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Unemployment Insurance Fund Insolvency and Debt in Michigan

Saul J. Blaustein
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Saul J. Blaustein

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for Employment Research

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Foreword

Michigan continues to face serious economic consequences of the recessions and structural industrial changes of recent years. None of them is more grim than the outpouring of unemployment benefits to workers left jobless by these events from an insolvent state unemployment insurance fund that has had to be subsidized heavily by federal loans. The time for repayment of these loans to begin is at hand, even as the debt accumulates further.

How this problem developed, where it is heading if not treated adequately, and what kinds of remedies are available are the subjects of this monograph. The federal-state unemployment insurance system is complex, but the Michigan law has its own idiosyncracies. Overlaying it all is a loan repayment process that further confounds understanding of the problem and how it may be handled. The author, with long experience in the study of unemployment insurance, has attempted to set forth a relatively concise yet comprehensive treatment of the subject to assist Michigan's policymakers as they formulate, evaluate, and eventually decide upon courses of action. The Institute makes the monograph available with the hope that it will bring some light and understanding to a difficult and vexing problem.

Facts and observations presented are the sole responsibility of the author. His viewpoints do not necessarily represent the positions of the W. E. Upjohn Institute for Employment Research.

E. Earl Wright
Director

September 1982

Preface

Many aspects of Michigan's unemployment insurance insolvency problem and ideas for its treatment were subjects of discussion at meetings of a Working Group of employer representatives held during the first several months of 1982. The group was appointed by the director of the state Department of Commerce to study the unemployment insurance financing system and develop recommendations. Professor Cynthia Rence of Michigan State University and this author also participated in these meetings, as did staff of the Commerce Department and the Michigan Employment Security Commission.

It became apparent from those discussions that the technical complexities of the program's financing structure, of its insolvency, of the rules for debt repayment, and so on, were so formidable that they could constitute in themselves a barrier to developing agreement on a reasonable course to pursue in dealing with the problem. For this reason, it seemed useful to attempt to assemble in one place an explanation of the system, the existing insolvency problem—its background and prospects—and some ideas for gaining control over it. In doing so, my intent has been to illuminate the subject with descriptive information and some objective analysis to promote as much understanding as possible as a basis for formulating policy beneficial to the state and fair to all sides. If this effort makes some contribution towards that end, it will have been worth it.

Several members of the Working Group made comments on an early draft of this paper and these were helpful. Significant comments by Professor Rence helped to clarify a few important points, for which I am grateful. Most of all, I must express my thanks to Thomas West of the Research and Statistics Bureau of the Michigan Employment Security Commission, who patiently responded to my endless questions concerning data, federal and state provisions, projections and changes in projections, and who read and commented on drafts of the paper. His help was invaluable. My thanks go also to S. Martin Taylor, director of the Commission, whose cooperation made possible the necessary assistance of his staff.

Closer to home, credit must go to my secretary, Irene Krabill, for her efficient and accurate "word processing" of the manuscript through its various stages and the innumerable changes that were made.

Any errors that remain in the paper are, of course, my responsibility alone. Positions and viewpoints I have expressed are my own and do not necessarily reflect those of the Institute, of any state agency, of the employer Working Group, or of any other interested party.

Saul J. Blaustein

Kalamazoo, Michigan
September 1982

Executive Summary

Without changes in Michigan's current unemployment insurance (UI) law, the state's UI debt of $1.6 billion, as of mid-1982, will probably rise to about $2.8 billion by the end of 1983 and to $3.8 billion by the end of 1985. Interest payments alone on these additional federal loans would amount to hundreds of millions over these years. Despite some slow, moderate decline, unemployment is likely to continue relatively high in Michigan for the next several years. Revenues produced by the state's existing UI tax structure will not come close to paying for expected benefit outlays, let alone repay any of the debt. Interest costs will have to be covered from other funding sources. Beginning with the federal UI payroll tax due for 1982, payable January 1983, Michigan employers will have to pay an additional penalty rate each year. The first penalty payment equals 0.3 percent of taxable payrolls; the rate rises progressively by 0.3 annually. Penalty tax proceeds, expected to total over $300 million through 1985, apply toward reducing the outstanding debt.

The federal UI tax rates are uniform while state rates, largely experience rated, vary from 1.0 to 9.0 percent. Employers who provide relatively stable employment and experience limited or no benefit charges against their accounts enjoy low or minimum state tax rates. They object to sharing equally, through the uniform federal penalty tax, in the payment of the past excess costs of other employers that have generated the debt. Many high-cost employers (nearly half of

all experience-rated accounts at mid-1981), such as firms in auto manufacturing and construction, have not covered their benefit charges because of limitations in the tax structure. They feel, however, that to impose sharply increased state UI taxes on them at this time would be discouraging to their recovery efforts.

Some changes are seen as necessary in the existing state UI program, at least to lessen if not curtail the need for further borrowing, and eventually to reduce the debt and restore the fund to a solvent position. The changes discussed are designed to increase revenues and lower benefit outlays. They include increases in the taxable wage base from its present $6,000 level, which now subjects only about a third of all payrolls to the tax—the lowest proportion among the states. A new employee tax is also reviewed, as are other tax changes aimed at raising more revenues from high-cost employers. Changes to reduce outlays include stiffening the qualifying requirement for benefits, imposing a noncompensable waiting week, and freezing the maximum weekly benefit amount payable at its present level instead of continuing its annual upward indexing by average wage level increases.

Using projections provided by the Michigan Employment Security Commission in June 1982, the effects of these changes on the fund are illustrated for the years 1983-1985. Together, they add to a total effort of over $2 billion in increased taxes and reduced benefit outlays over this period. Of the total, employer state tax increases account for about 54 percent, the new employee tax for about 16 percent, and benefit reductions for about 30 percent. The debt would peak in the first part of 1983 and then decline to about $1.7 billion by the end of 1985. Of the debt incurred after March 1982, which is subject to interest (earlier loans are not), only about $500 million would remain.

Changes in assumptions about unemployment, wage trends, and other economic factors which underlie the projections, and UI experience that deviates from past patterns could and probably will produce results different from those described. The projections, therefore, should be used only as general guidelines for policy planning purposes.

In any case, the burdens to be faced in dealing with the insolvency problem in Michigan are considerable and painful to bear. Failure to take some remedial action, however, will probably make the state's economic prospects more grim and its business climate less attractive. Short-run federal relief through some easing of repayment and interest provisions would be helpful. (The Tax Equity and Fiscal Responsibility Act of 1982 adopted by the Congress in August 1982 contains several changes along these lines.) Longer range easing of state solvency problems in unemployment insurance can be considered through some national pooling of excess benefit costs by reinsurance or cost equalization schemes, or by more federal sharing of benefits paid for longer duration unemployment.

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Introduction 1

The Michigan unemployment insurance (UI) trust fund, as of the end of July 1982, was in debt to the federal government for about $1.6 billion. High unemployment in the state in recent years swelled UI benefit outlays to levels beyond the revenue-generating capacity of the current state UI tax structure. The result was the exhaustion of trust fund reserves and the need to borrow federal funds in order to continue paying unemployment benefits. Repayment of the debt and rebuilding a solvent UI fund constitute a serious problem with which the state must begin to cope in the immediate future.

The gravity of the problem ahead for Michigan can hardly be overstated, particularly given the state's current unfavorable economic climate and outlook. Under the present UI law, the trust fund debt can be expected to grow considerably worse in the months and years ahead. Since UI costs are essentially a burden to business, the state fund's insolvency is perceived as a threat to the success of economic recovery efforts in Michigan. How the problem is managed, in turn, will depend on how well that recovery develops.

The past pattern of the state's economy has been one of cyclical ups and downs. Concentration in durable goods

manufacturing, heavily auto-related, has made employment especially sensitive to national economic conditions. Falloff in consumer demand for new cars has accompanied declines or slowed growth in personal income and translated into deep and widespread layoffs in Michigan. With recovery, the turnaround has been equally dramatic. Outlays for unemployment benefits in the state have followed this typical boom and bust mold, and the financing of those benefits was planned accordingly. During boom periods, however, trust fund reserves did not build up to levels generally recommended as likely to ensure solvency, recommendations which guided the UI financing policies of many states. While recession rapidly depleted most of Michigan's benefit reserves, vigorous recovery led to some rapid fund buildup, enough to stave off fund insolvency in the next recession. Unfortunately, that pattern broke down in the 1970s. The major causes of this change, including the Arab oil embargo, the gasoline shortages and price inflation, and the inroads of foreign competition into American car markets, contributed to diminished resiliency of the state's economy. Recovery from recession has been less vigorous and less sustained than before. A return to the former pattern is not expected, at least in the foreseeable future. That prospect carries important long term implications for UI financing policy.

The immediate problem, however, is to deal with the present and growing UI debt. This paper presents the background and dimensions of the problem, and discusses some possible approaches for its treatment. After a description of the general financing arrangements for UI, the tax structure of the Michigan UI program and some of its eligibility and benefit provisions, the paper reviews how the debt developed, the current federal provisions for its repayment, and the present outlook for the years ahead. The ensuing discussion of potential courses of action comprises most of the balance of the paper. Some longer term state and

federal policy considerations with regard to financing and solvency are noted briefly in concluding sections.

A few words are appropriate at this point about some of the figures that will be used in the course of the paper. The substance of this cautionary note will be repeated from time to time by way of emphasis. Much of the discussion centers eventually on measures that may be taken to deal with the problem. Necessarily, the discussion must look ahead to how the problem *might* develop and what effects the various measures *might* have. In doing so, one has to develop what are hoped to be reasonable scenarios about UI fund transactions—tax revenues, benefit outlays, loans, and repayments—over the next several years under various circumstances. For this purpose, the paper uses projections made by technical staff of the Michigan Employment Security Commission (MESC). What is important to bear in mind is that the numbers projected are not hard and fast predictions of the future. They are estimates based on conditions and past behavioral relationships about which certain assumptions are made that can and probably will be different from actual experience in the coming period. As time goes on and the experience begins to unfold, the projections will be modified and refined. New projected figures will be different from those used here, perhaps quite different in some cases. Indeed, in the course of preparing this paper, estimates based on earlier MESC projections were revised to take account of unemployment levels in recent months that were running higher than assumed earlier, and of other unanticipated trends that affects the projections significantly.

The economic outlook for Michigan is currently a bleak one, but it is also clouded in a great deal of uncertainty. The same clouds shroud these estimates. Nevertheless, even though the numbers will change, the general picture projected and its major components serve as a useful framework

within which to consider legislative policy alternatives. Having worked through the possibilities based on one set of projections, it should be possible to sort out the implications of subsequently revised and updated figures.

Financing of Unemployment Insurance 2

Employers in Michigan are solely responsible for financing unemployment insurance benefits paid under the state's law, as is the case in all but three other states.[1] Currently, the state UI tax on Michigan employers ranges between 1.0 and 9.0 percent of taxable wages, the first $6,000 paid to each employee in a calendar year. The rate varies among employers on the basis of their experience with unemployment. New employers pay a standard rate of 2.7 percent for the first two years, after which experience rating begins to introduce some variation. Taxes and payrolls estimated for 1981 in Michigan indicated an average tax rate of about 4 percent of taxable payrolls, or about 1.3 percent of total payrolls.[2] For 1982, these rates are expected to average about the same. The estimated 1982 average tax rate for Michigan, on the basis of total payrolls, is above the national average, but lower than the average rates expected in 19 states. (Table 1.)

State UI taxes paid are deposited in a state account maintained in the Unemployment Trust Fund in the U.S. Treasury. Each state has such an account. The Michigan account represents the trust fund reserves for benefits payable

Table 1
States Arrayed by Estimated Average Unemployment Insurance Tax Rate for 1982 Based on Total Wages

State	Tax rate[a]	State	Tax rate[a]
Puerto Rico[b]	3.0	Wisconsin[b]	1.1
Rhode Island[b]	2.3		
West Virginia[b]	2.1		
Alaska	2.0	UNITED STATES	1.1
Kentucky[b]	1.9		
Oregon	1.7		
Washington	1.7	California	1.0
New Jersey[b]	1.6	Delaware[b]	1.0
Pennsylvania[b]	1.6	Louisiana	1.0
Virgin Islands[b]	1.6	Nevada	1.0
		Tennessee	1.0
North Dakota	1.5	Alabama	0.9
Vermont[b]	1.5	Missouri[b]	0.9
Wyoming	1.5	New Mexico	0.9
Arkansas[b]	1.4	South Carolina	0.9
Idaho	1.4	Connecticut[b]	0.8
Illinois[b]	1.4		
Massachusetts	1.4	Maryland	0.8
Mississippi	1.4	South Dakota	0.8
Montana	1.4	Virginia	0.8
Maine[b]	1.3	Nebraska	0.7
		North Carolina	0.7
MICHIGAN[b]	1.3	Colorado	0.6
District of Columbia[b]	1.2	New Hampshire	0.6
Hawaii	1.2	Georgia	0.5
Iowa	1.2	Arizona	0.4
Indiana	1.1	Florida	0.4
Kansas	1.1		
Minnesota[b]	1.1	Oklahoma	0.4
New York	1.1	Texas	0.3
Ohio[b]	1.1		
Utah	1.1		

SOURCE: Unemployment Insurance Program Letter No. 22-82, June 7, 1982, U.S. Department of Labor, Employment and Training Administration, Office of Legislation and Actuarial Services.

a. Percent of total wages, as estimated by the states early in 1982.

b. State trust fund in debt as of June 30, 1982.

to the state's insured unemployed workers. These reserves may be used only for the payment of benefits or for the repayment of loans made to pay benefits. Funds are withdrawn to pay benefits, as needed, and tax revenues are deposited when collected.

Ideally, each state manages its UI finances so that sufficient reserves accumulate to handle benefit needs as they arise. Because of varying economic conditions, benefit needs can and do fluctuate widely over time. To remain solvent, the state's trust fund reserves must be ample to withstand a sudden heavy drain brought on by a steep rise in unemployment with its attendant soaring benefit costs, as occurs in recession periods. With few exceptions, state funds managed to remain solvent over the years, until the 1970s.[3] In that decade, in which two recessions occurred, insolvency became widespread. From 1972 through the end of June 1982, a total of 29 states exhausted their benefit reserves and required loans to continue the payment of benefits. Most, including Michigan, first borrowed in 1975 or 1976. As of June 30, 1982, 19 of these states were in debt for a total of $7.8 billion. (Table 2.)

Besides the state UI tax, employers pay a federal UI tax. Specified under the Federal Unemployment Tax Act (FUTA), this tax currently applies also to the first $6,000 of wages paid to employees each year. The FUTA tax rate is 3.4 percent.[4] A credit of 2.7 percent is allowed against the full federal tax, however, to employers in states with approved UI laws.[5] The net federal tax therefore is 0.7 percent of taxable wages, a uniform rate payable by all private, for-profit employers throughout the country.[6] Revenues raised by the 0.7 percent net tax go into federal accounts in the Unemployment Trust Fund to finance UI administrative expenses,[7] the federal share of extended benefit costs,[8] and a federal loan fund from which states borrow if their own reserves are depleted. The loan fund was established in 1954. Provisions

Table 2
Loans to States from Federal Loan Fund for Unemployment Insurance 1972 through June 30, 1982

State	Year first borrowed	Latest year borrowed	(millions) Amount outstanding 6/30/82	Amount repaid by 6/30/82
In debt—June 30, 1982				
Arkansas	1976	1981	$ 64.0	$ 30.0
Connecticut	1972	1978	272.0	242.0
Delaware	1975	1982	55.5	16.2
District of Columbia	1975	1979	41.7	31.8
Illinois	1975	1982	1,634.1	191.8
Kentucky	1981	1982	104.3	-
Maine	1975	1978	21.3	15.1
Michigan	1975	1982	1,587.5	624.0
Minnesota	1975	1982	209.8	172.0
Missouri	1982	1982	89.8	-
New Jersey	1975	1978	525.6	209.4
Ohio	1977	1982	1,068.2	1.9
Pennsylvania	1975	1982	1,608.7	305.6
Puerto Rico	1975	1978	66.4	22.3
Rhode Island	1975	1980	102.0	27.3

Vermont	1974	1977	31.3	16.5
Virgin Islands	1975	1977	3.0	8.1
West Virginia	1980	1982	104.8	-
Wisconsin	1982	1982	181.8	-
No debt outstanding				
Alabama	1975	1977		56.7
Florida	1976	1977		42.0
Hawaii	1976	1976		22.5
Maryland	1976	1977		62.7
Massachusetts	1975	1976		265.0
Montana	1976	1978		10.5
Nevada	1976	1976		7.6
New York	1977	1978		335.8
Oregon	1976	1976		18.5
Washington	1972	1976		149.4
Total			**$7,771.9***	**$2,884.4***

SOURCE: *Title XII Advances and Repayments, as of June 30, 1982, Summary of the Federal Unemployment Account* (Washington, DC: U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service, Division of State Program Management, Tax Administration Group, June 1982).

*Amounts do not add to totals due to rounding.

for borrowing and repayment have been amended often. Loans made before April 1, 1982 and still outstanding are interest-free; loans made from that date on do bear interest.

The Michigan UI Tax Structure

The state's present UI tax is made up of three components, each contributing to the overall tax rate assigned to each employer. These include:

(1) A chargeable benefit component (CBC)—a rate ranging from 0 to 6.0 percent based on experience as measured by the employer's benefit ratio, i.e., benefits charged to an individual employer's account over the last five years taken as a percent of that employer's taxable payrolls in those years.

(2) An account building component (ABC)—a rate ranging from 0 to 2.0 percent based on the balance in an employer's account (all past benefits charged less all taxes paid, excluding NBC taxes—see below) compared with what the balance should be to meet a minimum solvency standard. The extent to which the employer's account balance falls below its required minimum solvency level is calculated, and a fraction or multiple of 0.25 of this deficiency is divided by the employer's total payroll for the year. The result is taken as the ABC rate for the tax year, up to the maximum of 2.0 percent.[9] Although calculated as a percent of total payroll, the ABC rate is applied to taxable payroll.

(3) A nonchargeable benefit component (NBC)—a uniform tax rate, currently at its maximum level of 1.0 percent, to cover certain pooled costs, including benefit costs of employers who go into bankruptcy and the state share of extended benefit costs.[10]

All component tax rates apply to a state taxable wage base of $6,000. The total combined rate ranges from 1.0 to 9.0 percent. The first two components—the CBC and ABC—represent the experience-rated portion of the tax.

Two other details about the tax structure should be noted. With regard to the CBC and ABC rates, whenever the combined total of these rates equals or exceeds 4.0 percent, the amount of any increase in the tax rate from one year to the next is limited to 0.5 of a percentage point even though the experience rate calculations would call for a larger increase. There is no limit on rate reduction. Another special provision allows a credit against the NBC rate for half the rate increase in the FUTA tax imposed for debt repayment (see "Repayment Provisions" in chapter 3). Thus, a FUTA rate increase of 0.3 paid in one year would reduce the following year's NBC rate by 0.15, a 0.6 rate increase would reduce it by 0.3, and so on.

The existing state UI tax structure and taxable wage base were established in 1978. Table 3 shows what that structure has produced in recent years. Clearly, the taxes generated in 1980 and 1981 fell far short of benefit outlay levels in those years. With no reserves available, the shortfall created the need for substantial borrowing.

State Eligibility and Benefit Provisions

On the eligibility and benefit side of the program, the following provisions are important to the discussion of various possibilities available for dealing with the insolvency problem:

(1) To qualify for any benefits, a claimant must have worked, during a 52-week base period preceding the first claim, in at least 18 weeks with earnings of no less than $67 in each week (20 times the minimum hourly wage of $3.35).

(2) There is no waiting week—benefits are payable for the first valid week of unemployment claimed.

(3) The weekly benefit amount (WBA) payable is 70 percent of the claimant's average weekly wage earned in the base period, less any income and social security taxes ap-

plicable, up to a maximum WBA equal to 58 percent of the statewide average weekly wage in covered employment. The current maximum WBA is $197.

Table 3
Selected Unemployment Insurance Financial Data for Michigan 1979-1981[a]

Item	1978	1979	1980	1981
Total payrolls (billions)	$41.9	$45.4	$44.6	$47.5(E)
Taxable payrolls (billions)[b]	$17.1	$17.6	$16.4	$16(E)
Percent of total payrolls taxable	41%	39%	37%	34%(E)
Average employer tax rate (percent of taxable payrolls)	4.11%	4.03%	3.73%	4%(E)
Total taxes collected (millions)	$691	$724	$618	$624
Total benefit outlays, including state share of extended benefits (millions)	$424	$618	$1,293	$1,065

SOURCE: *Handbook of Unemployment Insurance Program Statistics,* Michigan Employment Security Commission, Bureau of Research and Statistics, pp. 2, 35, and 44.

(E) = Estimated.

a. Data for private, contributing employers covered by the Michigan Employment Security Act.

b. Based on taxable wage base of $6,000.

(4) Regular benefits are payable for from 13.5 weeks to a maximum of 26 weeks of unemployment on the basis of 3 weeks of benefits for 4 weeks of employment in the base period.

(5) Extended benefits are payable during periods of high unemployment in the state and add 50 percent to the claimant's regular benefit duration entitlement, up to a combined maximum of 39 weeks. Extended benefits have been payable in Michigan because of its high rate of insured unemployment. (The federal government covers half the cost of extended benefits paid to claimants with at least 20 weeks of base-period employment, but will not cover costs for the first week if the state has no waiting week for regular benefits.)

(6) Claimants who quit their jobs without good cause or are discharged for misconduct are disqualified; they may draw no benefits until after they have worked long enough to earn at least a minimum amount of wages and then are subsequently laid off under nondisqualifying conditions.

Provisions (1), (3), and (6) were enacted in 1980, but for only a limited period. They expire March 31, 1983, after which earlier provisions are to be restored. These are:

(1) A minimum requirement of 14 weeks of work with earnings of at least $25.01 per week.

(3) A WBA equal to 60 percent of the claimant's gross average weekly wage up to a maximum, based on the number of dependents claimed, ranging from $97 for claimants with no dependents to $136 for those with four or more dependents.

(6) Disqualifications for voluntary quits and misconduct discharges suspend benefits for 13 weeks, with a comparable reduction in duration entitlement; benefits may be drawn for unemployment after the suspension period ends.

The Michigan UI Debt and Its Outlook 3

Past and Recent Borrowing

Michigan qualified for and drew a federal loan of $113 million early in 1958, although its own reserves, apart from the borrowed funds, never did run out completely at that time. Since no interest was charged and repayments were not required to begin until more than four years had elapsed after the loan was made, repayments did not begin until 1963.[11] The debt was fully liquidated in 1967.

The recession of the mid-1970s was a severe one, hitting Michigan hard. By early 1975, the state's benefit reserves were exhausted and borrowing began. Over the next two years, the debt accumulated to a total of $624 million. Repayment was not required until November 1980. If not repaid by then, debt reduction was to take place through a series of increases in the FUTA net tax rate on Michigan employers. During the late 1970s, the state's economy experienced fairly good recovery. Benefit outlays declined well below 1975 levels, while expanded employment and payrolls combined with increased UI tax rates to rebuild the fund to a level where it was possible to repay the entire debt. In December 1979, the debt was repaid in full.[12]

During the latter part of 1979, however, the Michigan economy was again deteriorating. As benefit outlays rose sharply early in 1980, remaining benefit reserves were depleted quickly and borrowing from the federal loan fund resumed. Such borrowing has continued off and on since then, as unemployment has remained high. By the end of March 1982, the debt had grown to $1,563 million, none of which was subject to interest. Additional substantial borrowing is expected in the second half of 1982 and thereafter. The interest payable on debt incurred after March 31, 1982 is an obligation of the state but may *not* be paid from UI trust fund reserves.

Repayment Provisions[13]

Federal rules currently in effect call for repayment of the Michigan UI debt by November 1982. If it is not repaid by then, progressive increases in the FUTA tax rate are imposed each year on Michigan employers, the proceeds of which go to reduce the outstanding debt.[14] The net federal tax rate of 0.7 percent will rise by a 0.3 "penalty rate" to 1.0 percent of 1982 taxable payrolls, due for payment in January 1983, and by a 0.6 rate to 1.3 percent for 1983, payable January 1984. It will increase by a 0.9 penalty rate for 1984 payrolls and by 1.2 for 1985, to a total FUTA rate for that year of 1.9 percent. If the FUTA increase for 1985 does not eliminate all of the remaining debt, then an additional tax, through a "solvency rate" increase, will be imposed for that year, up to as much as another 1.5 percent of taxable wages.[15] The total federal tax payable, combining the penalty and solvency rates with the basic net rate of 0.7 percent, could therefore equal the maximum 3.4 percent of taxable payrolls in 1985 and later years, involving the loss of all of the federal tax credit normally allowed. The proceeds of the FUTA tax increases apply to reduce the outstanding loans in the order they were made, i.e., the oldest unpaid loans are retired first.

That means that the interest-free portion of the debt will be repaid first through this process.

At any time, of course, the state may accelerate the rate of debt repayment. One incentive for doing so is to reduce the liability for interest. As debt incurred after March 31, 1982 increases, so will the interest that will be payable. Any repayments made from the state fund apply to the latest loans made which do bear interest. Another incentive for faster repayment is to limit, as far as possible, the FUTA rate increases which are imposed on all Michigan employers. A major concern with these increases is their effect on new employers who pay a standard state UI tax rate of 2.7 percent for the first two years. Combined with the federal rate, the total state and federal tax for new employers will probably go to 4.3 percent for 1984 and could go as high as 6.1 percent of taxable wages for 1985. Efforts to attract new industry to Michigan would be hampered by the increasingly discouraging disincentive of loading new employers with a repayment burden for past UI debt to which they had not contributed. To the extent that some FUTA increases may be unavoidable, some other type of relief for new employers may be needed.

Another concern with the uniform FUTA increases is that they tend to nullify much of the desired effect of experience rating, which appears to be strongly favored by the employer community in the state. All employers would share the debt repayment burden equally, in relation to their taxable payrolls, through the FUTA tax rate method of repayment, regardless of wide variations among them in their past benefit charges. To the extent that experience rating continues as a preferred policy in Michigan, the emphasis is on raising more of the necessary funds for repayment through the state's UI tax structure, particularly through its experience-rating components, than through uniform federal tax increases.[16]

Amendments enacted in 1981 of the federal repayment provisions made it possible for a debtor state to qualify its employers for a ceiling or "cap" at 0.6 on the FUTA rate increase imposed for repayment purposes, or at a higher level of increase. For example, if the qualifying conditions are met, the 0.6 rate increase applicable for Michigan employers for the 1983 taxable year would apply for subsequent years (through 1987), or the 0.9 increase for 1984 could hold at that level for the next three years. To qualify for a cap after 1983, the following conditions must be met:

(1) No action is taken after August 1981 that reduces the state's UI tax effort.

(2) No action is taken after August 1981 that reduces the solvency of the state's fund, such as legislating benefit increases without compensating tax increases.

(3) The outstanding debt as of September 30 of the year for which the federal tax cap applies is not larger than the balance outstanding three years before. (For a 0.6 cap on the increase for 1984 in Michigan, for example, the debt balance on September 30 that year may not exceed the $1,015 million balance outstanding on September 30, 1981.)

(4) The average state UI tax ratio for the year of the federal tax cap is not less than the average of annual benefit-cost ratios of the five preceding years. (For this purpose, the average state tax ratio is total taxes paid into the state fund as a percent of total payrolls of taxable employers, and the annual benefit-cost ratio is total benefits paid out of the state fund during the year plus interest paid on loans as a percent of total payrolls for the year.)

At this time, qualifying for a cap on the FUTA increases appears to be remote as a possibility for Michigan, certainly at the 0.6 level. A 0.9 cap in 1985 may not be out of reach entirely, but it would be very difficult to achieve under conditions now foreseen.

The Outlook—Increasing Debt

Given current economic expectations and no changes in existing UI provisions, the prospects are for substantially more borrowing by the state fund over the next several years. Recent estimates made by the Michigan Employment Security Commission (MESC) show a continuing shortfall in state UI tax revenues during the 1982-85 period when benefit outlay projections range between $1.4 and $1.8 billion each year, while state tax revenues total less than $900 million annually. The projected total shortfall over these four years is over $3 billion, carrying the debt to more than $3.8 billion by the end of 1985 even after taking account of repayments made through FUTA tax increases in this period.

Projections of UI finances for years ahead are necessarily speculative. They are based on certain assumptions and past experience patterns which are subject to change. As explained in the Introduction of this paper, projected data should therefore be viewed with caution and understood as tentative approximations that can be useful for general guidance of policy considerations. New experience and changed assumptions can be expected to bring about modified projections from time to time, as has occurred recently.

One of the most important assumptions underlying the projections is the expected rate of unemployment in the state. Using estimates made in December 1981 by another office in the state's Department of Labor, earlier projections by MESC had assumed annual average unemployment rates for Michigan for the next five years as follows:[17]

1982 - 13.1% 1985 - 9.7%
1983 - 11.7% 1986 - 9.4%
1984 - 10.7%

It was also assumed that average wage levels in the state would rise by 7 percent each year, and that current UI tax, eligibility, and benefit provisions would continue, including

those enacted in 1980 as temporary. Using these assumptions, and a model reflecting existing state and federal provisions and past experience patterns, MESC provided, in early 1982, projected annual data for several years on payrolls, benefit outlays, state tax revenues, and FUTA tax increases for debt repayment. The level of the state fund (or outstanding debt) at the end of each year was also projected.

As a result of actual experience in the early months of 1982 and more data becoming available about 1981 experience, MESC adjusted these earlier estimates and provided new projections in June 1982. Unemployment has been running at rates higher than expected and may average around 14 percent in 1982. At the same time, larger proportions than usual of the insured unemployed had earned wages high enough to qualify for the maximum or near-maximum weekly benefit amounts. They have also been drawing benefits for longer periods, on average, than foreseen. These factors together called for upward adjustments of the earlier projections of annual benefit outlays. Moreover, the recession-depressed payrolls reported by employers have been totaling less than anticipated, leading to lower tax collections than expected. Downward adjustments were therefore applied to the earlier revenue projections. The combined effect of these adjustments has been to widen the estimated gap between fund outlays and revenues and greatly increase the amount of borrowing likely to be needed.

Table 4 summarizes these revised estimates for the years 1982 to 1985, assuming no changes in the existing state UI program or in relevant federal provisions. The estimates show that by the end of 1982, the debt will reach $2.2 billion. A year later, it may exceed $2.8 billion, and then climb to over $3 billion and reach towards $4 billion by the end of 1985. Despite moderate declines assumed in the unemployment rates over this period, benefit outlays are expected to increase each year after 1983 because of the continued index-

Table 4
Michigan Unemployment Insurance Fund Transactions and Debt: Projections under Current Law Provisions 1982-1985

Item projected	Estimated[a] (in millions)
Fund balance (negative)—December 31, 1981	($1,075)[b]
1982: Benefit outlays[c]	(1,773)
Employer state taxes	644
Fund balance (negative)—December 31, 1982	($2,204)
1983: Benefit outlays[c]	(1,427)
Employer state taxes	770
FUTA penalty tax payment (0.3 percent of 1982 taxable payrolls)	48
Fund balance (negative)—December 31, 1983	($2,813)
1984: Benefit outlays[c]	(1,507)
Employer state taxes (net)[d]	855
FUTA penalty tax payment (0.6 percent of 1983 taxable payrolls)	102
Fund balance (negative)—December 31, 1984	($3,363)
1985: Benefit outlays[c]	(1,535)
Employer state taxes (net)[d]	892
FUTA penalty tax payment (0.9 percent of 1984 taxable payrolls)	162
Fund balance (negative)—December 31, 1985	($3,844)

NOTE: Figures within parentheses represent negative fund balances or subtractions from the fund.

a. Based on data supplied by Michigan Employment Security Commission, June 1982.

b. Represents actual indebtedness.

c. Includes state share of extended benefit costs.

d. Net of tax credit allowed against the NBC rate for half the FUTA penalty rate paid in previous year.

ed rise in the weekly benefit ceiling.[18] Projected state tax revenues reach higher levels each year as employment expands and many employers are assigned higher tax rates, but the revenue increases are restrained by the unchanging taxable wage base and by the limiter on annual tax rate increases. Moreover, beginning in 1984, tax credits for part of the FUTA penalty taxes paid provide increasingly larger offsets to state taxes.

The FUTA penalty taxes provide the major new element and are expected to total over $300 million in this period. The credits allowed on the NBC rates for the penalty tax payments made in the prior years would offset somewhat over half. The FUTA tax increase projected for 1985, payable in January 1986 and therefore not reflected on Table 4, combines a 1.2 percent penalty rate with a 1.5 percent maximum solvency rate to yield a total of almost $500 million. The credit for this payment would offset the entire 1.0 percent NBC tax for 1987.

Also not shown on the table, since it is not paid from the trust fund, is the interest liability relating to funds borrowed after March 31, 1982. While very little interest is expected to be paid in 1982, the amount due in 1983 is estimated at about $84 million. While not estimated for later years, it is clear that the interest liability will rise steeply with the debt increases that have been projected.

Beyond 1985, projections become very tenuous and unreliable. One could perhaps speculate, however, that even if unemployment were to continue a moderate decline, as long as the UI program remained unchanged, it would probably take another ten years or so to pay off the debt, largely through the uniform FUTA tax which would continue at its maximum level. That scenario is not a realistic one, however. To expect unemployment to moderate and hold steadily to lower levels for so many years is not a reasonable way to view the future. With no reserve surplus, any kind of a reces-

sion in these years would see Michigan borrowing heavily again. Neither is it reasonable to expect so many years to go by without changes in the UI program at both the state and federal levels.

The Outlook—Higher Taxes

The average Michigan employer faces rising UI taxes in coming years, even without changes in state tax provisions. As the high benefit outlays of the early 1980s increasingly dominate the five-year experience base used for calculating the chargeable benefit component of the state tax, the rates for many employers can only move upwards. Projections indicate that under the current law, the average state tax rate may rise from about 4 percent in 1981 to over 5 percent by 1985. The NBC tax credit for part of the FUTA penalty tax increase, however, would lower the 1985 net state tax rate to about 5 percent. Around the average, of course, tax rates vary considerably among employers because of experience rating.

A major division among employers is between those with negative and those with positive account balances.[19] At mid-1980 about 4 out of 10 employers had negative account balances; a year later, the proportion was nearly half. Negative account employers are mostly of two kinds. One type, such as found in construction and tourism, has significant seasonal operations followed by large layoffs about the same time every year. Employers of this type are always, or almost always, in a negative balance position, and are assigned at or near maximum tax rates. They include both high-wage and low-wage paying employers. The other type includes employers who are highly sensitive to recession conditions, such as firms engaged in durable goods manufacturing. Many are very large firms which pay high wages; automobile manufacturers are the leading examples. Since 1970, the proportion of all employers with negative balances has grown from about 20 percent to near 50 percent, mainly

because of the impact of several recessions over these years. At mid-1981, all negative balances aggregated almost $1.5 billion, more than the amount of the fund's debt at that time. The state's UI tax structure has not been very effective in recouping as much of these heavy charges as one might expect considering the high maximum tax rate.[20] In 1981, fewer than 6 percent of all employers were at the 9.0 maximum rate; less than 10 percent had rates of 7.5 or higher. The largest concentration of taxable payrolls clustered at tax rates around the 5 percent level. The 0.5 limit on year-to-year rate increases has prevented greater concentration at higher rates. Among broad industry groupings, the UI tax rates in 1981 averaged highest in construction (6.3 percent), followed by manufacturing and mining (4.7 percent in each); finance, insurance, and real estate employers had the lowest average rate (2.6 percent).[21]

The federal net tax rate, currently at 0.7 percent, will rise as the rate increases for debt repayment are added. The total federal tax rate to be paid will be 1.3 for 1983, 1.6 for 1984, and could jump to as high as 3.4 percent for 1985, barring any efforts to accelerate debt repayment or a more rapid decline in unemployment than projected. After allowing for credits against the state tax rate for half the FUTA rate increases, up to the 1.0 percent limit of the NBC rate, the combined average state and federal tax rate could rise from about 4.6 percent in 1981 to about 8.4 percent by 1985, based on current projections. It is important to bear in mind the assumption for these projections that the taxable wage base will continue at $6,000, for both state and federal tax rates. On the basis of projected total wages, the combined average state-federal tax rate could rise from approximately 1.5 percent in 1981 to about 2.3 percent in 1985. However one chooses to look at the problem, it represents a growing burden for Michigan employers generally.

Michigan's competitive position, vis-a-vis other states, in attracting new business and keeping the business it has is

widely perceived as poor, although this view tends to be exaggerated.[22] High UI taxes are cited often as a negative factor in that connection. The outlook for continued high unemployment rates in the state and for mounting UI debt and taxes offers no relief from that perception. The discouraging effect of loading FUTA debt repayment increases on new employers was noted earlier. Firms which tend to have favorable UI cost experience and thereby qualify for low state rates would see their federal tax rates rise regardless, swamping the effects of experience rating. The state tax credits allowed for half the federal rate increases help to moderate that result, but not for new employers in their first years under the program. By itself, the existence of a serious and worsening insolvency problem with no plan yet in hand for dealing with it may be the most disturbing aspect of the state's UI program because of the uncertainties it poses about future costs for prospective new and expanding businesses.

State UI Program Changes to Reduce Insolvency 4

These grim prospects call for serious consideration of possible changes in existing state UI provisions that might ease the burden, distribute it more equitably, reduce its unfavorable effects, and at least begin the effort needed to bring the problem under control. The best solution of all, of course, would be a rapid and vigorous recovery of the economy. Short of that, however, there are some helpful, though painful, actions that can be taken in the form of increasing tax revenues or reducing benefit outlays, or a combination of the two.

Alternatives and Goals

At one extreme, of course, the state can decide to take no action with respect to its existing UI law. The only provision it needs to make is for financing the interest that will be payable on the debt. Without any other action, the temporary UI amendments adopted in late 1980 will sunset at the end of March 1983 and the former provisions will again apply. Some benefit outlay increases would result from the return to the easier qualifying requirements and to the payment of benefits, after a 13-week suspension, to UI claimants disqualified for voluntary quits or misconduct discharges. These increases, however, would be swamped by

substantial outlay reductions caused by the deep cut in the weekly benefit ceiling to earlier levels. Recent MESC estimates (June 1982) indicate that the reduced ceiling alone could lower projected outlays by more than $1.5 billion during the 1983-85 period. The debt would rise much less than projected with all other current provisions continuing unchanged. This particular approach to dealing with the problem, however, is so Draconian in its negative effects on the benefits of unemployed workers that it is unlikely to be acceptable. Rather, the possibility of those effects may help to provide a strong incentive to take some action before the sunset date.

At the other extreme, the state can decide to take whatever action necessary to liquidate the debt completely and rebuild the fund to a sound level in as short a period as possible. Very heavy tax increases and severe benefit restrictions would have to be concentrated in the next few years, which are not expected to be properous economic times. This alternative also appears unlikely to attract much support because of its drastic immediate effects on both employers and workers. Some approach between these two extremes seems a more reasonable probability.

In designing a set of changes to move the UI fund toward solvency, some goal setting is useful. One could, for example, specify that the debt be repaid in full by a certain date and that the fund accumulate an adequate reserve in a given period of time thereafter. To be sure, how specific that goal can be and how closely pursued depend on how reliable the projected outlook is for the years ahead. As noted before, available projections are not certain and are likely to change. Yet, they furnish a basis for setting a tentative goal to guide planning for policy and program changes. The need for flexibility and for subsequent reconsiderations should be appreciated.

It is possible to indicate various goals that could be considered to help determine changes to make in Michigan's UI

law. Several are described below in ascending order of the total effort required to achieve them, as measured by increased tax revenues and reduced benefit outlays. Projected debt repayment through FUTA tax increases are taken into account by the estimates cited.

1. Minimize or avoid the FUTA solvency tax that could apply for 1985.

   Any solvency rate added to the FUTA tax for 1985 is to be calculated as the amount by which the annual average of benefit costs of the prior five years, taken as a percent of estimated taxable payrolls in 1985, exceeds the average state UI tax rate estimated for 1985, also based on taxable payrolls. The solvency rate for that year cannot exceed 1.5 percent. Together with the penalty rate of 1.2 percent scheduled to apply for 1985, the total increase could be the maximum addition of 2.7 to the basic net FUTA rate of 0.7, thereby eliminating entirely the normal tax credit allowed against the federal tax. Based on projections under current UI provisions, the solvency rate would be set at the 1.5 level for 1985. State tax revenues for that year would have to be over $250 million more than projected to reduce the rate below 1.5 and in excess of $500 million more to avoid any solvency tax. The 1.5 percent FUTA solvency tax rate that year would add an estimated $270 million to the federal tax. Working up to the required state revenue effort in 1985 over the 1983-1985 period, even with some help from benefit reductions in 1983 and 1984 to lower the five-year average cost rate somewhat, is probably the least demanding goal to pursue. Achieving it would not, by itself, do much to lower the debt or stem its increase, given the current outlook. The FUTA penalty tax rate would continue to rise 0.3 each year for some years thereafter.[23]

2. Minimize or avoid the need for more borrowing.

   Since interest is payable on any new debt incurred

since April 1, 1982, it is clearly desirable to avoid, as much as possible, further borrowing. To keep the interest-bearing portion of the debt from rising beyond the level currently projected at the end of 1982, it would take a combination of revenue increases and outlay reductions estimated at about $650 million a year for the 1983-1985 period.

3. Cap the penalty rate increase in the FUTA tax at 0.9 for 1985.

   The conditions required to qualify for a cap on the penalty rate were described in chapter 3. The two key requirements are a specified lowered debt level by the end of the fiscal year and a specified revenue rate level in the tax year for which the cap is sought. Based on the MESC projections of June 1982, the debt at the close of 1985 is estimated at $3.8 billion; it may be somewhat less at September 30, the end of the fiscal year. Without any changes in current provisions, the debt would stand about $2 billion higher than the level of three years earlier, failing one of the key capping requirements. The average tax or revenue rate for 1985 would fall far short of the prior average annual five-year benefit cost ratio, failing the other test. The increases in revenues and reductions in outlays necessary to close these gaps would have to exceed those changes necessary to avoid further borrowing after 1982.

4. Reduce the outstanding debt to that portion not subject to interest.

   Debt incurred before April 1, 1982 does not bear interest. In addition to the effort needed to avoid further borrowing during the 1983-1985 period, about another $650 million in more revenues and benefit savings would be needed over these years to bring the debt down to the interest-free level.[24]

5. Cap the penalty rate increase in the FUTA tax at 0.6 for 1984.

   The efforts required to meet the tests for this goal in 1984 appear to be beyond any reasonable expectations at this time. All of the needed revenue increases and outlay reductions would have to concentrate in the next two years. They would have to total about $2 billion to lower the debt to the approximately $1 billion level of September 30, 1981, as required for the 1984 cap. State tax revenues in 1984 alone would have to rise to about $1.5 billion, compared with the level projected for that year of about $850 million under current provisions.

These goals and the possibilities for achieving them have been outlined only through 1985. Even with substantial effort, it may not be plausible, given the present outlook, to plan for much more than slowing down the increase in the debt and interest costs. If the state's economy improves more rapidly than now anticipated, that would help matters considerably by reducing benefit outlays and increasing revenues even without taking account of program changes, and the economy could sustain a stronger effort to speed repayment. Beyond 1985, the outlook is too uncertain and projections too unreliable to set changes in the law now that should be expected to stand without further review.

There are many possible changes in state UI provisions that can be considered to develop more revenues and to reduce outlays. The more significant examples are described next along with some estimates of their impact.

Increasing Revenues

States are fairly free to adopt whatever UI financing arrangements they choose in order to supply the necessary revenues. The only restriction imposed by the federal law is that employer state tax rates may not drop below 2.7 percent of taxable wages except on the basis of experience rating, on penalty of losing the full credit allowed against the federal

tax. States can suspend experience rating and apply a uniform rate, provided it is at least 2.7 percent.[25] Several states follow this route when their reserve funds reach a low point or go into debt.[26] Because of its chronically high benefit cost levels and need to borrow in the past, Alaska added an *employee* tax some years ago which varies between 0.5 and 1.0 percent of taxable wages ($14,600 as of 1982) depending on the level of the fund. Alabama and New Jersey also have an employee tax (0.5 percent in each state); Alabama applies it only when the fund declines below a specified level, as is now the case. Other approaches to increase revenues include a higher taxable wage base, a higher tax rate schedule for given levels of cost experience, the addition of a special surtax when the state fund is low or insolvent, a higher minimum tax rate, and a higher maximum rate.

Suspension of experience rating or the imposition of a high minimum rate are not generally acceptable alternatives for Michigan since experience rating appears to be so well supported in the state. The inclusion of the uniform NBC rate of 1.0 percent in the state tax reform adopted in 1977 was in part the result of a federal requirement the state had to meet to qualify for a deferral of debt repayment coming due at the time. In general, the coming progressive increases in the uniform FUTA tax rate are looked upon as an undesirable weakening of the experience-rating element in UI financing. That effect has been countered to some extent by the provision that credits half the FUTA rate increases against the uniform state NBC tax rate. The problem is that the credit slows down debt reduction. An employer group that studied the UI financing problem in early 1982 reaffirmed experience rating as the basic concept for the UI tax structure.[27]

Increases in the Taxable Wage Base

Michigan's taxable wage base of $6,000 has been in effect since 1978, rising then from $5,400. The federal base also

went to $6,000 that year, from $4,200. States at least match the federal wage base but many set higher levels. As of July 1982, 26 jurisdictions taxed more than the first $6,000. In 6 states, the base exceeded $10,000; in 11 states, it ranged from $8,000 to $10,000.[28] In 13 states, the base is adjusted annually to maintain a constant relationship to the state average annual wage; among these states, the proportions range between about 54 and 100 percent.[29]

The problem with a fixed dollar wage base is that as wage levels rise over the years, the proportion of payrolls subject to the tax diminishes. A relatively narrow base tends to restrict the scope for experience rating. Short of taxing total wages, nominal minimum and maximum tax rates translate into different *effective* rates among employers on the basis of total wages paid, depending on the proportions of their total payrolls that are taxable. The latter, in turn, vary by the level of wages paid as well as the amount of labor turnover. Apart from Alaska, Michigan has averaged a higher wage level than any other state. As a result, it taxes the lowest proportion of payrolls—only an estimated 34 percent in 1981; it taxed about 41 percent in 1978 when the present base was established. (For the United States as a whole in 1978, the proportion was about 50 percent.) Michigan has not taxed as much as half its payrolls since 1967. The growing restrictiveness of its tax base is part of the reason for its UI financial problem, especially as the weekly benefit levels provided have increased and extended benefits have stretched the duration of weekly payments.

Raising the taxable wage base in Michigan is estimated to increase revenues by between $100 million and $125 million a year for each increase of $1,000 in the base, up to about the $9,000 level. At $9,000, the base would equal about half the state's average annual wage level in 1981. Without compensating adjustments in the tax rate structure, most employers would pay more taxes in the first years of the increase. In time, the rates would tend gradually to adjust downward, assuming no increase in the level of benefit charges. Those

employers with negative account balances who are already at the maximum tax rate, or at a rate kept under the maximum by the limit on annual rate increases, would continue to pay more taxes. So would employers at the minimum rate of 1.0 percent.

High-wage paying employers who have also experienced high benefit charges, such as many of those in construction and in durable goods manufacturing, would have to take on a heavier tax burden with a higher wage base, as compared with other employers. That result would satisfy the experience-rating objective more effectively. To ease the impact, a wage base increase could be accomplished gradually over a period of years, such as raising the base by $1,000 or $1,500 per year for each of the next several years. That approach, of course, would slow down the revenue increases needed urgently at this time. The best time to raise the wage base is when employment and payrolls are expanding well and the fund is in fairly good condition so that compensating tax rate adjustments could occur more quickly. If and when Michigan reaches that stage, a base pegged to a set proportion of the annual average wage would warrant serious consideration.

Other Changes in Employer Taxes

The only other change in the present tax structure estimated to have a revenue effect almost as large as a $1,000 increase in the taxable wage base is an increase in the uniform NBC rate from 1.0 to 1.5 percent. A milder or more gradual alternative would be to eliminate the credit allowed against the NBC rate for the coming FUTA increases for debt repayment. Such an increase in the uniform component, however, runs contrary to the experience-rating objective. In 1982, 20 states have a minimum tax rate higher than 1.0 percent, and about two-thirds of these states have taxable wage bases above $6,000.[30]

Two other changes that could be considered would tend to strengthen the experience-rating effect of the tax: the

elimination of the 0.5 limit on annual tax rate increases for employers with combined CBC and ABC rates at or above 4 percent; and an increase in the ABC tax rates of individual employers with inadequate reserves by raising the multiple used in calculating the rate from 0.25 to 0.50 (see footnote 9). These two changes, together, were estimated to increase revenues by about $115 million to $125 million a year at the $6,000 taxable wage base, and by more at higher wage bases. Eliminating the "limiter" entirely could produce a severe impact for some employers. A more moderate alternative would be to raise the limit from 0.5 to, say, 1.0.

Other types of changes do not seem to offer much in the way of added revenues. These include raising the maximum tax rate by a percentage point or two, and increasing the standard rate for new employers. The former would raise the maximum rate to a double-digit figure, while the latter would make more difficult the effort to attract new business to the state. At some point, a review of the total UI tax structure for another possible overhaul would probably be in order.

An Employee Tax

Michigan has never looked to workers to help finance UI benefits. The state's policy on this score is strongly rooted in the philosophy that unemployment compensation should be a cost of doing business and the sole responsibility of employers. This view heavily influenced the character of the UI system adopted for the United States; experience rating is a direct descendant of that philosophy. Exclusive employer financing through an experience-rated tax structure is a distinctly American phenomenon in unemployment insurance. Much of the motivation for the adoption of an employee tax by the nine states that had it originally was the expectation that costs would exceed the resources available from employer taxes then deemed feasible. As the UI program developed, costs were less than expected; seven of the nine states dropped the employee tax or shifted it to the

financing of public temporary nonwork-connected disability insurance. Alabama retained it but only in periods when its benefit reserves were low. New Jersey adopted an employee-financed temporary disability insurance program but also kept a portion of the employee tax for UI financing. Alaska, the first state to experience serious financial difficulties in UI, added an employee tax to strengthen its financing. No other state has taken this approach.

Besides adding strength to UI financing, another argument supporting an employee tax is that it would instill in workers a stronger sense of responsibility for and interest in a good, well-balanced program, as well as justify a more direct claim to an earned right to benefits. Many workers believe they already pay into the UI program, mistakenly ascribing their UI coverage to their social security contributions. Theoretically, a case is made that employer UI tax costs are ultimately shifted to workers anyway, either through restraints on wages or additions to consumer prices.[31] Countering the view that an employee tax would fortify labor's interest in balanced UI legislation and fair administration is the position held by some employers that such a tax would strengthen labor's demand for a more liberal program. Employers, generally, have not favored employee UI financing. Worker resistance to an employee tax reflects general resistance to any tax increases and the view that employers are entirely responsible for involuntary unemployment. Many economists also hold a negative view of an employee payroll tax because it is regressive, especially one levied on a relatively low wage base.

Consideration of an employee UI tax arises at this time in Michigan because of the program's financial problems. The burden of debt repayment and reestablishment of a solvent fund appears to be an overwhelming one for employer financing to carry alone in the coming years. The Michigan employer UI working group adopted as a guiding principle that the burden should be shared between business and labor. The labor contribution could take the form of benefit

restraint or reductions. But it could also include direct employee contributions to the fund, at least as a temporary measure. It can be argued that workers still employed could afford a modest tax charge more readily than unemployed workers could afford benefit reductions, although both approaches may be utilized.

Using MESC taxable payroll projections for the 1983-1985 period, estimates indicate that for each 0.1 percent of taxable wages, employee taxes could raise about $17 to $18 million a year at the current $6,000 base. For each $1,000 added to the taxable wage base, up to the $9,000 level, the yield would rise by about 10 to 15 percent.

Changes to Reduce Benefit Outlays

Given current eligibility and benefit provisions, and the assumed unemployment rates, MESC projects annual benefit outlays from the fund at between $1.4 and $1.6 billion during the 1983-1985 period. Despite gradual lowering of estimated unemployment levels over these years, outlay levels would still be high, even increasing after 1983 because of annual increases in the indexed weekly benefit ceiling.

Early in 1982, the Governor proposed to increase the state's minimum qualifying requirement for regular benefits from 18 to 20 weeks of base-period employment and to restore a waiting week of noncompensable unemployment.[32] Federal provisions now prohibit the payment of federally-shared extended benefits to claimants with less than 20 weeks of base-period employment, and also prohibit federal sharing of the cost for the first week of extended benefits paid when no waiting week had been served for regular benefits.[33] The states are not required to adopt these rules for regular benefits, but a few have moved in that direction. MESC projections for the 1983-85 period estimate that the two proposed changes would reduce benefit outlays by about $90 to $95 million per year. Another possible change is to increase the

minimum weekly earnings requirement from $67 (20 times the minimum hourly wage) to $100 (30 times that wage); projected benefit savings amount to about $20 million a year for this change.

The new temporary weekly benefit amount (WBA) provisions adopted at the end of 1980 moved Michigan from being one of the least liberal states in this regard to one of the more liberal. In relation to average weekly wage levels, the state's former benefit ceilings, which had been unchanged since 1975, were about the lowest in the country; the current ceiling, at 58 percent of the average wage, compares much more favorably. While, as of mid-1982, there were 23 states which provided indexed WBA ceilings at higher percentages of their average weekly wage levels, only 2 states had higher dollar ceilings than the $197 level then applicable in Michigan and 6 more had higher ceilings for claimants with dependents.[34] At levels below the maximum, the proportion of the claimant's weekly wage compensated by the WBA tends to be somewhat larger for some claimants than is the case in most states, although that was even more the case before the change. Michigan's unique formula sets the WBA at 70 percent of the weekly wage net of taxes, which makes the benefit generally about 50 to 60 percent of the gross wage depending on the claimant's wage level and number of exemptions. Most states compensate about 50 to 55 percent of the gross weekly wage.[35]

To reduce benefit outlays, various adjustments to the WBA provisions can be considered. One is to hold or freeze the maximum where it is now. MESC projections indicate cost savings over the 1983-1985 period rising from about $50 million to $185 million a year. given the assumed unemployment rates and annual 7 percent increases in average wage levels. Without a freeze, the WBA ceiling would rise each year reaching about $241 by 1985. Other possible WBA changes to reduce cost include dropping the benefit-wage index percentage for the maximum from 58 percent to a lower

figure, and reducing the 70 percent of weekly-after-tax-wage rate for individual WBA determinations. These changes would not save as much as the freeze on the dollar ceiling unless the reductions were rather substantial.

Cost savings can also be realized by cutting back on the duration of benefits allowed by the Michigan program. Considering the worsened unemployment problem in the state, especially the increase in long term unemployment, there have been no serious suggestions advanced to reduce benefit outlays in this manner. The state's regular duration provision is about comparable with that of most states; about 20 states are more liberal in their provisions and only about half a dozen states are distinctly less liberal.[36]

Effects of UI Program Changes on State Fund 5

It is assumed that no legislative action will take place in 1982 that will affect benefit outlays and revenues for that year. The projected 1982 year-end debt level of $2.2 billion (Table 4) is therefore taken as the starting point for the state's UI fund in 1983. Time is running short, but failure to take action that would be effective for 1983 would be a serious mistake, a lost opportunity to begin the long difficult climb back to solvency before matters grow much worse.

The problem will not be resolved by one round of legislation. It will have to be dealt with over a period of many years during which its character and surrounding circumstances are likely to change. Any changes adopted in the months ahead probably should be considered applicable for only the next two or three years. Near the end of that time, the situation should be reexamined and further action formulated, as appropriate. Much will depend on how economic conditions develop. Changes may also occur at the federal level that will need to be taken into account.

The focus of discussion here, therefore, is on the near term prospects—on changes that would affect the program and

trust fund in the 1983-1985 period. Taking the goals described earlier that may be considered as reasonably possible for this period, the objective of the discussion is to show how they might be achieved based on the latest available estimates.

Overall View of Illustrative Changes

Table 5 illustrates how one combination of changes may affect fund transactions over the 1983-1985 period. The data are based on estimates made, as of June 1982, by MESC. These changes represent but one of several possible combinations. Their selection for this particular illustration does not necessarily connote approval, although some taxable wage base increase and some restriction on the maximum WBA are probably unavoidable in any combination.

The changes used for the Table 5 illustration are listed below along with the approximate estimates of their effects, by year, on revenues and outlays as compared with estimates projected under current provisions.

1. Increase the taxable wage base for state UI taxes from $6,000 to:
   a. $7,000 for 1983 - adds $116 million to revenues
   b. $8,000 for 1984 - adds $247 million to revenues
   c. $9,000 for 1985 - adds $331 million to revenues

   The federal taxable wage base for FUTA taxes is assumed unchanged at $6,000. (The $6,000 base is estimated to equal about 32 percent of the average annual wage in 1982 and about 27 percent in 1985; a $9,000 base in 1985 would equal about 39 percent of the projected average annual wage that year.)
2. Increase the multiple used in the calculation of the ABC rate from 0.25 to 0.50, effective beginning 1983.

   Estimated additions to revenues:

   1983 - $ 79 million

1984 - 92 million
1985 - 101 million

The revenue additions estimated for this change take account of the increased wage bases specified above. Currently, the ABC rate rises slowly for most employers with account balances below the required level because of the lower multiple and because the rate is calculated on the basis of total payrolls though applied to taxable payrolls (see footnote 9 for formula).

3. Eliminate the limiter on annual increases in the state UI tax rate, effective beginning 1983.

   Estimated additions to revenues:

   1983 - $58 million
   1984 - 68 million
   1985 - 74 million

   The estimated revenue additions take account of the increased taxable wage bases specified for these years.

4. Institute an employee UI tax contribution at 0.5 percent of taxable wages, beginning 1983.

   Estimated additions to revenues:

   1983 - $ 97 million
   1984 - 113 million
   1985 - 124 million

5. Freeze the maximum weekly benefit amount payable at its current level (1982) of $197 through 1985.

   Estimated savings in benefit costs:

   1983 - $ 52 million
   1984 - 129 million
   1985 - 183 million

   By 1985, the $197 maximum will have declined to less than half the previous year's average weekly wage, if the assumed annual 7 percent wage increase projected from 1981 is realized.

6. Increase the minimum number of weeks of work required in the base period to qualify for benefits from 18 to 20, effective beginning 1983.

   Estimated savings in benefit costs:

   1983 - $35 million
   1984 - 37 million
   1985 - 38 million

7. Establish a noncompensable waiting week for the first week of unemployment claimed, effective beginning 1983.

   Estimated savings in benefit costs:

   1983 - $56 million
   1984 - 58 million
   1985 - 56 million

Table 5 shows that if all these changes were adopted with their effects on revenues and outlays as estimated, then the debt level would be up somewhat, to $2.3 billion, at the end of 1983. It would be down to $2.1 billion a year later, and substantially lower, to $1.7 billion, by the end of 1985. The total effort encompassed by all these changes over the three years would equal over $2 billion. Employer state tax increases would account for slightly over half, the employee tax for about one-sixth, and benefit cost for almost a third. In addition, FUTA penalty taxes levied on employers over the three years would total an estimated $312 million, of which $108 million would be offset by credits allowed for the penalty taxes to reduce state taxes paid by employers in 1984 and 1985.

To meet certain more limited goals, not all of these changes would be required. More ambitious goals may require all of them and perhaps other or even larger changes than those illustrated. The types and mix of changes to be included in any package, and their timing, would be subjects of controversy. In the end, it will be necessary to reach an acceptable compromise, a passable balance between employers

Table 5
Projections of Michigan Unemployment Insurance Fund Transactions and Debt Under Selected Illustrative Changes in Current Provisions 1983 - 1985

Item projected		Estimated[a] (in millions)
Fund balance (negative)—December 31, 1982		($2,204)[b]
1983: Benefit outlays under current provisions[c]		(1,427)
Cost savings from		
freeze of maximum WBA	$ 52	
increase in qualifying weeks	35	
waiting week	56	143
Employer state taxes under current provisions		770
Added revenues from		
$7,000 wage base	$116	
increased ABC multiple	79	
elimination of limiter	58	253
FUTA penalty tax (0.3 percent of 1982 federal taxable wages)		48
Employee tax (0.5 percent of state taxable wages)		97
Fund balance (negative)—December 31, 1983		($2,320)
1984: Benefit outlays under current provisions[c]		(1,507)
Cost savings from		
freeze of maximum WBA	$129	
increase in qualifying weeks	37	
waiting week	58	224
Employer state taxes under current provisions[d]		882
Added revenues from		
$8,000 wage base	$247	
increased ABC multiple	92	
elimination of limiter	68	407
Credit on NBC for part of FUTA penalty tax paid in 1983		(34)
FUTA penalty tax (0.6 percent of 1983 federal taxable wages)		102
Employee tax (0.5 percent of state taxable wages)		113
Fund balance (negative)—December 31, 1984		($2,133)

Table 5 (continued)

Item projected		Estimated[a] (in millions)
Fund balance (negative)—December 31, 1984		($2,133)
1985: Benefit outlays under current provisions[c]		(1,535)
Cost savings from		
freeze of maximum WBA	$183	
increase in qualifying weeks	38	
waiting week	56	277
Employer state taxes under current provisions[d]		946
Added revenues from		
$9,000 wage base	$331	
increased ABC multiple	101	
elimination of limiter	74	506
Credit on NBC for part of FUTA penalty tax paid in 1984		(74)
FUTA penalty tax (0.9 percent of 1984 federal taxable wages)		162
Employee tax (0.5 percent of state taxable wages)		124
Fund balance (negative)—December 31, 1985		($1,727)

NOTE: Figures within parentheses represent negative fund balances or subtractions from the fund.

a. Based on data supplied by Michigan Employment Security Commission, June 1982. (See text for more description of changes.)

b. From Table 4.

c. Includes state share of extended benefit costs.

d. Before allowance of credit for FUTA penalty tax paid.

and labor, between positive and negative account employers, and even between workers with more and those with less stable employment.

Avoiding a 1985 FUTA Solvency Rate Increase

A key planning factor will be to agree on some goal reachable during the period. Of the goals enumerated earlier, the least burdensome is to minimize or altogether avoid the solvency rate increase on the FUTA tax that will apply to 1985 payrolls beyond the penalty rate increase.

The penalty tax for that year is scheduled to rise to 1.2 percent of federal taxable wages. A maximum solvency tax of 1.5 percent could be added making the total of penalty and solvency taxes due in January 1986 a projected $486 million. That would amount to a tripling of the FUTA tax increase paid the previous year and, of course, would apply uniformly to all employers. To avoid any solvency tax for 1985, the average state tax rate for 1985 would have to equal the average benefit cost rate based on outlays of the previous five years. Without any changes in current UI provisions, the projected averages show that 1985 state tax revenues would be short of this requirement by about $500 million.[37]

Changes to bring about the needed revenue increases could be made to take effect in 1985. Earlier changes would not be necessary if avoiding the solvency rate were the only goal to be pursued. Based on projections for 1985 shown in Table 5, the increases in employer state taxes that year resulting from the $9,000 wage base, the higher ABC multiple, and the elimination of the limiter would total slightly over $500 million. Because of the higher wage base, the credit allowed for the FUTA penalty tax paid would be about $20 million more bringing the net increase down to below $500 million. A 0.5 percent employee tax in 1985 on the $9,000 base would yield $124 million. It would even be possible, based on these

projected figures, to reduce or eliminate about $100 million of these changes through, for example, a smaller wage base increase, a lower employee tax rate, or retention or an enlargement of the limiter, and still meet the revenue requirement to avoid a solvency tax increase for 1985.

It should be noted that lowered benefit outlays in 1985 would not contribute toward this particular goal since that year does not enter into the five-year benefit cost averaging. Benefit reductions in 1983 and 1984 would help to lower the average cost rate somewhat.

If the solvency tax is avoided by raising $500 million in additional state taxes in 1985, with no other changes the projected total outstanding debt at the close of that year would equal about $3.3 billion. Although some interest costs would be saved after 1985, they would continue to run very high. It should be remembered that the proceeds of the FUTA penalty taxes all apply to reduce the noninterest-bearing portion of the debt first. Apart from some interest savings, the main advantage gained would be to raise the added revenues through experience-rated taxes, as generally preferred, rather than by a uniform rate. The FUTA penalty rates would continue upward in later years. While the smaller solvency rate additions could be avoided by similar action, the advantage narrows.[38]

Keeping the Debt from Growing

To avoid the need to borrow further funds after 1982 would be a substantial accomplishment. The projections (Table 4) indicate that the debt will probably rise from $2.2 billion to more than $3.8 billion over the next three years if current UI provisions remain unchanged. Table 5 illustrates how this goal can be achieved, and even exceeded.

The changes indicated would not forestall the need to borrow about an additional $160 million in 1983. While benefit outlays would be cut to less than $1.3 billion that year, in-

creased state tax revenues, including the employee tax, would still fall short by this much. (The total debt outstanding at the end of 1983 would rise by less than this amount because of the FUTA penalty tax payment applied to the noninterest-bearing portion of the debt.) That result could be avoided, for example, by raising the taxable wage base to more than $7,000 for that year, or by a larger employee tax rate, or some combination of the two; or by some additional benefit cuts. Assuming that only the changes shown in Table 5 are adopted, then no additional loans would be required in 1984 and, indeed, a surplus generated from operations that year would permit repayment of about half the amount borrowed in 1983. With the 1984 FUTA penalty tax payments, the total debt would be down to below $2.2 billion by the end of the year. The projected operating surplus grows to nearly $250 million in 1985 with the illustrated changes, allowing a substantial debt reduction that year. If a smaller effort is preferred in 1985, changes producing higher revenues could be eased, such as holding the taxable wage base at the 1984 level of $8,000, or reducing the employee tax rate. The freeze on the maximum WBA could be relaxed to allow for some benefit increase, or some other restriction on benefits or eligibility could be eased to reduce the effort. If the goal is confined to keeping new debt from rising above the 1982 year-end level, then there would be room for a lessened burden in 1985.

On the other hand, to confine the 1985 effort to satisfying only that goal could lose the opportunity to avoid a solvency tax increase for 1985. The changes shown on Table 5 would accomplish that goal as well. Indeed, taking account of the estimated state revenue increases illustrated for 1985, projected state revenues for that year would exceed by about $160 million the level required to avoid a solvency tax increase, as determined by the average annual benefit cost projected for the 1980-1984 period. Holding on to *all* of the changes shown for 1985 would reduce the interest-bearing

portion of the debt to about three-fourths of what it would be if the effort were limited to keeping that portion down to the 1982 level.[39]

Another consideration to bear in mind is that the state's economy might be improved enough in 1985 to make it easier to handle the heavier burden. If so, that would be the more favorable time to step up rather than reduce the effort. That judgment, however, can be made more appropriately in the latter half of 1984.

Other Goals

A third goal listed earlier is to cap the FUTA penalty tax at 0.9 percent for 1985. Given the scenario illustrated in Table 5, it appears that projected revenues for 1985 would fall short of the required level to qualify for the cap by about $160 million.[40] A larger taxable wage base increase, or higher employer or employee tax rates, could produce the additional amount needed.[41] Whether to make the extra effort is a decision that may be determined on a more solid basis in 1984.

Another goal discussed earlier is to liquidate the interest-bearing debt as soon as possible so as to reduce and eliminate interest costs. As of the end of 1982, about $640 million of the projected debt of $2.2 billion is estimated to be interest bearing. The changes illustrated on Table 5 result in a projected debt level by the end of 1985 down to a little over $1.7 billion. About $475 million would remain subject to interest. To raise this much more in added revenues and benefit cost savings during the same period would require more severe changes than illustrated. One would need to consider such possibilities as higher tax bases, higher tax rates for employers and employees, and further cutbacks in benefit amount levels beyond holding the maximum frozen. It will be difficult enough to achieve the illustrated changes, let alone larger changes or others in addition.

As pointed out earlier, a cap on the FUTA penalty tax increase for 1984 at 0.6 appears to be out of reach. State tax revenues in 1984, with the changes illustrated, would be about $80 million short of the specified requirement. More difficult, however, is that in addition to the changes projected in Table 5 for 1983 and 1984, about another $1 billion would be needed to reduce the debt to the required level.

Summing up, then, it appears that efforts to avoid a solvency rate in 1985 and to keep the debt from rising above the level expected at the end of 1982 are within reasonable bounds, though not to be considered easy to achieve. If economic conditions improve as hoped, it may be possible to go further. Even capping the penalty rate at 0.9 percent for 1985 might become a plausible outcome if all goes well. In any case, about mid-1984 may be the right time to review the problem again in the light of conditions at that time.

Proposed Federal Changes 6

Over the years, the tendencies in Congress have been to tighten federal UI loan and repayment provisions. As more states have borrowed increasing amounts from the loan fund, concern has grown over a lack of financial discipline at the state level. The imposition of interest on loans made after March 1982 is the latest in a series of moves to make borrowing less attractive to the states. The objective is to encourage stronger state efforts to assure financial solvency for their UI funds.

At the same time, however, the problem remains that the timing, frequency, and severity of cyclical economic downturns are not easily or accurately predictable. Experience since 1970 has included four recessions with varying effects on the states. Over half of the states have had to borrow at some time during this period. That unexpected experience followed nearly a decade of almost continuous prosperity and growth, also unexpected. While a lack of responsible UI financing has contributed to the insolvency problems of a number of states, it is the unpredictable and uneven impact of recessions on individual states that causes the basic difficulty in planning for financially solvent programs. Michigan has been a prime example of this problem.

Proposals for Short Term Relief

The debt problem in Michigan and other states has led, from time to time, to suggestions for some relaxation of the federal repayment provisions. Appeals for outright forgiveness of part or all of a state's indebtedness are not taken seriously since that step would amount to discriminatory treatment. It would be unfair to states which borrowed little or none at all, or repaid their loans quickly, through strong efforts to remain solvent or to restore solvency.

Proposals to delay repayment or stretch it out over a longer period have brought some response in the past. Because of the severity of the recession of the mid-1970s, states which borrowed were allowed an extra three years before beginning debt repayment, although they had to meet certain minimum requirements in regard to their tax provisions to qualify for the extension. By the time this extension ended, another recession had developed posing further financial difficulties for some of the borrowing states. Rather than begin the repayment process then through the FUTA progressive tax increases, Michigan chose to repay its entire debt at the close of 1979, since it had accumulated the funds to do so, and to obtain new loans very soon thereafter. Repayment of the new debt through FUTA tax increases will not begin until January 1983, three years after the new borrowing began.

The current recession generally has been about as serious as that of the mid-1970s, and even worse in some states. Congress, however, has not been inclined to delay the repayment process again. Instead, through the amendments adopted in 1981, states were offered the option of leveling out the FUTA penalty tax rate increases by capping the rate, during a period of several years, if they exerted greater efforts toward regaining solvency. Michigan leaders and Con-

gressional delegates have recently pressed for some postponement of federal tax rate increases and suspension of interest charges for states that experience very high rates of insured unemployment and maintain above-average tax efforts. Another proposal advanced by Michigan representatives is to allow states to make the repayments called for by the FUTA tax increases from state UI tax funds instead so as to apply experience rating to these past costs. That approach would also relieve the problem of the FUTA increases on new employers.[42]

Congressional reluctance to ease debt repayment provisions may reflect the attitude that the states have not done enough to improve the solvency prospects for their programs. Not very many states have been in so serious a predicament as Michigan, thus limiting the number of states pressing for relief. Moreover, since UI trust fund transactions are included in the consolidated federal budget, there may be a fair amount of resistance at the federal level to changes that reduce or delay inflows of funds from loan repayments amid efforts to cut down federal budget deficits. The estimated totals of UI loan repayments and interest rise from about $900 million in fiscal year 1982 to about $2.5 billion in fiscal 1985.[43]

Long Term Remedies for Insolvency

Federal budget concerns may partly explain the total neglect of certain recommendations of the National Commission on Unemployment Compensation, made in 1980, which would help ease some of the UI financial problems in the states.[44] These recommendations view a portion of the UI benefit costs for long term unemployment of the national recession of the mid-1970s as an appropriate burden of general revenues of the federal government rather than of UI tax funds. Under one proposal, federal general revenues would reimburse the states for the state share of any extend-

ed benefits they paid in 1975 through 1978 when the national trigger was on.[45] A total of $3.3 billion would be restored to state funds to be used for current benefit needs or debt repayment. The other recommendations call for retroactive general revenue financing of the federal share of extended benefits paid during the same period and of federal supplemental benefits paid in the earlier part of that period, which had been financed by FUTA tax revenues.[46] A total of over $9 billion is involved for these federal benefit costs. The present basic net FUTA tax rate of 0.7 percent includes 0.2 percent to cover most of these costs which were financed at the time by advances from the U.S. Treasury. In effect, those advances would be cancelled and the FUTA tax rate could thereby be reduced. Besides the federal budget concerns noted above, opposition to any general revenue financing of UI benefits discourages serious consideration of these recommendations.

A more fundamental remedy for the insolvency problem is that of reinsurance or cost equalization. These approaches have been considered and debated over the years, especially when states encountered financial difficulties. Interest and support probably reached their highest levels in the late 1970s when so many states were insolvent. While insolvency remains and has again grown more widespread, interest in and support for reinsurance have receded. The subject is complex, controversial, and politically divisive.[47]

The cost equalization or reinsurance concept provides for a second line of protection against extremely high or catastrophic costs that may be beyond the means or resources of individual insurers. Reinsurance against such costs is broadly pooled among all insurers. In UI terms, extreme or "catastrophic" benefit costs are defined as those associated with very high levels of unemployment in a state.[48] A national reinsurance or cost-equalization fund, established from a uniform tax applicable in all states, would

finance a portion of those costs. With such a scheme in effect, the worst UI cost extremes of recessions experienced by some states would be eased. State planning for the financial solvency of their UI funds would be easier and more reliable. A major supporting argument for reinsurance is that national recessions arise from developments and carry effects that are not confined within states lines. The recessions that Michigan and some other states have been experiencing have reached extremes because of national and international factors for which, it is argued, the employers of those states cannot be held solely responsible when it comes to UI costs. Opponents argue that even these high costs are not beyond the means of the individual states and that pooling contravenes the cost allocation objective of experience rating. Most states, moreover, believe they would never benefit, or benefit very little from reinsurance or cost equalization depending on how the key elements are defined.

Various reinsurance and cost equalization plans have been advanced in past years. The National Commission on Unemployment Compensation conducted a thorough review of the different ideas it received and recommended a modest version of one.[49] Based on past experience, Michigan would stand to benefit more than most states from almost any reasonable plan.

Another approach to easing the state burdens of extreme recession benefit costs is to pool nationally more of the costs of long term benefits, carrying further the degree of sharing now applicable in the case of triggered extended benefits. One version of this idea is contained in a suggested restructuring of the UI system developed elsewhere by this author.[50] In that plan, benefits paid to compensate for increasingly long term unemployment would be increasingly pooled on a national basis. States would finance all the costs of the first 13 weeks of benefits, share equally with the federal government the costs of the next 13 weeks, and pay none of the

costs of the 27th through the 39th weeks of benefits which would be entirely financed by the federal unemployment tax. Since the duration of unemployment lengthens in recessions, the states that are hit the hardest would benefit the most from increased federal financing of long term benefits. The underlying rationale is that unemployment which continues beyond the usual limits of a short term, temporary layoff is more likely to have characteristics of a permanent job dislocation in a labor market adversely affected by external conditions. The remedy for the individual's problem may require close job search assistance, job development, vocational guidance, retraining and other adjustments. Long term unemployment—its character, treatment, and costs, including UI—appears increasingly removed from the concepts of experience-rated employer financing and individual state responsibility.[51]

Summary and Concluding Observations 7

Summary

At mid-1982, the Michigan unemployment insurance trust fund owed a total of $1.6 billion to the federal loan fund. Further borrowing will probably raise the debt to about $2.2 billion by the year's end. Loans made before April 1982 bear no interest, but subsequent loans do. Even with some modest, gradual decline in the state's high unemployment levels, without changes in its present UI provisions, the tax structure will not raise sufficient revenues to come close to covering the benefit outlays projected over the next several years. The debt, therefore, can be expected to grow. As estimated in June 1982, it could reach $2.8 billion by the end of 1983 and rise by another half billion in each of the next two years. The interest liability alone would come to several hundred million dollars in this period and would have to be paid from funds outside the UI program.

Beginning with the tax applicable to 1982 taxable payrolls and payable in the following January, the uniform federal tax rate levied under the Federal Unemployment Tax Act (FUTA) will rise for all Michigan employers by 0.3 of a percentage point each year, progressively. These "penalty"

rate increases go towards reducing the debt. The increase will be 1.2 percent for 1985, to which could be added a "solvency" rate of as much as another 1.5 percent. Payable January 1986, this combined maximum FUTA increase of 2.7 percent for 1985 is projected at about $500 million, assuming the present federal taxable wage base of $6,000. Penalty taxes for the three previous years are estimated to total about $300 million.[52] Even with these repayments, the interest liabilities remain undiminished since the FUTA tax increases apply to reduce the noninterest-bearing portion of the debt first.

Michigan employers generally, and especially those who have generated little or no UI costs, object to the FUTA tax approach to debt repayment because it assesses the burden uniformly among all employers, contrary to the preferred approach of experience rating. The state's UI tax rates vary among individual employers between a minimum of 1 and a maximum of 9 percent of taxable wages on the basis of their benefit cost experience. At mid-1981, nearly half of all rated employers had negative account balances—past taxes they had paid in were exceeded by the benefits charged to them. Positive account employers feel that since they are not responsible for the debt, they should not be burdened with its repayment. They prefer to see state taxes increase in ways that will draw more heavily from negative account employers, such as firms in construction and auto manufacturing. In turn, the latter argue that their businesses are too depressed to take heavy tax increases at this time.

To help overcome the insolvency problem, discussions have centered on changes in state UI provisions designed to increase revenues and reduce benefit outlays. The immediate objectives are to stem the borrowing and, possibly, begin to cut the debt during the next few years. Because of the problem's severity and the current economic distress, efforts by both employers and workers are emphasized in working toward these goals. On the revenue side, the most prominent changes include increases in the state's taxable wage base,

larger annual increases in tax rates by easing restrictions that now limit such increases, and a temporary employee tax. Changes examined on the benefit side that would restrict outlays include holding the weekly benefit maximum at its current $197 level instead of allowing it to index upwards, establishing a noncompensable waiting week, and increasing from 18 to 20 the minimum number of weeks of work required to qualify for benefits.

Using estimates provided by the Michigan Employment Security Commission (MESC), based on projections that agency made in June 1982, several changes were selected to illustrate how they might affect revenues, outlays, and the debt over the 1983-1985 period (see Table 5). The changes include raising the tax base from its present $6,000 level by $1,000 each year to $9,000 in 1985, eliminating the limit of 0.5 of a percentage point on annual tax rate increases, altering the formula to allow for a larger annual increase in the account building component of the tax for employers with inadequate account balances, and setting an employee tax at 0.5 percent of taxable wages. They also include the three changes noted above on the benefit side. The combined increase in revenues and reduction in outlays projected over the three years are substantial, totaling over $2 billion. These changes, together with estimated FUTA penalty tax payments in these years, would keep the debt from rising much above the $2.2 billion level after the early part of 1983, and make possible some reduction in 1984 and a sizable reduction in 1985 to about $1.7 billion by the end of that year. Interest costs would be considerably lower as a result. The changes would also enable the state to avoid a solvency rate addition on the FUTA tax for 1985.

As emphasized more than once in the course of this paper, the projections of UI fund transactions and debt for the next several years represent estimates based on various assumptions about economic conditions and related experience patterns which may not, and probably will not endure. That is

especially so in times of uncertainty, stress, and change as characterize the current period. It would be prudent, therefore, to expect that events and new experience will require altered projections from time to time, perhaps considerably altered in some respects. The main value of looking ahead, even somewhat speculatively, is to obtain some idea of the general dimensions of the insolvency problem and what potential remedies might contribute to its control and reduction. Projections beyond 1985 are not used since the further out in time they go, the more tenuous they become. Program changes probably are best planned for the next two or three years only, with a fresh review before proceeding further.

The projected effects of the UI changes selected to illustrate what could be accomplished over the 1983-1985 period show heavy burdens and sacrifices on the part of employers and workers (Table 6). Of the total of $2.1 billion in added state revenues and reduced outlays in these years, employer tax increases resulting from the changes account for about 54 percent, the employee tax about 16 percent, and the benefit reductions about 30 percent. Adding the FUTA penalty taxes payable in these three years (about $300 million) raises the total effort to over $2.4 billion and the employers' share to 58 percent The combined effects grow larger each year with less than 25 percent of the 3-year total coming in the first year and over 40 percent in the third. The hope is that the increasing size of the changes will be matched by improvements in the economy, making them somewhat easier to sustain. It has been noted that the higher state tax revenues produced by the changes in 1985 would preclude any solvency addition to the FUTA tax for that year. In effect, that result would offset over half the projected 1985 increase in employer state taxes substituting an experience-rated for a uniform tax.

As summarized in Table 7, the projections show that the state average UI tax rate of Michigan employers will prob-

ably hover around 1.3 percent of total payrolls between 1982 and 1985 with no changes in current tax provisions. Adding the basic FUTA taxes and penalty rates for these years, and the solvency rate increase for 1985, the combined average rate rises from 1.6 percent in 1982 to 1.8 percent in 1984 and then jumps to 2.3 percent in 1985. With the tax changes noted and illustrated in Table 5, the average state tax rate increases to 2.1 percent by 1985 while the combined state-federal rate rises to 2.6 percent by that year.

Table 6
Summary of Estimated State Revenue Increases and Outlay Reductions Resulting from Illustrative UI Changes, Michigan 1983-1985

	(Estimate of change—in millions)			
Type of change	1983	1984	1985	Total 1983-1985
Increased revenues:				
Employer taxes	$253	$400[a]	$486[a]	$1,139
Employee taxes	97	113	124	334
Reduced benefit outlays	143	224	277	644
Total	$493	$737	$887	$2,117

SOURCE: Table 5.

a. Net of additional credit allowed against state tax, due to increased state taxable wage base, for half the FUTA penalty tax rate.

Even given continued slow but steady improvement in the state's economy and a gradual decline in unemployment, many years of strong effort may be needed to repay the debt completely and rebuild the fund to adequate reserve levels. Any recurrence of a cyclical downturn would probably reverse at least some of the gains made and require renewed borrowing. Not to expect one or more recessions over the next 8 to 10 years, however, would seem to be unrealistic.

Table 7
Projected UI Taxes and Average Tax Rates Paid by Michigan Employers Under Current (1982) Law and With Illustrative Changes 1982 - 1985

	(Dollar figures in millions)			
	1982	1983	1984	1985
Under current (1982) law				
State UI taxes	$644	$770	$855[a]	$892[a]
Federal (FUTA) UI taxes[b]	160	221	288	612[c]
Average UI tax rate (as percent of total payrolls):				
- State	1.3%	1.3%	1.4%	1.3%
- Combined state-federal	1.6	1.7	1.8	2.3
With illustrative changes (1983-1985)[d]				
State UI taxes	$644	$1,023	$1,255[a]	$1,378[a]
Federal (FUTA) UI taxes[b]	$160	221	288	342
Average UI tax rate (as percent of total payrolls):				
- State	1.3%	1.8%	2.0%	2.1%
- Combined state-federal	1.6	2.2	2.4	2.6

SOURCE: Based on projections prepared by the Michigan Employment Security Commission in June 1982.

a. Net of FUTA penalty rate credits allowed against state tax in 1984 and 1985.

b. Includes basic net tax of 0.7 percent and penalty rate increases applicable for year and payable in January of the following year.

c. Includes solvency rate addition applicable for 1985 and payable in January 1986.

d. See Table 5.

The changes described for the Michigan UI program and the added burdens they entail for employers and workers over the next few years are painful, perhaps more than they can reasonably be expected to bear under current and anticipated conditions. Congress is being urged to provide some relief from federal repayment and interest re-

quirements during a period of economic distress for states in such difficulty, mainly by allowing more time for recovery first. Some effort to deal with the problem at the state level may be necessary before a favorable federal response can be expected. For the longer run, there remains the problem of severe and uneven impact of regional, national and international dislocating factors on state economies. To hold employers within a heavily impacted state fully liable for all UI costs that may be traced to such external causes raises some question about the proper balance between state and national considerations. The remedies that have been advanced and debated for this kind of problem include national UI cost equalization or reinsurance schemes and enlarged national pooling of long duration unemployment benefit costs. Further consideration of the problem and of such approaches is warranted.

Some Concluding Observations

At present, each state remains responsible for its own UI benefit costs regardless of how severe unemployment becomes or its cause. Only when extended benefits are payable for long term joblessness during recession periods is there some broader national sharing of part of these costs.[53] Given current experience and that of the past decade or so, unemployment seems likely to remain a larger and more costly problem than it was in the previous twenty years. Individual states, therefore, should probably plan to accumulate larger benefit reserves than they had before to assure fund solvency and to minimize the need to borrow, particularly if their experience and industrial characteristics make them vulnerable to recession extremes or prolonged structural changes in their economies.

The predominant view of unemployment insurance financing in this country regards benefit costs primarily as part of the cost of business operations allocable to the goods and services produced, and, through the price mechanism,

subject to the competitive discipline of the market system. That view underlies the experience rating concept in UI taxes. There are limits, however, to the application of this concept. Within states, some pooling occurs of costs that are not charged to individual employers, or which are not entirely recovered even if charged. These include benefits charged to employers who terminate their business with no funds remaining to cover their UI liabilities, or benefits not *effectively* charged to employers who always have negative account balances because of chronically heavy seasonal layoffs. In many states, including Michigan, the state share of extended benefit costs is not charged to individual employers.

Where the limits are drawn on experience rating varies considerably from state to state. For example, in only 2 states was it possible in 1982 for employers to qualify for a zero tax rate, but in 11 others the minimum rate was 0.1 percent or less; the minimum exceeded 2.0 percent in 7 states.[54] Maximum tax rates varied in 1982 from 2.8 percent in Utah to 10.0 percent in Kentucky. Even at the maximum rate, there are always some employers whose taxes never cover their benefit charges. A top limit is set to keep the tax from becoming so prohibitive as to drive these firms out of business or out of the state.

Michigan's high maximum tax rate of 9.0 percent appears to confirm the state's strong commitment to the experience-rating principle.[55] On the other hand, its current taxable wage base of $6,000 is so low, relative to wage levels generally, as to nullify much of that commitment. That is especially so since so many high-cost employers are also high-wage employers, or at least they account for a disproportionate share of all payrolls. The 0.5 limit on annual tax rate increases in Michigan accentuates that effect. (Curiously, the lowest state tax rate ceiling of 2.8 percent in Utah is not much different from the maximum rate of 9.0 percent in Michigan when both are converted to a total payrolls basis since Utah's taxable wage base is set at 100 percent of the

state's average annual wage while Michigan's base is about a third of its average annual wage.)

Raising the taxable base in Michigan is probably the most significant step that can be taken both to deal with the current debt and to assure the future solvency of the state fund. Low-cost employers currently tend to favor this move, along with ending the tax increase limiter and speeding the rebuilding of individual employer account balances through higher ABC rates, all designed to recover benefit costs as charged. The alternative is to finance more of these costs through the uniform state tax component (NBC) and FUTA penalty rate increases. High-cost, high-wage employers, who in most cases also support experience rating but who have been seriously affected by the recession (particularly firms in auto manufacturing, construction, and related industries) oppose these changes at this time, or at least oppose the adoption of all of them at once. Whatever the current solution adopted, however, the long term need to raise the taxable wage base to a much higher level and to maintain it in a reasonable relationship to average wage trends must be addressed eventually.

The undesirable disincentive effects of the FUTA penalty tax increases with respect to new employers has been noted. Since penalty tax proceeds apply to reduce the debt to which new employers had not contributed, some means of offsetting or relieving them of this tax charge would be appropriate. Until experience rating is fully operative for them, new employers do not have an NBC rate against which to allow the credit provided other employers for half the FUTA penalty rate. It might be useful to consider a deferred credit allowance against a new employer's NBC rate when the latter applies even though the credit is taken after the normal time. Perhaps a 100 percent credit could be allowed in such cases instead of only half. Federal law may not permit this approach, in which case an enabling amendment could be sought to allow it, or in some other way relieve new

employers of the penalty tax. The state is not required to charge new employers the standard rate of 2.7 percent; it could be lower. Several states do apply lower rates until experience rating applies.[56] Michigan might want to consider this approach. Another alternative would be to allow new employers to take a credit against the state's Single Business Tax for the FUTA penalty tax paid.

The various measures representing what workers may contribute toward reducing the debt are also difficult to contemplate in the current economic climate. Labor has not paid close attention in the past to UI financing, considering that to be strictly an employer concern. As is evident, however, inadequate financing can raise problems for the benefit side of the program. A small temporary UI tax on employees, perhaps one that would take effect when the fund is below a specified solvency level, could help balance labor's interest in the program on a long term basis while helping to overcome the present insolvency.

Other changes considered above—the waiting week, a higher qualifying requirement, and a freeze on the WBA maximum—are bitter pills for labor to swallow. There has been some tendency to blame much of the state's financial difficulties in UI on allegedly overly generous benefit and eligibility provisions. The current high dollar weekly maximum is often cited as an example in comparisons with other states. A few facts should be noted to place such claims in perspective. As of July 1982, eight states paid weekly benefit amounts higher than Michigan's current maximum of \$197.[57] More important is the relationship of benefits to wage levels. Except for Alaska, Michigan's average wage clearly exceeds that of all other states (Alaska's WBA ceiling is \$222 for claimants with three or more dependents). Michigan's maximum WBA in relation to its average wage level, set at 58 percent, is as high as or higher than the comparable relationship in about half the states. While Michigan's adoption of this level for the maximum in April

1981 did increase benefit outlays sharply over what they would have been otherwise, it must be remembered that the former level was very low, unchanged since 1975. The mistake was to have increased weekly benefits without providing the needed additional financing for them at the same time. In effect, the 1975 weekly maximum of $136 (less for claimants with fewer than four dependents) was frozen at that level for over five years while Michigan overcame its earlier debt problem. Even without the increase in the ceiling in April 1981, unemployment has been so high in the state that the fund would have been deeply in debt in any case. Almost $900 million of the current debt was incurred before the new benefit provisions went into effect.

Michigan is 1 of only 11 states that have no waiting week, although 7 additional states compensate that week retroactively after the unemployed worker has drawn benefits for at least a specified number of weeks, ranging among these states from 3 to 9 weeks. As for the qualifying requirement, Michigan's minimum of 18 weeks of base-period employment is about as high as or higher than that of nearly half the states; 26 states require 20 or more weeks of work, or some equivalent spread of earnings over the year. Michigan's benefit duration provision is about average and its major disqualification provisions, like most states, now call for a minimum amount of earnings (or work) after the disqualification to requalify for benefits. In general, Michigan's eligibility and benefit provisions are not out of line in comparison with other states.[58]

To what extent labor may be willing to forego gains made, even temporarily, may depend on how well employer financing faces up to the insolvency problem. In the interest of job security and employer continuity, workers recently have shown some willingness to restrain wage and benefit demands. Cooperation in resolving the present problem is also important to a reasonable solution and to longer term fund solvency as well.

The possible changes in the state's UI program reviewed in this paper have been examined for their estimated effects on the fund for the next several years. Even if all changes were to be adopted and the projections were to come fairly close to actual experience, there would still remain a substantial debt at the end of 1985 and the task of building an adequate reserve beyond that. It will be necessary to return to dealing with the problem and to consider further program changes or extensions of earlier changes. Experience, moreover, probably will not coincide with projections, and the problem could take unforeseen turns. The long term outlook promises more questions to resolve, more controversy, and the need for continuing study and analysis.

In view of the sensitive nature of the problem, as well as its long term aspects, it might well be worth considering the establishment of a broadly representative, high-level group of citizens of the state as an independent body to maintain a continuing study of the UI insolvency problem and to provide recommendations for treatment. Such an approach should not be the occasion for any delay of the action needed now for the next two or three years. The task would be to review the situation and experience with the changes made in place and to determine what might be done thereafter. The group should be constituted so as to command the widest respect and authority. Although it must reflect and take account of the major economic interests that are concerned, the group must keep foremost the overall interest of all the people of Michigan. The problem of the state's debt and continuing insolvency is too large and too serious to leave to a desultory process for its eventual resolution.

Supplementary Note
New Federal Legislation

As this paper was being prepared for publication, Congress adopted a number of amendments to the provisions of the Federal Unemployment Tax Act (FUTA) which have an important bearing on Michigan's UI financing problems. The FUTA amendments were included among a group of tax changes designed to raise more federal revenues over the next several years to help reduce the large budget deficits projected over that period. The tax changes are contained in the Tax Equity and Fiscal Responsibility Act of 1982 (H.R. 4961) passed by the Congress August 19, 1982. This note summarizes the relevant elements of the FUTA changes and how they may alter the analyses presented in the paper.*

Increase in FUTA Tax Base and Rate

One of the amendments raises the taxable wage base for the federal unemployment tax from $6,000 to $7,000, and increases the net basic FUTA tax rate from 0.7 to 0.8 percent (the total rate increases from 3.4 to 3.5 percent less the 2.7 percent tax credit). Both increases become effective in calendar 1983.

The increase in the federal base requires the Michigan UI taxable wage base also to rise to at least $7,000 in 1983. A $7,000 base is one of the changes illustrated for Michigan

*This summary was prepared from excerpts of the report of the House-Senate Conference Committee on the bill.

that year in chapter 5 (see Table 5). The annual progressive 0.3 percent FUTA penalty *rate* increases will be the same, but the projected *amount* of the tax increases they represent is almost 15 percent more than that shown for the years affected because of the higher base. Thus, the projected total of penalty tax payments due in 1984 and 1985, based on 1983 and 1984 payrolls, respectively, rises by about $36 million, producing more debt reduction by 1985.

The increase in the net basic FUTA tax rate from 0.7 to 0.8 percent does not affect the Michigan UI fund. Its purpose, along with that of the federal wage base increase, is to raise FUTA tax revenues to finance more adequately the program's administrative costs and the federal share of extended benefit costs.

Elimination of the FUTA Solvency Rate Addition

As part of the FUTA tax increase method of making UI debt repayments, the provisions adopted in 1981 called for adding a solvency rate to the penalty rate increase. In Michigan's case, the solvency rate would be added each year, beginning with the year when the penalty rate reaches 1.2 percent, and is based on a comparison of the prior five-year average cost rate and the current year's average tax rate. The addition would apply unless certain state revenue conditions are met (see "Repayment Provisions" in chapter 3). Without any change in current state UI provisions, Michigan employers would face a solvency tax addition of 1.5 percent for 1985, payable in 1986, resulting in the loss of the entire FUTA tax credit of 2.7 percent. The FUTA solvency tax addition for that year is projected to total about $270 million on the $6,000 taxable wage base or $310 million on the $7,000 base. It would require adoption of most of the state UI tax changes illustrated for 1985 on Table 5 to avoid the addition of the solvency tax.

One of the FUTA amendments adopted in August 1982 eliminates the solvency rate addition based on comparisons with average cost rates as part of the repayment process. The FUTA penalty rate increase continues to apply and rise, progressively, by 0.3 per year.

With the solvency rate addition out of the picture, the state tax increases produced by the changes illustrated in Table 5 for 1985 could be substantially reduced if the goal is confined to keeping the debt from rising above the $2.2 billion level projected for the end of 1982. As noted earlier, however, easing the effort would lose the opportunity for significant reduction of the debt, particularly of the interest-bearing portion. If the state's 1985 economy appears capable of carrying the larger UI tax burdens called for by the changes illustrated, that would be an opportune time to press for debt reduction.

State Fund Repayment Option for Penalty Tax

Under a new provision added by the August 1982 FUTA amendments, a state may choose to pay from its own UI funds, accumulated through increased tax revenues, an amount equivalent to the FUTA penalty tax due, instead of the amount being collected through the uniform FUTA tax. In doing so, the debt repayment could be made through funds raised as the state chooses, including increases in experience-rated taxes, thereby overcoming a major objection to the uniform FUTA tax approach. Repayment through state UI funds would also solve the problem for the new employer who would be subject to the FUTA penalty tax increase.

The state, however, must meet certain other conditions in order to choose this option. These include having enough accumulated in the state UI fund to cover expected benefit

costs in the three months following the payment (from November 1) without resorting to further loans in that period, and the repayment of all loans made during the year for which the penalty rate applies. The objective is to assure that the state does not relax its effort to regain solvency by shifting gains it is making to cover the payment of the penalty tax equivalent. These conditions probably will be very difficult to meet for 1983 when a 0.6 percent FUTA penalty rate applies, even if all state UI program changes illustrated in Table 5 are adopted. The chances for the option would be better in 1984 with those changes.

Deferred Interest Payment in Recession

Another FUTA amendment allows a state liable for interest on UI loans to defer 75 percent of the amount due for a given fiscal year if its insured unemployment rate in the January-June period of the preceding calendar year averaged 7.5 percent or more. One-third of the deferred interest would become payable in each subsequent year in which the specified insured unemployment rate requirement was not met until the total amount deferred was paid. Additional interest accrues on the portion deferred.

Michigan's insured unemployment rate for the January-June 1982 period averaged above the 7.5 percent level. As a result, only one-fourth of the interest payment due October 1983 for fiscal 1983, projected at about $84 million, need be paid then—about $21 million—if the state chooses to defer.

Effects on Average State-Federal Tax Rates

Table 7 (in chapter 7) compares employer UI taxes and tax rates projected under current law with those estimated after allowing for the changes illustrated in Table 5. Among the data reflecting the changes, the estimated amount of federal taxes shown as paid in the 1983-1985 period would be over 20

percent more because of the higher federal wage base and rate. The combined average state-federal UI tax rate on a total payrolls basis would still round to 2.2 percent in 1983 but rise slightly in 1984 and 1985, rounding to 2.5 and 2.7 percent, respectively.

The amount of federal UI taxes shown for 1985 in Table 7, under current law, reflects the projected solvency tax applicable for that year. Elimination of the solvency tax increase reduces the amount of federal taxes projected for that year on the $6,000 base by $270 million. Adjusting further for the effects of the higher FUTA base and rate, but with no changes in current state tax provisions besides substituting a $7,000 base, would probably result in a combined state-federal rate for 1985 of about 2.1 percent of total payrolls. The equivalent averages would be about 2.0 percent for 1983 and 2.1 percent for 1984.

Other Changes

Congress also adopted some other modifications affecting UI financing. One, not to take effect until 1985, would increase the gross FUTA tax rate from the present 3.4 percent to 6.2 percent and the tax offset allowed from 2.7 to 5.4 percent. The net basic FUTA rate would remain at 0.8 percent, including the temporary 0.2 now collected to repay U.S. Treasury advances to the federal UI trust fund account to cover the federal share of extended benefit costs and the costs of federal supplemental benefits paid in 1976 and 1977 prior to their financing by general revenues. The principal effect of this change would be to require all states to have a maximum tax rate in their own laws of not less than 5.4 percent, as compared with 2.7 percent now. In 1982, only 21 states, including Michigan, had maximum tax rates at least that high. The apparent objective is to increase the effectiveness of experience rating through a wider range of tax rates. One result may also be to restrain tendencies to in-

crease the taxable wage base and shift more of the burden to lower wage paying employers.

Another change would increase the proportion of FUTA taxes collected (other than penalty taxes for loan repayments) to be allocated to the federal account used to cover the federal share of extended benefit costs. The intent is to speed up repayment of past Treasury advances made to this account to cover federal extended and supplemental benefit costs it could not finance currently. The temporary 0.2 percent addition to the FUTA tax rate, imposed to repay these advances, will be terminated sooner as the result of this change.

The Congress also agreed to extend unemployment compensation for additional weeks beyond those covered by regular and extended UI benefits. This temporary program of Federal Supplemental Compensation (FSC) will be available from about mid-September 1982 to March 31, 1983. The program provides FSC to claimants who exhausted their UI benefit entitlement and who qualified for regular benefits with at least 20 weeks of base-period employment (or an equivalent distribution of base-period earnings). They may draw up to 10 weeks of FSC in states which have paid extended benefits at any time since June 1, 1982, up to 8 weeks in states with an averaged insured unemployment rate of at least 3.5 percent over a 13-week period, and up to 6 weeks in all other states. These additional benefits will be financed out of federal general revenues and therefore have no effect on the basic financing of UI.

NOTES

1. Employees also help finance benefits in Alabama, Alaska, and New Jersey.

2. Taxable payrolls accounted for only about a third of total payrolls as estimated for 1981.

3. Prior to 1972, only Alaska and Pennsylvania actually had to use borrowed funds to pay benefits; Michigan borrowed funds in 1958 but never had to use them to pay benefits. Several other states qualified for loans in the late 1950s but chose not to borrow.

4. Congress had under consideration in August 1982 a proposed increase in both the FUTA tax base and rate, to become effective in 1983 (see Supplementary Note).

5. The tax credit allowed to an employer is for state UI taxes paid up to the 2.7 percent level, but if the employer pays a state tax that is lower than 2.7 percent because of experience rating, the full 2.7 percent credit is allowed. All employers qualify for the full credit on this basis.

6. Nonprofit and governmental employers are not subject to the federal tax.

7. Annual federal grants to the states cover all their UI program administrative costs.

8. The state and federal governments share equally the costs of extended benefits paid to insured unemployed workers who exhaust their regular state UI benefits during periods of high unemployment.

9. The minimum solvency standard is 3.58 percent of total payrolls, representing the highest 12-month benefit-cost ratio experienced by the state since 1956. That occurred in the 12 months ending November 1975. The ABC tax rate for an employer is calculated by the following formula:

$$\frac{.25\ (.0358 \times \text{total payroll} - \text{current balance})}{\text{total payroll}}$$

10. An NBC tax applies as long as the total state fund (excluding debt outstanding) remains below a specified solvency position; as the fund rises sufficiently towards that level, the NBC rate declines and becomes zero when it reaches or exceeds that level.

11. Federal borrowing and repayment rules were stiffened after this experience.

12. Although repayment was not required until the following November, the funds available at the time would have gone to pay benefits in 1980 instead, leaving none for loan repayment, and the FUTA tax rate increases would have begun in 1980. The new loans necessary in 1980 were not due for repayment until November 1982. Full repayment of the earlier debt, therefore, postponed FUTA rate increases for two more years.

13. Provisions governing loans and their repayment are contained in Title XII of the Social Security Act and Section 3302 of the Federal Unemployment Tax Act; the repayment provisions were most recently amended by Section 2406 of the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). Additional amendments were enacted by the Congress in August 1982 (see Supplementary Note).

14. The FUTA rate increase occurs through a reduction in the 2.7 percent tax rate allowed as credit against the full FUTA tax rate of 3.4 percent.

15. The added solvency rate is the amount, if any, by which the average state UI tax rate (based on taxable wages) for the year falls short of the average annual benefit outlay of the prior five years as a percent of taxable payrolls for the year. The penalty and solvency rates combined may not exceed 2.7 percent, the amount of the full tax credit normally allowed. An amendment enacted in August 1982 will eliminate the solvency rate increase.

16. Congress amended the repayment provisions in August 1982 (see Supplementary Note) to allow states to pay the penalty tax amounts out of state UI funds instead of FUTA tax increases.

17. These unemployment estimates were developed by the Bureau of Employment and Training of the Michigan Department of Labor in cooperation with staff of the Department of Management and Budget and consultants at the University of Michigan. State unemployment estimates have been made annually as a basis for planning data called for by the full employment policy statute in Michigan.

18. The projected maximum WBA payable rises 7 percent each year to match this assumed rate of increase in the average wage level. The maximum is expected to rise from $197 in 1982 to about $211 in 1983, $226 in 1984, and $241 in 1985.

19. A negative balance occurs when the employer's tax payments from the CBC and ABC tax components have not been enough to cover past benefit charges.

20. The maximum tax rate has been 9.0 percent since 1981. It was 8.5 in 1980, 8.0 in 1979, and 7.5 in 1978.

21. Material in this paragraph is based on data supplied by MESC.

22. See Timothy L. Hunt, *The Business Climate in Michigan* (Kalamazoo, MI: The W. E. Upjohn Institute for Employment Research, 1982).

23. The penalty rate would rise to 1.5 for 1986, 1.8 for 1987, and so on. The maximum solvency rate that could be added each year would, accordingly, be lower since the combined 2.7 percent limit would still apply.

24. The proceeds of the FUTA penalty tax paid each year apply to reduce the interest-free portion of the debt and therefore do not ease the effort required to reach the interest-free level.

25. In August 1982, Congress enacted an increase in the full FUTA tax rate and in the tax credit allowed (see Supplementary Note). Suspension of experience rating therefore will require the higher rate equivalent to the full tax credit allowed.

26. The State of Washington uses this approach and is currently taxing all employers at 3.0 percent of taxable wages ($10,800 in 1982). Utah and Wyoming also provide for such suspension.

27. *Final Report of the Unemployment Insurance Financing System Working Group,* April 5, 1982, p. 1.

28. *Significant Provisions of State Unemployment Insurance Laws, July 4, 1982,* U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service. Includes Puerto Rico, which taxes total payrolls.

29. *Comparison of State Unemployment Insurance Laws,* U.S. Department of Labor, Employment and Training Administration, updated to January 1982, pp. 2-25 and 2-26, Table 201. Includes New Jersey, which sets its taxable wage base at 28 times the state's average weekly wage—equivalent to about 54 percent of the annual average wage.

30. *Significant Provisions, op. cit.*

31. See Paul J. Mackin, *Benefit Financing in Unemployment Insurance: A Problem of Balancing Responsibilities* (Kalamazoo, MI: The W. E. Upjohn Institute for Employment Research, 1978), pp. 72-74.

32. Senate Bill 581 contains these proposals.

33. These provisions are contained in Section 2404, P.L. 97-35 and Section 102, P.L. 96-499, the Omnibus Budget Reconciliation Acts of 1981 and 1980, respectively.

34. *Significant Provisions, op. cit.*

35. Prior to the change in formula, the weekly benefit in Michigan came to 60 percent of the claimant's gross weekly wage at levels below the maximum. The 50 to 60 percent range indicated for present benefits is based on gross wages before taking account of withheld federal and state income taxes and social security contributions. Some Michigan cities also require a local income tax deduction, which would lower the net wage and the benefit amount. A tax reduction, such as the 10 percent federal income tax cut effective July 1982, increases the net wage and benefit amount. The state income tax was raised for several months beginning April 1982; its rise and fall also affect the weekly benefit payment, though usually by only small amounts.

36. *Significant Provisions, op. cit.* More liberal duration provisions include those with a regular duration maximum above 26 weeks, uniform duration of 26 weeks, and a variable duration formula more generous than Michigan's which provides 3 weeks of benefits for 4 weeks of base-period employment up to the 26-weeks maximum.

37. The average of annual benefit outlays during the years 1980 to 1984, including projected outlays for the last three of those years, equals $1.4 billion, 7.8 percent of taxable payrolls estimated for 1985. Projected state tax revenues for that year total about $900 million, 5 percent of taxable payrolls.

38. Repeal of the FUTA solvency rate provision by the Congress in August 1982 (see Supplementary Note) makes pursuit of this goal irrelevant.

39. At the end of 1982, the projected outstanding debt of $2,204 million includes interest-bearing debt of $641 million. By the end of 1985, the projected FUTA penalty taxes paid in 1983-1985 will reduce the interest-free portion of the debt from its 1982 balance of $1,563 million to an estimated level of about $1,250 million. The interest-bearing portion then would be about $475 million, with all changes taken as shown.

40. The required level is about $1,660 million which represents the average (2.5 percent) of annual benefit-cost ratios (actual and projected) in the 1980-1984 period, based on total payrolls, applied to estimated 1985 total payrolls. The total state revenues projected with the changes illustrated on Table 5 add to about $1.5 billion.

41. The other key capping requirement calls for an outstanding debt level, as of September 30, 1985, no higher than that of three years earlier. By raising the $160 million additional revenues noted, that requirement would probably be met as well.

42. FUTA amendments enacted by the Congress in August 1982 will ease some debt repayment and interest provisions along these lines (see Supplementary Note).

43. *UI Outlook, FY 1983 President's Budget, Midsession Review,* prepared by U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service, Division of Actuarial Services, Washington, DC, July 30, 1982, p. 17.

44. See *Unemployment Compensation: Final Report,* National Commission on Unemployment Compensation, July 1980, p. 79.

45. The national trigger was on and extended benefits were payable in all states when the national insured unemployment rate (seasonally adjusted) over a 13-week period averaged at least 4.5 percent. A 1981 amendment of the federal law eliminated the national trigger; only state triggers now operate this program.

46. Federal supplemental benefits, which were provided to unemployed exhaustees of regular and extended benefits, were financed by general revenues after March 1977.

47. Joseph M. Becker, *Unemployment Insurance Financing: An Evaluation* (Washington, DC: American Enterprise Institute for Policy Research, 1981), pp. 40-42, 44ff; Mackin, *op. cit.,* pp. 85-90.

48. A national program of disaster unemployment assistance now exists, financed by general revenues, to compensate workers unemployed as the direct result of major natural disasters (floods, earthquakes, hurricanes, etc.), as declared by the President. Proponents of national UI reinsurance or cost-equalization schemes sometimes refer to these ideas as means of protecting against economic disasters.

49. *Unemployment Compensation: Final Report, op. cit.,* p. 102.

50. Saul J. Blaustein, *Job and Income Security for Unemployed Workers* (Kalamazoo, MI: The W. E. Upjohn Institute for Employment Research, 1981).

51. The proposed three-tiered restructuring of the UI program is accompanied by a major reemphasis on and expansion of reemployment and adjustment assistance.

52. An increase in the federal taxable wage base to $7,000 beginning 1983 (see Supplementary Note) would probably raise the amount of penalty taxes payable by approximately 15 percent.

53. Special federal benefit programs, financed entirely by general revenues, are provided to compensate for unemployment resulting from certain types of dislocations, usually in specified industries. The most prominent of these has been the Trade Readjustment Allowance program for workers laid off because of import competition. These programs lie outside the UI system and have been criticized for being discriminatory among the unemployed, duplicative, and more generous than UI. See Murray Rubin, "The Proliferation of Special Employee Protection Programs," in *Unemployment Compensation: Studies and Research,* Vol. 3, National Commission on Unemployment Compensation, July 1980.

54. *Significant Provisions, op. cit.* Excludes three jurisdictions which did not experience rate in 1982.

55. Once the state fund reaches a specified solvency level, a zero tax rate can be assigned.

56. *Comparison of State Unemployment Insurance Laws, op. cit.,* pp. 2-27 and 2-28, Table 202.

57. *Significant Provisions, op. cit.*

58. *Ibid.*