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CRS Report for Congress

Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits

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Summary

This report provides a summary of how Unemployment Compensation (UC) benefits are funded through the Unemployment Trust Fund (UTF). The UTF in the U.S. Treasury is designated as a trust fund for federal accounting purposes. Although the UTF is a single trust fund, it has 59 accounts: the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), and the Federal Unemployment Account (FUA), 53 state accounts, the Federal Employees Compensation Account (FECA), and 2 accounts related to the Railroad Retirement Board. Federal unemployment taxes are credited to the ESAA; each state's unemployment taxes are credited to the state's unemployment account. Federal taxes pay for administration grants to the states and half of extended UC benefits. State unemployment taxes are dedicated to pay for regular UC benefits and half of extended UC benefits. This report will be updated as legislative activity warrants.

The Unemployment Compensation (UC) Program

Unemployment Compensation (UC) is a joint federal-state program financed by federal taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes under the State Unemployment Tax Acts (SUTA). The underlying framework of the UC system is contained in the Social Security Act (SSA). Title III of the SSA authorizes grants to states for the administration of state UC laws; Title IX authorizes the various components of the federal Unemployment Trust Fund (UTF); and Title XII authorizes advances or loans to insolvent state UC programs.

Federal Unemployment Tax Act. If a state UC program complies with all federal rules, the net FUTA tax rate for employers is 0.8% on the first $7,000 of each worker's earnings. The 0.8% FUTA tax funds both federal and state administrative costs as well as the federal share of the Extended Benefit (EB) program, loans to insolvent state UC accounts, and state employment services. Federal law defines which jobs a state UC program must cover for the state's employers to avoid paying the maximum FUTA tax rate (6.2%) on the first $7,000 of each employee's annual pay.

Expiring Provision: P.L. 110-140. On December 19, 2007, the President signed P.L. 110-140. Among many other items, P.L. 110-140 includes a one-year extension of 0.2% FUTA surtax. At the end of CY2008, the effective FUTA tax on employers for each employee will decrease to 0.6% (down from 0.8%) on the first $7,000 of wages. SUTA taxes are not directly affected by the expiring provision.

State Unemployment Tax Acts. States levy their own payroll taxes on employers to fund regular UC benefits and the state share of the EB program. The SUTA tax rate of an employer is, in most states, based on the amount of UC benefits paid to former employees. Generally, the more UC benefits paid to its former employees, the higher the tax rate of the employer, up to a maximum established by state law.

The Unemployment Trust Fund

The UTF is designated, by law, as a trust fund in the U.S. Treasury. The designation as a trust fund is a federal accounting mechanism to directly link revenues and distributions connected to the UC programs. The UTF accounts include the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), and the Federal Unemployment Account (FUA), 53 state accounts,[1] the Federal Employees Compensation Account (FECA), and two accounts related to the Railroad Retirement Board.[2] Federal unemployment taxes are credited to the ESAA; each state's unemployment taxes are credited to in the state's unemployment account. Federal taxes are dedicated to pay for UC administration grants to the states and half of extended UC benefits. State taxes are dedicated to pay for regular UC benefits and half of extended UC benefits.

Although the UTF contains 59 separate accounts (often referred to as *book accounts*) to attribute and distribute the monies appropriately based on program purpose, the UTF is a single trust fund. The use of separate accounts means that revenues and distributions are directly linked to UC program purpose. The use of a single trust fund (the UTF) for all UC programs permits a balance to carry over surplus spending authority to subsequent years. The balance represents reserve spending authority available in addition to the spending authority provided by the automatic appropriation of current tax receipts. This reserve spending authority is used during recessions when UC outlays exceed UTF tax revenues; that is, when current spending exceeds current receipts. Like many of the UTF's other transactions, the balance is effectively a bookkeeping entry.

The Unemployment Trust Fund and the Federal Budget. All UC tax receipts and outlays for benefits and administration flow through the Treasury, and thus affect federal revenue, outlays, and the overall financial position (deficit or surplus) of the federal government. The UTF accounts for all UC financial transactions. This accounting device (designation as a trust fund) is used to accumulate legal spending

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[1] The District of Columbia, Puerto Rico, and the Virgin Islands are considered to be states in UC matters.

[2] For the purposes of this report, the Railroad funds will be ignored.

authority that is available automatically when needed. However, the UTF does not contain financial resources. The required cash the federal government needs to pay benefits or administrative costs must be drawn from current resources through either taxation or borrowing. The revenue and the expenditures of the UC system are counted in the federal budget.

Federal laws require that excess UC funds be "invested" in federal government securities. However, because the UTF is a federal account, its holdings of federal securities are simply obligations from the federal government to itself. These obligations represent a budgetary resource to the UC program, not a financial resource to the federal government. This is because, while no cash has been raised, the interest earned on the investments is credited to the UTF. Because the federal government is holding its own securities, no cash is raised when these securities are liquidated. The UTF's federal securities must be backed by cash raised through taxation or additional public borrowing. All things being equal, a UTF surplus reduces the federal deficit, lowering the amount the federal government must borrow from the public. Conversely, a UTF deficit increases the overall federal budget deficit and increases federal borrowing needs.

Unemployment Trust Fund Revenues and Distributions. The UTF is credited[3] with revenues from three primary sources:

- state unemployment taxes on employers,
- federal unemployment taxes on employers, and
- U.S. government agency transfers.

Although UC benefits are taxable and are fully subject to the federal income tax, those revenues do not support the UC system.[4] These three types of revenues are depicted at the top of **Figure 1.**

State Unemployment Tax Revenues Are Credited to the State Unemployment Accounts Within the Unemployment Trust Fund. States are authorized to designate that these funds be used to pay UC benefits. State unemployment account funds that are attributable to state unemployment taxes may only be used for unemployment benefits and the state's portion of extended unemployment benefits. Administrative costs are funded through distributions from the ESAA to the state unemployment accounts. At the end of FY2006, states were estimated to have collected $35.94 billion while expending $30.15 billion in regular UC benefits and $10 million for their share of extended benefits.

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[3] All revenues associated with UC are deposited to the U.S. Treasury, and all UC distributions (payments) are made by the U.S. Treasury. The revenues and distributions made by the U.S. Treasury are linked to the different UC programs and purposes through the federal accounting mechanism of the UTF and its separate accounts.

[4] This differs from funds from the taxation of Social Security benefits that help support the Social Security and Medicare programs.

Federal Unemployment Taxes Are Credited to the ESAA. Each fiscal year, funds are appropriated through the federal budget process to make distributions from the ESAA for the states' costs of administering their unemployment compensation programs, and for the federal costs of administration. The Secretary of Labor determines (certifies) the amount of the administrative payments, and permits the Secretary of the Treasury to make the payments to the states. The Secretary of Labor in certifying a state for payment takes into account that (1) the state's UC programs contain specific provisions related to the payment of monies from the state unemployment system, (2) the state agency's specific responsibilities in administering the UC program and UC benefits, and (3) the rights and responsibilities of the UC benefit recipients.

UTF Revenues

State Unemployment Taxes. Employers required to pay state unemployment taxes may remit their state unemployment taxes to states on a monthly, quarterly, annual or another basis as determined by state laws and regulations. States in turn, then remit the collected taxes to the Treasury. These funds are credited to the appropriate state unemployment account in the UTF.

Federal Unemployment Taxes. Employers may also be required to pay FUTA taxes on a quarterly basis. If the estimated quarterly federal tax is less than $500, an employer may roll the liability over to the next quarter until the liability is $500 or more. At that point, the employer must pay the FUTA taxes to the Treasury. An annual tax return reconciles the quarterly deposits to the actual tax liability. The ESAA is credited with the federal unemployment taxes.

U.S. Government Agency Transfers. Each federal agency is responsible for UC benefits paid on the agency's behalf. Each agency must budget for the unemployment benefits paid and reimburse the UTF for unemployment compensation paid on its behalf by states. The funds are credited to the FECA.

Each Month, the ESAA Distributes 20% of the Net Monthly Activity to the EUCA. Net monthly activity is the sum of revenues credited to the ESAA less distributions for refunds of FUTA taxes and additional taxes attributable to a reduced credit for SUTA taxes. By the end of FY2006, the federal accounts had collected $7.10 billion; the ESAA held $3.32 billion. Since the ceiling for the ESAA was $1.44 billion, the excess $1.89 billion in the ESAA was transferred to the EUCA. At the end of FY2006, the ESAA had distributions of $3.85 billion to the states for administrative costs.[5]

If states have an active EB program, EUCA distributions are made for the federal portion (50%) of EB benefits. At the fiscal year end after any required distribution from the ESAA, the balance in the EUCA is determined. The EUCA balance is limited to the maximum of $750 million or 0.5% of covered wages.[6] If the EUCA balance exceeds the limitation, the excess is distributed to the FUA. At the end of FY2006 $10 million was expended to pay for the federal share of EB benefits and the EUCA balance was $12.67 billion. The EUCA ceiling was $21.16 billion; thus, there was no fund transfer to the FUA.

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[5] For a description of the TEUC program see CRS Report RL33362, *Unemployment Insurance: Available Unemployment Benefits and Legislative Activity*, by Julie M. Whittaker.

[6] P.L. 105-33, increased the statutory ceiling on the FUA from 0.25% to 0.5% of covered wages, effective October 1, 2001. P.L. 102-318, had lowered the FUA from 0.625% to 0.25% and increased the ceiling for EUCA from 0.375% to 0.5%. P.L. 100-203, had raised the EUCA ceiling from 0.125% to .375% and increased the FUA ceiling from 0.125% to 0.625%.

In addition to any EUCA distribution, the FUA is credited with the additional taxes paid by employers when a reduced credit against federal taxes exists because the state has an outstanding unpaid loan from FUA. FUA funds are distributed as loans to states, through the state unemployment accounts. (See the discussion below on loans to insolvent accounts for a more detailed explanation of these loans.) The FUA balance is limited to the maximum of $550 million or 0.5% of covered wages. At the end of FY2005, the FUA balance was $13.43 billion, lower than the $21.16 billion ceiling.

Distributions are made to the state unemployment accounts from the FECA to reimburse the states for employment compensation paid to former federal employees. Each federal agency reimburses the UTF for its share of federal workers' UC benefits.

Other Unemployment Trust Fund Expenditures (Reed Act Distributions). At the end of the fiscal year, there is a limitation on the balance in the ESAA — the account balance cannot exceed 40% of the prior fiscal year's appropriation by Congress. If the balance in the ESAA exceeds this limitation, the excess is distributed to EUCA. After the distribution, if the balance in the EUCA exceeds the limitation, the excess is distributed to the FUA. If after the distribution from the EUCA, the FUA balance exceeds the limitation, the excess is distributed, as a Reed Act distribution, to the states.[7] At the end of FY2006, the ESAA balance was $3.32 billion. Because the ESAA ceiling was $1.44 billion, the excess of $1.89 billion was transferred to the EUCA. After this distribution, the EUCA balance was $12.67 billion. The EUCA ceiling was $21.16 billion: there was no transfer of funds to the FUA. The FUA balance was $13.43 billion while the FUA ceiling was $21.16 billion. There was no Reed Act distribution.

Loans to Insolvent Accounts. The Treasury can write checks for a state unemployment account, provided that legal spending authority exists for such spending. That is, the state unemployment account has a positive balance. During some recessions, current taxes and reserve balances were insufficient to cover expenditures for UC benefits. Some state unemployment accounts required "loans." Like all other transactions of the UTF, these are book account transactions that involve no exchange of cash. The loans are additional credits to a state unemployment account. Subsequent repayment of these loans reduces the credits in the state unemployment accounts.

The state unemployment accounts can borrow from the FUA. The principal of the loan is repaid by reducing federal tax credits for SUTA taxes and crediting those increased revenues to the FUA. The state cannot pay the interest on such loans using the state unemployment account but must pay the interest through state general revenues or other measures. Federal law also authorizes appropriations if balances in the federal accounts are insufficient to cover their expenditures. For example, if the states' borrowing needs exceed the available FUA balance, Congress is authorized to appropriate additional spending authority to cover the amount needed. Such appropriations require discretionary action by Congress and the President.

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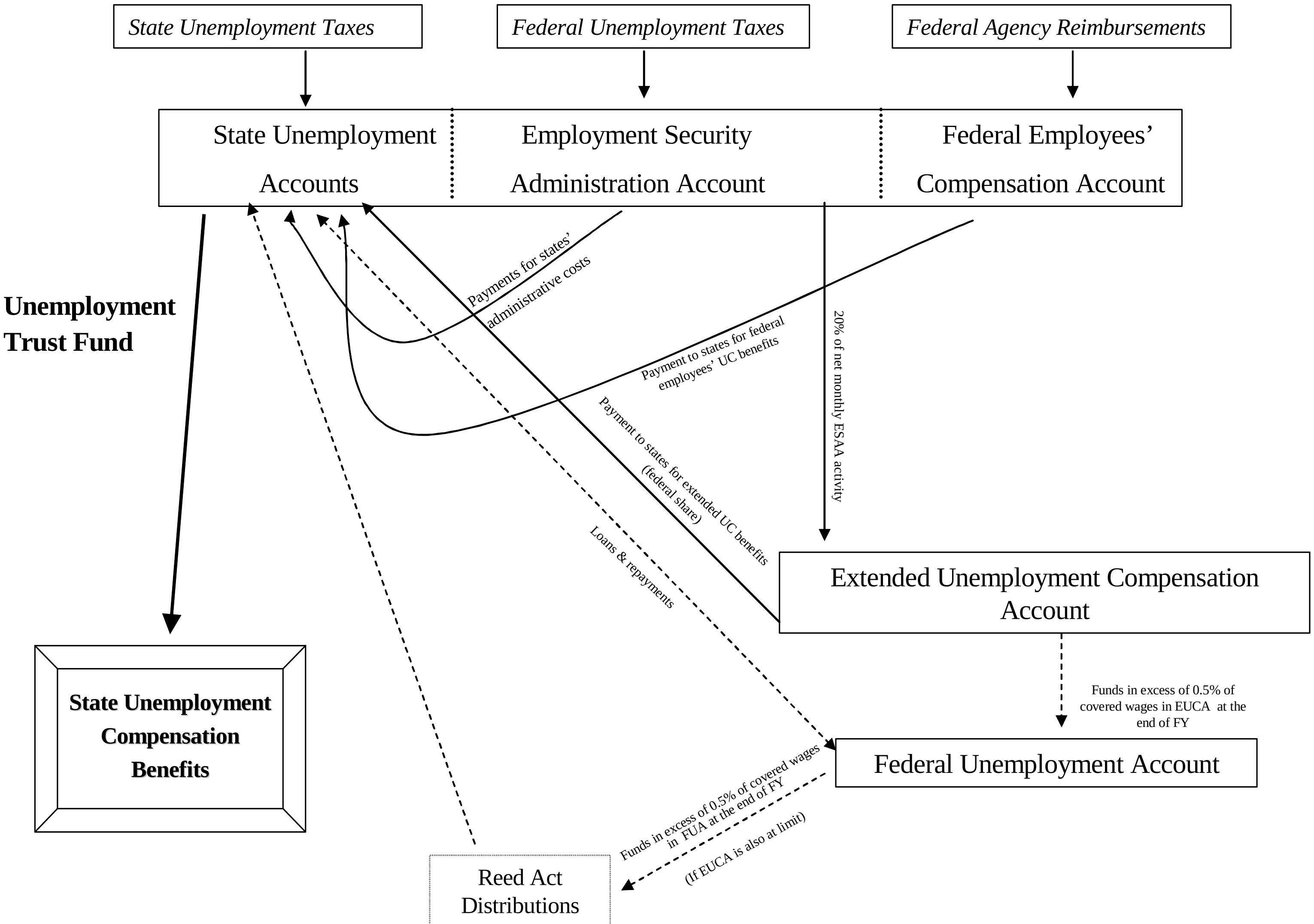
[7] For more information on Reed Act distributions, see CRS Report RS22006, *The Unemployment Trust Fund and Reed Act Distributions*, by Julie Whittaker.

Figure 1. The Unemployment Trust Fund



Source: Figures prepared by The Congressional Research Service (CRS).