these more-prepared states are three times as likely as their less-prepared counterparts to have a positive trust fund balance despite the recession. Had Michigan's trust fund met the solvency benchmark four years ago, the state could have avoided borrowing during this recession, or, at the least, experienced significantly less UI borrowing.



Not all wages are subject to UI payroll taxation. Taxes are imposed only on wages that fall within a “taxable wage base.” Federal UI (FUTA) taxes have a taxable wage base of \$7,000, while Michigan’s state UI taxable wage base is \$9,000. Among the most important elements of establishing and maintaining a well-financed state UI trust fund is having a taxable wage base that subjects enough wages to taxation to permit a state’s UI payroll tax mechanism to generate revenue sufficient—when combined with reserves—to keep up with benefit payments. In 2002, Michigan’s legislature reduced its taxable wage base from \$9,500 to \$9,000 as part of another round of ill-advised UI tax reductions.

As noted, the taxable wage base is the amount of employee wages subject to taxation. States that met the solvency benchmark (AHCM = 1.0) prior to the recession had an average taxable wage base of over \$19,000, compared to a wage base of only \$13,500 for less solvent states. Other programs such as Social Security and Medicare increase the taxable wage base each year to match wage growth. While it would make sense to base UI “premiums” on the amount of wages that are covered, there is no such wage indexing requirement for unemployment insurance. With each passing year, state UI taxes apply to a declining proportion of state wages, thereby ensuring that benefit payments will exceed revenues collected (**Figure 2**).

At \$9,000, Michigan currently has one of the lowest wage bases, lagging behind 34 other states. Meanwhile, 17 states index their taxable wage bases to wage growth, but Michigan does not. Those 17 states with indexed taxable wage bases are far more likely to have higher taxable wage bases, making them more likely to be solvent. Only one-third of non-indexed states are solvent today, while nearly 60 percent of indexed states remain debt-free (**Table 1**).

Table 1. States Meeting Solvency Benchmark Prior to Recession, More Likely to Remain Solvent

	Number of States	Average Taxable Wage Base (2011)	Solvent in June 2011	
			Number	Percentage
<i>Taxable Wage Base</i>				
Indexed	17	\$27,335	10	59%
Not Indexed	36	\$10,221	12	33%
<i>Met Solvency Benchmark (Average High Cost Multiple = 1.0 in December 2007)</i>				
Met Benchmark	19	\$19,616	14	74%
Did not Meet Benchmark	34	\$13,528	8	24%

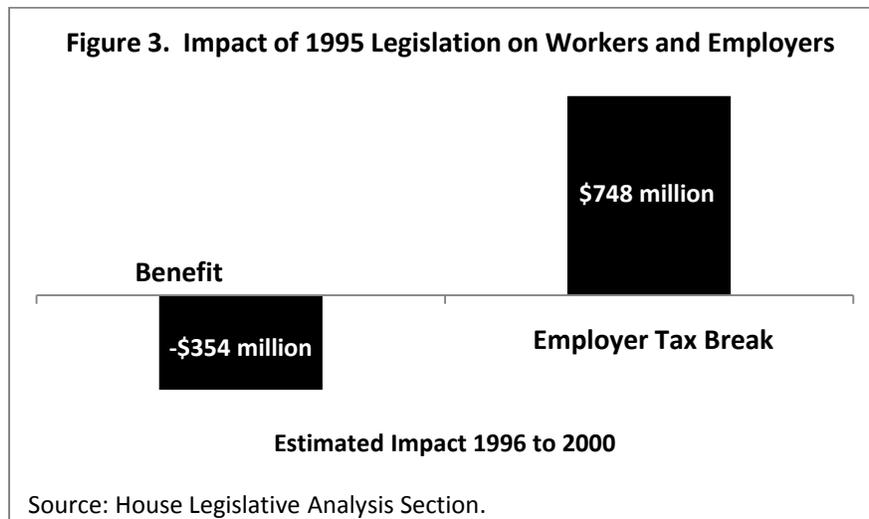
Source: U.S. Department of Labor, Handbook 394 and Significant Provisions of State UI Laws, January 2011. Note: Included with the 50 states are the Virgin Islands, Puerto Rico, and Washington, D.C. for a total of 53 UI jurisdictions.

Rather than cutting benefits, Michigan should be looking for ways to sustain the long-term financial health of the state’s UI trust fund. One of the most important actions a state can take is to increase its taxable wage base by indexing it to wage growth. Some of the most fiscally

conservative, business-friendly states (Utah, North Dakota, Wyoming, Iowa) have chosen this route to long-term solvency. Meanwhile Michigan has followed irresponsible financing policies that have eroded the state's capacity to pay UI benefits during even a modest recession.

MICHIGAN UI HISTORY: TAX CUTS AND BENEFIT RESTRICTIONS

Michigan's history of cutting employer UI taxes dates back to the 1990s, when the business community secured a \$750 million tax cut that came at the expense of the state's UI trust fund and was financed in part by a \$350 million benefit reduction.⁸ As trust fund reserves then declined in the early 2000s, employer groups lobbied successfully for lower tax rates and for a \$500 reduction in the amount of employee wages subject to tax (taxable wage base).⁹ And, with the state's trust fund broke and relying upon federal loans in 2009, the legislature again provided special state tax breaks for employers rather than permitting UI payroll taxes to rise moderately as designed by existing federal and state UI tax rules. In sum, Michigan has a long record of not facing up to UI solvency questions and avoiding employer responsibility for forward financing of UI benefits.



Today's trust fund debt is the result of these employer tax breaks dating back to the 1990s and 2000s, combined with increased UI claims associated with the Great Recession and the lingering weak labor market. Even though these tax breaks came at the expense of UI benefits and the long-term stability of trust fund finances, employer groups are once again calling for more worker sacrifices in 2011. The recently enacted reduction in benefit weeks and proposed legislation to reduce weekly benefit amounts and to deny workers eligibility for UI are not surprising in light of Michigan's history of unequal sacrifice when financing UI.

At this point, we recount in detail legislative changes impacting UI financing in Michigan since 1995. This detailed examination demonstrates that the maximum weekly benefit amount available to unemployed workers increased once in this time period, while new UI restrictions

made it more likely that low-income workers would receive fewer benefits or not qualify for benefits at all.

1990s: Workers Pay for Employer Tax Breaks

Bolstered by a recovering economy and UI solvency measures enacted during the 1980s, Michigan's trust fund began accumulating a balance during the early 1990s. Before long, Michigan employers used growing trust fund reserves to justify calls for UI tax breaks. Not only did employers succeed in gaining lower UI taxes, they also convinced lawmakers to freeze the maximum weekly benefit amount and lower weekly benefits for low- and moderate-income workers by changing the weekly benefit formula. Overall, workers sacrificed over \$350 million in benefits during the last half of the 1990s, while employers enjoyed at least a \$750 million tax break (**Figure 3**). In effect, UI benefit reductions partially paid for these UI tax breaks by reducing the overall revenue shortfall that resulted from this one-sided legislation.

1990s Legislative Elements

- Reduced minimum tax rate from 1.0 percent to 0.5 percent in 1994 and 1995, after which point, the minimum tax was lowered gradually to 0.1 percent in 2002.
- Cut tax rate by 0.1 percent, giving employers up to a 10 percent reduction in actual taxes paid.
- Lowered weekly benefit amounts for workers who were eligible for less than the maximum benefit amount.
- Froze maximum weekly benefit amount at \$300.
- Tightened eligibility restrictions for temporary and seasonal employees.
- Discouraged UI recipients from seeking part-time work.

2002: More Employer Tax Breaks Accompany Long-Overdue Benefit Increase

By 2002, the UI Trust Fund balance was on the decline, reeling from a combination of inadequate revenue and the 2001 recession. Faced with declining reserves, contrarian lawmakers decided to grant employers additional tax breaks. Unemployed workers managed to win a modest increase in the maximum weekly benefit (to \$362) that fell well short of the amount necessary to have kept pace with inflation since benefits were frozen in 1996.

2002 Legislative Elements

- Wages subject to UI tax lowered from \$9,500 to \$9,000.
- Reduced minimum tax rate from 0.1 percent to 0.06 percent (or \$5) a year per employee.
- Increased maximum weekly benefit from \$300 to \$362—the first and only increase since 1996.
- Reduced number of benefit weeks available to low- and moderate-wage workers.
- Made it easier for employers to disqualify workers from UI.

In short, Michigan entered its most serious recession with inadequate trust fund reserves produced by a conscious focus on lower UI taxes as a goal, rather than striving for forward financing of its UI trust fund.

Table 2. Michigan Average Employer Tax Rates by Decade

Decade	Percentage
1960s	1.2%
1970s	1.2%
1980s	1.7%
1990s	1.2%
2000s	0.9%

Source: U.S. Department of Labor, Handbook 394.

As a result of 1990s legislation, average employer tax rates on total wages fell from 1.7 percent during the 1980s to 1.2 percent during the 1990s and again to 0.9 percent over the last decade. As a percentage of wages paid, employer contributions to the UI system had never been lower than they were between the 2001 and 2007-09 recessions (**Table 2**). Meanwhile, nearly one in five Michigan employers pays the minimum state tax rate of just \$5 a year per employee.¹⁰

TODAY: MICHIGAN CONFRONTS TRUST FUND BORROWING

We recognize that Michigan employers have started paying moderately higher state and federal UI payroll taxes in recent years. In particular, federal UI payroll taxes on Michigan employers started increasing in 2010 and will continue increasing each year due to the “FUTA credit reduction.” This higher federal payroll tax is being imposed by federal law to ensure that some UI loan repayments occur by adding \$21 per employee each year until the state’s federal loans are repaid.¹¹ As a result of Michigan’s borrowing, the federal unemployment insurance tax that was \$56 per employee, increased to \$77 per employee in 2010 at a cost of \$68 million to employers.¹² FUTA taxes paid climbed to \$98 per Michigan employee in 2011 and will continue to increase by \$21 per employee each year, until all federal trust fund loans are repaid (or other caps within FUTA rules are reached).*

* Congress recently permitted a portion of the 0.8 percent FUTA tax to expire, reducing the FUTA tax to 0.6 percent on wages earned after July 1, 2011. In January 2012, Michigan employers will owe a federal UI payroll tax of either \$119 or \$105, depending on whether taxable wages were earned before or after July 1, 2011. This tax will increase to a maximum of \$126 per employee on wages earned in 2012, assuming no further FUTA tax changes are made.

Of immediate concern, Michigan faces a \$117 million federal interest payment in September. Additional federal interest payments on trust fund loans will follow for many years. These interest payments cannot be lawfully repaid from Michigan's UI trust fund, and a 1980s solvency tax has proven insufficient to raise funds needed to repay the full \$117 million by September 30th.

Despite these mounting UI debts, Michigan lawmakers continued appeasing employers with further state UI tax breaks in recent years, including a recent break on the state's solvency tax (assessed to pay interest on trust fund loans)¹³ and a partial state UI tax offset of the initial FUTA tax increases that went into effect on 2009 wages.¹⁴ Blocking the solvency tax in 2009 and 2010 cost the trust fund around \$43 million, while partially rebating the solvency tax may force the state to pay as much as \$51 million of this September's federal interest levy from state general funds.¹⁵ In conclusion, Michigan's employers have only begun to feel the impact of UI payroll taxes, which must increase further to address Michigan's UI revenue requirements.

Enacted and Proposed Benefit Cuts Will Not Prevent Further Employer Tax Increases

While Michigan has an established history of lowering UI taxes and imposing sacrifices on UI claimants, proponents of UI cuts are wrong to claim that these cuts will protect Michigan employers from higher UI payroll taxes. This is partially because of the size of Michigan's UI revenue shortfall. Michigan's annual gap between trust fund revenues and payments averaged over \$500 million from 2001 to 2007 and reached a peak of \$2.3 billion in 2009. Enacted and proposed cuts to the UI program could cost workers as much as \$500 million a year, but this amount would barely close the historical gap between revenues and payments, let alone enable Michigan to begin paying down its federal UI loan balance.

Assuming UI benefit cuts of \$500 million per year, Michigan's UI trust fund is still estimated to be insolvent in 2015. That year, as a result of added FUTA credit reductions, Michigan employers will owe annual federal UI payroll taxes of \$189 per employee under current law, while employers in solvent states will owe just \$42 per employee. And between 2012 and 2016, Michigan will pay an estimated \$400 million in interest on loans from the federal government.¹⁶

Despite Michigan's history of UI tax cuts, it is difficult to conceive that even more draconian UI cuts would be imposed to continue avoiding fuller employer responsibility for UI financing. In short, while painful for workers facing double-digit unemployment rates, employers will realize little or no immediate benefit in terms of lower taxes from rolling back UI benefits in Michigan.

Negative Impacts of UI Cuts on Michigan's Economy

As we have shown, cutting UI benefits represents a futile effort to reach solvency. At the same time, cutting UI benefits threatens the ability of the program to help jobless workers, affected communities, and Michigan's economy.

While too many try to deny that government actions, other than tax cuts, have any positive impact on Michigan's economy, cutting UI benefits represents an attack on one of the most effective ways to boost spending and economic output available to state governments. Here in Michigan, state UI benefits put \$3.8 billion into our economy and just a bit over \$2 billion in 2010.¹⁷ While these are substantial amounts, their economic impact was even more substantial, according to economists.

Wayne Vroman, a leading economist on UI and unemployment, recently estimated that the economic impact of UI benefit payments (net of UI taxes) made up for about 2 percent (0.183) of the shortfall of gross domestic product during the recession (Q3:2008 through Q2:2010), calculating the multiplier effect of UI as 2.0.¹⁸ Mark Zandi, chief economist of Moody's Analytics, has issued a number of widely-cited estimates for various forms of economic stimulus during this downturn and recovery period. He, too, has found that UI has contributed about \$1.60 in increased economic output for every \$1 paid in UI benefits. In short, cutting UI benefits not only impacts jobless workers. Benefit cuts will hurt Michigan's economic growth and prospects in coming years.

CONCLUSION

Michigan's recent legislation is part of a larger historical trend taking place in many states. Over the past 20 years, employer groups have lobbied for tax breaks when the economy is strong and state UI trust funds have little trouble maintaining a positive (but, not necessarily adequate) balance. When the economy turns sour, unemployment benefits payments exceed trust fund revenues, which is to be expected. But, because states did not accumulate adequate reserves, trust funds are quickly depleted during downturns, forcing states to borrow from the federal government to make UI payments. Inevitably, the same employer groups that favored tax cuts in the past favor benefit reductions as the only means to repay loans and "save" the system.

History shows that benefit reductions and eligibility restrictions do not strengthen state trust funds over time. "Cost savings" are partially offset by later employer tax breaks passed along through experience rating mechanisms, while restrictive measures reduce UI payments and ensure that fewer workers are covered by UI. Scaling back the UI program harms workers and diminishes the program's effectiveness as an economic stabilizer during economic downturns.¹⁹

Recently-enacted Michigan legislation and further benefit cuts that are still on the table offer more of the same false promises. While there is little doubt that these measures will directly impact workers, they will do nothing to reduce employer tax expenses this year, nor will sacrifices by workers today improve long-term trust fund finances. You simply cannot restore UI trust fund solvency in Michigan without substantial state and federal UI payroll tax increases.

Authors' Note

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About the National Employment Law Project

The National Employment Law Project is a non-partisan, not-for-profit organization that conducts research and advocates on issues affecting low-wage and unemployed workers. For more than 40 years, NELP has sought to ensure that work is an anchor of economic security and a ladder of economic opportunity for working families across America. In partnership with grassroots and national allies, NELP promotes policies to create good jobs, enforce hard-won workplace rights, and help unemployed workers regain their economic footing. For more about NELP, please visit www.nelp.org."

ENDNOTES

¹ U.S. Department of Labor, Outstanding Loans from the Federal Unemployment Account, Balances as of July 28, 2011, <http://www.workforcesecurity.doleta.gov/unemploy/budget.asp#tfloats>. Readers needing further background information on UI solvency and financing issues should visit NELP's website at www.nelp.org.

² Unemployment insurance benefits paid out exceeded employer contributions for 2001 to 2010. See U.S. Department of Labor, Handbook 394, <http://www.workforcesecurity.doleta.gov/unemploy/hb394.asp>.

³ In November 1991, Congress created the Advisory Council on Unemployment Compensation with passage of The Emergency Unemployment Compensation Act (P.L. 102-64). Consisting of eleven members from business, labor and state governments, the Advisory Council was tasked with publishing three comprehensive reports outlining recommendations on unemployment insurance reforms.

⁴ U.S. Department of Labor, Historical State Trust Fund Solvency Calculator, available at <http://www.workforcesecurity.doleta.gov/unemploy/calculator.asp#>. The taxable wage base is the amount of employee wages subject to taxation as discussed below in more detail.

⁵ There are 53 unemployment insurance jurisdictions encompassing the 50 states, Puerto Rico, the Virgin Islands, and Washington, D.C. Unless otherwise noted, counts of "states" include the 53 jurisdictions.

⁶ U.S. Department of Labor, Historical State Trust Fund Solvency Calculator.

⁷ U.S. Department of Labor, Handbook 394.

⁸ Public Act 25 of 1995 capped the maximum weekly benefit amount at \$300 and lowered employer tax rates. When the law went into effect in 1996 the Michigan Employment Security Commission estimated that from 1996-2000 there would be a net tax savings of \$748 million and a net benefit reduction of \$354 million. These estimates were published by the House Legislative Analysis Section, Third Analysis of House Bill 5763 as enrolled, Public Act 192 of 2002, <http://www.legislature.mi.gov/documents/2001-2002/billanalysis/House/pdf/2001-HLA-5763-d.pdf>.

⁹ Public Act 192 of 2002 lowered the taxable wage base from \$9,500 to \$9,000 for 2003 onward, <http://www.legislature.mi.gov/%28S%28ururhq55sjofoqy3dwiwok45%29%29/mileg.aspx?page=getObject&objectname=2002-HB-5763>. This act also lowered the minimum UI tax from 0.1% to 0.06%, or \$5 per employee.

¹⁰ U.S. Department of Labor, Significant Measures of State UI Tax Systems, CY 2010, <http://www.workforcesecurity.doleta.gov/unemploy/pdf/sigmeasuitaxsys10.pdf>.

¹¹ House Fiscal Agency, Memorandum to House Appropriations Committee, Subcommittee on Economic Development, Jan. 7, 2011, http://house.michigan.gov/hfa/PDFs/Title12_InterestLiabilityMemo2011.pdf.

¹² Pratt, Elizabeth and Maria Tyszkiewicz, "Solvency of Unemployment Compensation Fund – An Update," Michigan State Senate, Senate Fiscal Agency, <http://www.senate.michigan.gov/sfa/publications/notes/2010notes/notessum10lpmt.pdf>.

¹³ Public Act 1 of 2009 (H.B. 4239), <http://www.legislature.mi.gov/documents/2009-2010/publicact/pdf/2009-PA-0001.pdf>. For an explanation see State of Michigan Department of Energy, Labor & Economic Growth, "Solvency Tax is Temporarily Suspended," http://www.michigan.gov/documents/uia/123_-_Solvency_Tax_Waiver_03_2009_271028_7.pdf.

¹⁴ State of Michigan Department of Energy, Labor & Economic Growth, "Michigan Tax Credit Coming in Mid 2010 For Positive Reserve Balance Employers," http://www.michigan.gov/documents/uia/130_-_MI_UI_tax_credit_07_09_292795_7.pdf.

¹⁵ House Fiscal Agency, Memorandum to House Appropriations Committee.

¹⁶ Future trust fund balances are difficult to predict and depend on a number of unknown variables such as future unemployment rates and potential legislative changes. The estimates provided here are based on a Center on Budget and Policy Priorities and NELP solvency model which assumes that unemployment will fall to 6.3% by 2016.

¹⁷ Unemployment Insurance Agency, "CY 2010 Statistical Highlights for Michigan's Unemployment Benefit Program," Fact Sheet #82 (May 2011).

¹⁸ Wayne Vroman, "The Role of Unemployment Insurance as an Automatic Stabilizer During a Recession," Impaq International (July 2010).

¹⁹ Government Accountability Office, "Unemployment Insurance Trust Funds: Long-standing State Financing Policies Have Increased Risk of Insolvency," [GAO-10-440](http://www.gao.gov/new.items/d10440.pdf), Apr 14, 2010, <http://www.gao.gov/new.items/d10440.pdf>, p. 23.