The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States

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January 21, 2009

Congressional Research Service
7-5700
www.crs.gov
RS22954

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

During some recessions, current taxes and reserve balances were insufficient to cover state expenditures for unemployment compensation (UC) benefits. UC benefits are an entitlement, and states are legally required to pay benefits even if the state account is insolvent. Some states may borrow funds from the Federal Unemployment Account (FUA) within the Unemployment Trust Fund (UTF) in order to meet UC benefit obligations. This report summarizes how insolvent states may borrow funds from the federal account within the UTF in order to meet its UC benefit obligations. Outstanding loans listed by state may be found at the Department of Labor's website: http://atlas.doleta.gov/unemploy/content/tfloans.asp. This report will be updated to reflect major changes in state UTF account solvency.

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Unemployment Compensation and the Unemployment Trust Fund

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.

Originally, the intent of the UC program, among other things, was to help counter economic fluctuations such as recessions.[1] This intent is reflected in the current UC program's funding and benefit structure. When the economy grows, UC program revenue rises through increased tax revenues, whereas UC program spending falls as fewer workers are unemployed. The effect of collecting more taxes while decreasing spending on benefits dampens demand in the economy. This also creates a surplus of funds or a "cushion" of available funds for the UC program to draw upon during a recession. In a recession, UC tax revenue falls and UC program spending rises as more workers lose their jobs and receive UC benefits. The increased amount of UC payments to unemployed workers dampens the economic effect of lost earnings by injecting additional funds into the economy.

Unemployment Taxes

UC benefits are financed through employer taxes.[2] The federal taxes on employers are under the authority of the Federal Unemployment Tax Act (FUTA), and the state taxes are under the authority given by the State Unemployment Tax Acts (SUTA). These taxes are deposited in the appropriate accounts within the Unemployment Trust Fund (UTF).

Federal Unemployment Taxes

FUTA imposes a 6.2% gross tax rate on the first $7,000 paid annually by employers to each employee. Employers in states with programs approved by the federal government and with no delinquent federal loans may credit 5.4 percentage points against the 6.2% tax rate, making the minimum net federal unemployment tax rate 0.8%. (Most recently, because New York had unpaid loan balances, the New York employers' rate was higher for 2004 and 2005.)

Because all states currently have approved programs, 0.8% is the effective federal tax rate. The 0.8% FUTA tax funds both federal and state administrative costs as well as the federal share of

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[1] See, for example, President Franklin Roosevelt's remarks at the signing of the Social Security Act at http://www.ssa.gov/history/fdrstmts.html#signing.

[2] For a detailed description of UC financing, see CRS Report RS22077, *Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits*, by Christine Scott and Julie M. Whittaker.

the Extended Benefit (EB) program, loans to insolvent state UC accounts, and state employment services.

Broad Guidelines for State Unemployment Taxes

Federal laws and regulations provide broad guidelines on state unemployment taxes. States levy their own payroll taxes on employers to fund regular UC benefits and the state share of the EB program. These state UC tax rates are "experience-rated," in which employers generating the fewest claimants have the lowest rates. The state unemployment tax rate of an employer is, in most states, based on the amount of UC paid to former employees. Generally, in most states, 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 experience rating is intended to ensure an equitable distribution of UC program taxes among employers and to encourage a stable workforce. State ceilings on taxable wages in 2008 range from $7,000 (eight states) to $34,000 (Washington). The minimum rates range from 0% (eight states) to 1.69% (Rhode Island). The maximum rates range from 5.4% (17 states) to 10.96% (Massachusetts). Approximately $32.2 billion in SUTA taxes were collected in FY2008. In comparison, states spent an estimated $38.1 billion on regular UC benefits and $4.1 million on extended benefit payments in FY2008.

Adequate Trust Fund Balances

Whether a state trust fund balance is adequate is ultimately a matter up to each state as there is no statutory requirement of an adequately funded state UC program. However, the U.S. Department of Labor (DOL) suggests that, to be minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs on the basis of the highest levels of benefit payments experienced by the state over the last twenty years. This is called the average high-cost multiple (AHCM). A ratio of 1.0 or greater prior to a recession indicates a state is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. DOL provides the AHCM in its *Quarterly Program and Financial Data* report in the summary of financial data. These reports are available online at http://www.workforcesecurity.doleta.gov/unemploy/finance.asp.

Table 1 provides financial information for the third quarter of calendar year 2008. The first data column lists the amount of state taxes collected in the previous 12 months. The second column lists the balance each state's account in the UTF at the end of the 12-month period. The third column calculates the ratio of the trust fund balance to the estimated sum of wages earned by employees in jobs covered by the UC system. The final column lists the AHCM where a number less than 1 does not meet DOL's definition of minimally solvent.

Table 1. Unemployment Trust Fund Accounts: Financial Information by State, 3rd Quarter 2008

State	Revenues Last 12 Months (thousands of $)	Trust Fund Balance (thousands of $)	Trust Fund Ratio to Total Covered Wages	Average High Cost Multiple (AHCM)
Alabama	231,358	395,511	0.67	0.52
Alaska	136,779	346,883	3.35	1.07
Arizona	290,273	964,520	1.08	1.12
Arkansas	263,264	151,276	0.46	0.32
California	4,869,746	1,785,177	0.28	0.27
Colorado	415,479	699,891	0.78	0.67
Connecticut	565,401	566,678	0.72	0.54
Delaware	84,202	153,778	0.96	0.90
District of Columbia	110,751	423,003	1.48	1.10
Florida	849,082	1,767,806	0.69	1.05
Georgia	519,012	1,151,446	0.81	0.98
Hawaii	83,245	485,523	2.68	1.88
Idaho	110,741	128,142	0.72	0.47
Illinois	1,977,454	1,849,318	0.79	0.35
Indiana	549,337	90,735	0.10	0.29
Iowa	363,127	756,589	1.77	0.88
Kansas	223,343	635,593	1.37	0.97
Kentucky	392,982	194,414	0.37	0.21
Louisiana	170,236	1,483,865	2.51	0.94
Maine	99,943	466,735	3.00	1.64
Maryland	388,071	896,734	0.99	0.79
Massachusetts	1,519,733	1,403,903	0.95	0.50
Michigan	1,590,532	35,773	0.03	N.A.
Minnesota	832,356	574,137	0.60	0.38
Mississippi	105,600	717,381	2.50	1.70
Missouri	605,678	221,588	0.26	0.12
Montana	82,866	282,048	2.37	1.45
Nebraska	109,979	296,858	1.17	1.19
Nevada	358,686	714,598	1.50	1.02
New Hampshire	51,776	196,300	0.90	1.19
New Jersey	1,957,272	792,885	0.45	0.21
New Mexico	87,426	543,833	2.38	1.88
New York	2,316,834	809,721	0.20	0.09
North Carolina	924,136	439,808	0.34	0.23

State	Revenues Last 12 Months (thousands of $)	Trust Fund Balance (thousands of $)	Trust Fund Ratio to Total Covered Wages	Average High Cost Multiple (AHCM)
North Dakota	49,706	137,638	1.57	0.79
Ohio	1,099,404	333,956	0.20	0.12
Oklahoma	166,021	856,198	1.84	1.51
Oregon	804,084	2,121,559	3.92	1.46
Pennsylvania	2,214,250	1,483,767	0.78	0.30
Puerto Rico	180,930	539,026	3.24	1.00
Rhode Island	187,785	114,033	0.79	0.38
South Carolina	284,134	102,549	0.19	0.26
South Dakota	26,620	28,245	0.29	0.33
Tennessee	412,978	558,644	0.62	0.48
Texas	1,035,946	1,671,383	0.42	0.45
Utah	148,286	851,275	2.29	1.47
Vermont	63,146	153,975	1.91	1.20
Virgin Islands	1,505	15,162	1.30	0.80
Virginia	342,558	731,008	0.54	0.71
Washington	1,125,909	4,117,673	3.88	1.53
West Virginia	140,521	249,994	1.38	0.45
Wisconsin	668,123	413,611	0.49	0.29
Wyoming	55,677	258,691	2.87	1.15

Source: U.S. Department of Labor.

Notes: Total covered wages are based on extrapolated wages for the most recent 12 months.
N.A.= Not Applicable; Michigan has an outstanding debt exceeding its fund balances after obligations from the Reed Act distribution of 2002 are considered.

Insolvency: Insufficient UTF Reserve Balances

During economic slowdowns or recession, some states have found that current state unemployment taxes and UTF reserve balances were insufficient to cover state expenditures for unemployment compensation (UC) benefits.

Insolvent States Required to Pay UC Benefits

States have a great deal of autonomy in how they establish and run their unemployment system. However, the framework established by the federal government requires states to actually pay the UC benefits as provided under state law. If the state does not pay the UC benefits, federal law is quite explicit. The state will not have a UC program meeting federal requirements and thus the federal tax on employers would be a net tax of 6.2% (with no credit for state unemployment taxes) rather than 0.8% if the state UC program paid benefits and had no outstanding loans.

In budget terms, UC benefits are an entitlement (although the program is financed by a dedicated tax imposed on employers and not by general revenues). Thus, even if a recession hits a given state and as a result that state's trust account is depleted, the state remains legally required to continue paying benefits. To do so, the state will be forced to borrow money from the dedicated loan account, the Federal Unemployment Account (FUA), within the Unemployment Trust Fund (UTF) or from outside sources. If the state chooses to borrow funds from the FUA, not only will the state be required to continue paying benefits, it will also be required to repay the funds (plus any interest due) it has borrowed from the federal loan account. Such states will probably be forced to raise taxes on their employers and/or reduce UC benefit levels, actions that dampen economic growth, job creation, and consumer demand. In short, states have strong incentives to keep adequate funds in their trust fund accounts.

Mechanism for Receiving a Loan

In order for a loan to be made to a state account, the governor of the state (or the governor's designee) must apply to the Secretary of Labor for a three-month loan. Once the loan is approved by the Department of Labor, the funds are placed into the state account in monthly increments.

Interest Charges on Loans

Since 1982 (P.L. 97-35), states are charged interest on new loans that are not repaid by the end of the fiscal year in which they were obtained. Under previous law, states could receive these loans interest-free. The interest is the same rate as that paid by the federal government on state reserves in the UTF for the quarter ending December 31 of the preceding year, but not higher than 10% per annum. States may not pay the interest directly or indirectly from funds in their state account with the UTF.

States still may borrow funds without interest from the FUA during the year. To receive these interest-free loans, the states must repay the loans by September 30. No loans may be made in October, November, or December of the calendar year of such an interest-free loan. Otherwise, the "interest-free" loan will accrue interest charges.

Federal Tax Increases on Outstanding Loans Through Credit Reductions

States with outstanding loans must repay them fully by November 10 following the second consecutive January 1 on which the state has an outstanding loan. If the outstanding loan is not repaid by that time, the state will face federal tax increases. This means that a state may have from approximately 22 to 34 months to repay the loan without a federal tax increase, depending on when it obtained the outstanding loan. If the state does not repay fully by November 10, it becomes subject to a reduction in the amount of credit applied against the federal unemployment tax beginning with the preceding January 1 until the state repays the loan fully. That state's employers must pay the additional federal taxes resulting from the credit reduction no later than January 31 of the next calendar year.

The additional federal taxes are then deposited into the appropriate state account. Thus the amount of the loan (or the funds the state must continue to borrow) is reduced by the additional federal taxes paid by the state employers.

Credit Reduction

The credit reduction is initially 0.3 percentage points for the year beginning with the calendar year in which the second consecutive January first passes during which the loan is outstanding and increases by 0.3 percentage points for each year there is an outstanding loan. (For example, in the first year, the credit reduction results in the net federal tax rate increasing from 0.8% to 1.1%; in the second year, it would increase to 1.4%.) There are two potential additional credit reductions (on top of the cumulative 0.3 percentage point increases) during the ensuing calendar years in which a state has an outstanding loan: (1) in the calendar years after which the third and fourth consecutive January 1 pass and (2) in the calendar years after which the fifth or more consecutive January 1 pass.

Reducing the Credit Reduction

There are also ways in which the state may reduce the amount of credit reduction applied in a year by meeting certain statutory criteria. For example, in Section 272 of P.L. 97-248, a delinquent state may have the option of repaying on or before November 9 a portion of its outstanding loans each year through transfer of a specified amount from its account in the UTF to the FUA. The state also must repay all loans for the most recent one-year period ending on November 9, plus the potential additional taxes that would have been imposed for the taxable year. In addition, the state must have sufficient amounts in the state account of the UTF to pay all compensation for the last quarter of that calendar year without receiving a loan. Finally, the state must also have altered its state law to increase the net solvency of its account with the UTF. If the state complies with all these requirements, the credit reduction is reduced by a statutory formula.

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