Congressional Research Service

The Unemployment Trust Fund and Reed Act Distributions

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January 21, 2009

Congressional Research Service
7-5700
www.crs.gov
RS22006

Summary

Under the Federal Unemployment Tax Act (FUTA, P.L. 76-379), the federal unemployment tax on employers finances: the states' administrative costs of Unemployment Compensation (UC), half of extended UC benefits, and loans to states with insolvent UC programs. These funds are placed into the Unemployment Trust Fund (UTF) that—among its many accounts—contains three federal accounts and 53 individual state accounts from the states' unemployment taxes. Under certain financial conditions, excess federal tax funds in the Unemployment Trust Fund (UTF) are transferred to the individual state accounts within the UTF. The transferred funds are referred to as Reed Act distributions.

The Reed Act, P.L. 83-567, set ceilings in the federal UTF accounts that trigger funds to be distributed to state accounts; Congress has changed these ceilings several times (P.L. 105-33, P.L. 102-318, and P.L. 100-203). There are other transfers in the UTF that are labeled by legislation as *special* Reed Act distributions. These are distributed in a manner similar to the Reed Act but do not follow all of the Reed Act provisions.

The most recent *regular* Reed Act distribution was $15.9 million and occurred in 1998. The Balanced Budget Act (BBA) of 1997, P.L. 105-33, limited Reed Act distributions for the 1999 to 2001 period to *special* Reed Act distributions of $100 million each year. In March 2002, the Job Creation and Worker Assistance Act of 2002, P.L. 107-147, provided for a one-time *special* Reed Act distribution of up to $8 billion to state accounts. According to the Department of Labor, there is no projected Reed Act distribution through FY2013 on account of additional benefits paid from the extended unemployment compensation account (EUCA) for the Emergency Unemployment Compensation (EUC08) program.

Introduced on January 8, the Unemployment Insurance Modernization Act (UIMA), H.R. 290, would distribute up to a total of $7.5 billion to the states through a special transfer of funds from the federal accounts within the UTF to the state accounts, using the methodology required by the Reed Act to determine the maximum state allotments. As proposed by the House of Representatives, The American Economic Recovery and Reinvestment Plan has an almost identical provision. It is expected that the Senate stimulus proposal will also have a similar provision.

This report will be updated if legislative activity affects Reed Act distributions.

Contents

Tables

Contacts

What Is the Reed Act?

Unemployment Compensation (UC) is a joint federal-state program and is financed by federal taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes. The underlying framework of the UC system is contained in the Social Security Act: Title III authorizes grants to states for the administration of state UC laws; Title IX authorizes the various components of the federal UTF; and, Title XII authorizes advances or loans to insolvent state UC programs. Among its 59 accounts, the federal UTF in the U.S. Treasury includes the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), and the Federal Unemployment Account[1] (FUA), 53 state accounts,[2] the Federal Employees Compensation Account, and two accounts related to the Railroad Retirement Board. Federal unemployment taxes are placed in the ESAA, the EUCA, and the FUA; each state's unemployment taxes are placed in the appropriate state's account.

In law, the term Reed Act refers to a part of the Employment Security Financing Act of 1954, P.L. 83-567.[3] This legislation amended Titles IX and XII of the Social Security Act (SSA) and established the basic structure of the UTF. The amendments to Title IX, among other things, provided for the transfer of excess funds in the federal portion of the UTF to the individual state accounts under certain conditions.

In practice, there have been two forms of Reed Act distributions. The first form, regular Reed Act distributions, follows the terms as set forth in the Reed Act. The second type, *special* Reed Act distributions, distributes some of the federal UTF funds to the states where these special distributions may follow some but not all of the conditions set by the Reed Act. The 1998-2002 Reed Act distributions were special distributions.

Federal law restricts states to using Reed Act distributions only to cover the cost of state benefits, employment services (ES), labor market information, and administration of state UC and ES programs. Suggested uses by the Department of Labor included establishing revolving funds for UC and ES automation costs, UC and ES performance improvement, costs related to reducing UC fraud and abuse, and improvement in UC claims filing and payment methods.[4] An appropriation by the state's legislature is necessary before the state's share of this distribution may be used for UC and ES administrative expenses.[5] Funds may not be used to extend a temporary unemployment benefit such as the Emergency Unemployment Compensation (EUC08) program.[6]

[1] The FUA is an account from which repayable advances are made to depleted state trust fund accounts to ensure that UC benefit obligations are met.

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

[3] The Reed Act was named for Representative Daniel A. Reed who was Chairman of the House Ways and Means Committee when the Employment Security and Financing Act passed.

[4] U.S. Department of Labor, Training and Employment Guidance Letter No. 24-01, May 8, 2002, at http://ows.doleta.gov/dmstree/tegl/tegl2k1/tegl_24-01.htm.

[5] See U.S. Department of Labor, Training and Employment Guidance Letter No. 18-01, April 22, 2002, Question and Answer 9, at http://ows.doleta.gov/dmstree/tegl/tegl2k1/tegl_18-01.htm.

[6] For an explanation of the EUC08 program, see CRS Report RS22915, *Temporary Extension of Unemployment Benefits: Emergency Unemployment Compensation (EUC08)*, by Julie M. Whittaker.

How Does the Release of Reed Act Funds Occur?

Under FUTA, the federal tax on employers finances the administrative costs of UC, half of extended UC benefits, and loans to states with insolvent UC programs. State UC payroll taxes finance the costs of regular UC benefits and half of extended UC benefits. Under FUTA, employers pay a federal tax of 6.2%[7] on wages of up to $7,000 a year paid to each worker. The law, however, provides a credit against federal tax liability of up to 5.4% to employers who pay state taxes in a timely manner. Accordingly, in states meeting the specified requirements, employers pay an effective federal tax of 0.8%, or a maximum of $56 per covered worker, per year.

At the end of the federal fiscal year, on September 30th, the net balance of the ESAA is determined. If the amount in this account exceeds 40% of the prior year's appropriation by Congress, then an "excess" balance exists. This excess balance is transferred first to the EUCA. When that account reaches its statutory maximum, the remaining excess balance is transferred to the FUA.[8] *When all three accounts are at their statutory maximums*, any remaining excess balance is distributed to the accounts of the states in the UTF based on each state's share of U.S. covered wages. These distributions are called Reed Act distributions.

Reed Act distributions occurred in 1956 through 1958 and 1998 through 2002. **Table 1** lists the distributions. The most recent Reed Act distribution that was a *regular* and not a *special* Reed Act distribution was $15.9 million and occurred in 1998. The Balanced Budget Act (BBA) of 1997, P.L. 105-33, limited the Reed Act distributions for the 1999 to 2001 period to *special* distributions of $100 million each year. Any amounts in excess of the $100,000,000 that—absent the BBA amendments—would have been transferred to the states "shall, as of the beginning of the succeeding fiscal year, accrue to the federal unemployment account, without regard" to its statutory limit.

In March 2002, the Job Creation and Worker Assistance Act of 2002, P.L. 107-147, provided for a *one-time special* Reed Act distribution of up to $8 billion to state accounts in the UTF, where the funds were distributed based upon the formula used for regular Reed Act distributions, using calendar year 2000 state information.[9] The law labeled this transfer a "Reed Act" distribution although it differed from traditional Reed Act distributions, most notably because the law distributed a set dollar amount which was not determined by the statutory ceilings in the federal accounts and was distributed before the end of a fiscal year.

There was no Reed Act distribution in 2003, and there is no projected distribution through FY2013.[10] According to the Department of Labor, there is no projected distribution through FY2013 on account of the Emergency Unemployment Compensation (EUC08) program.[11]

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[7] This includes a 0.2% surtax that is scheduled to expire at the end of 2007.

[8] The statutory maximum for the EUCA is the greater of $750 million or 0.50% of wages subject to state UC laws. The statutory maximum for the FUA is the greater of $550 million or 0.5% of the covered wages.

[9] For information on how states used the 2002 distributions, see General Accountability Office, *Unemployment Insurance: State Use of the 2002 Reed Act Distribution,* GAO-03-496 and GAO-03-567T, March 2003.

[10] U.S. Department of Labor, Office of Workforce Security, Division of Fiscal and Actuarial Services, *UI Outlook FY 2009 Budget Midsession Review*, July 2008.

[11] *UI Outlook: FY2009 Budget Midsession Review*, U.S. Department of Labor, Office of Workforce Security, Division (continued...)

Table 1. Reed Act Distributions

(in millions)

Year	Reed Act Amount
1956	33.4
1957	71.0
1958	33.5
1998	15.9
1999[a]	100.0
2000[a]	100.0
2001[a]	100.0
2002[b]	8,000.0
2003	0.0
2004	0.0
2005	0.0
2006	0.0
2007	0.0
2008	0.0

Source: CRS table created from U.S. Department of Labor, Employment and Training Administration data.

a. These distributions were set by the Balanced Budget Act of 1997.

b. This distribution was set by Job Creation and Worker Assistance Act of 2002.

How Was the $8 Billion Reed Act Distribution Spent by the States?

According to a Government Accountability Office (GAO) report, the $8 billion Reed Act distribution reduced 2003 unemployment taxes in 22 states and UC administration costs in 17 states.[12] The Center for Employment Security Education and Research (CESER), a component of the National Association of State Workforce Agencies (NASWA), with the assistance of Booz Allen Hamilton and Decern Consulting, examined how states used the $8 billion special Reed Act Distribution of 2002.[13] This study found that approximately half of the Reed Act distribution was used to lower state unemployment taxes in 2003 and 2004 from what they would have otherwise been. The special distribution also led to increases in spending on UC benefits, UC administration and employment services.

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of Fiscal and Actuarial Services, July 2008. See http://workforcesecurity.doleta.gov/unemploy/content/midfy2009/home.asp under "Enacted Legislation."

[12] U.S. Government Accountability Office, *Unemployment Insurance: States' Use of the 2002 Reed Act Distribution,* GAO-03-496, March 2003.

[13] *Unemployment Insurance: Assessment of the Impact of the 2002 Reed Act Distribution-Final Report,* Department of Labor, ETAOP 2004-11, released August 2008.

Policy Issue

Congress has changed the Reed Act's statutory ceilings that trigger surplus funds to return to the states' accounts several times.[14] Although *the surplus* funds are credited to the UTF, the *revenue* from FUTA becomes part of the general federal fund surplus or deficit. An increase in a UTF trigger has the impact of lowering the federal deficit and decreasing the amount of UTF monies that would have otherwise gone to the states. There is no legislation in the 111th Congress that considers altering the statutory ceilings of FUA or EUCA.

State administrators generally have maintained that all surplus revenue collected by the FUTA should be distributed to the states' FUTA accounts through Reed Act distributions. The National Governors Association (NGA) has voiced its belief that the current ceiling for the loan account within the UTF is too large (FUA, 0.5%). The NGA has maintained a position of reducing the ceiling to the rate that existed in 1987 (0.125% of covered wages paid in the last year). The NGA maintains that changes in UC laws now make it impossible for a state to default on federal UC loans and thus the FUA ceiling should be lowered. Furthermore, they maintain that if there is a need for states to borrow and the FUA does not have sufficient funds to accommodate the borrowing by states, the FUA is authorized to borrow from the general fund.[15]

Legislation in the 111th Congress

On January 9, 2009, Representative McDermott introduced H.R. 290, the Unemployment Insurance Modernization Act (UIMA). H.R. 290 would provide a special transfer of UTF funds from the federal unemployment account (FUA) of up to a total of $7 billion to the state accounts within the UTF as "incentive payments" for changing certain state UC laws. The maximum incentive payment allowable for a state would be calculated using the methods used in Reed Act distributions. That is, funds would be distributed to the state UTF accounts based on the state's share of estimated federal unemployment taxes (excluding reduced credit payments) made by the state's employers. In addition, H.R. 290 would transfer a total of $500 million from the federal employment security administration account (ESAA) to the state's accounts in the UTF.

As proposed by the House of Representatives, The American Economic Recovery and Reinvestment Plan has proposal has an almost identical provision. It is expected that the Senate stimulus proposal will also have a similar provision.

[14] The Balanced Budget Act of 1997, P.L. 105-33, increased the statutory ceiling on the FUA from 0.25% to 0.5% of covered wages, effective October 1, 2001. The Unemployment Compensation Amendments of 1992, P.L. 102-318, lowered the FUA from 0.625% to 0.25% and increased the ceiling for EUCA from 0.375% to 0.5%. The Omnibus Budget Reconciliation Act of 1987, P.L. 100-203, raised the EUCA ceiling from 0.125% to .375% and increased the FUA ceiling from 0.125% to 0.625%.

[15] See the NGA's Education, Early Childhood, and Workforce Committee and the Economic Development and Commerce Committee's statement on the Employment Security System on July 14, 2008, at http://www.nga.org.

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