SENATE FISCAL AGENCY
MEMORANDUM

DATE: January 27, 2011

TO: Members of the Michigan State Senate

FROM: Elizabeth Pratt, Fiscal Analyst
Josh Sefton, Fiscal Analyst

RE: FY 2010-11 Interest Payment on Federal Unemployment Account Loans

In recent years the balance in Michigan's Unemployment Compensation Fund was exhausted due to the high levels of unemployment. Revenue from unemployment taxes paid by employers did not keep pace with benefit costs. Michigan used a Federal program to obtain loans to pay benefits. The State currently has approximately $3.7 billion in loans outstanding from the Federal Unemployment Account (FUA). The first interest payment on these loans (since the expiration of a Federal interest waiver) is due on September 30, 2011. The interest payment is estimated at $111.0 million in FY 2010-11. The Unemployment Insurance Agency (UIA) has identified approximately $64.6 million available to make this payment. This leaves a shortfall of $46.4 million. In the absence of Federal action to delay or waive the payment, funds must be identified to make the entire payment or the State could face Federal penalties.

Background

Michigan's unemployment compensation system is administered by the Unemployment Insurance Agency within the Department of Energy, Labor, and Economic Growth (DELEG). The system pays benefits of up to $362 per week for a limited number of weeks to qualifying workers who have lost employment through no fault of their own. The benefits are paid from State unemployment taxes levied on employers. These taxes apply to the first $9,000 of wages paid to each covered employee during the year. Tax rates for employers are determined according to a statutory formula based in part on an employer's experience rating, or the benefits paid attributable to that employer.

The unemployment system is designed so that during periods of low unemployment a balance of tax revenue accumulates in the State Unemployment Compensation Fund. That balance is then available to pay benefits during periods of higher unemployment. If the State Unemployment Compensation Fund is depleted, the State can borrow from the Federal Unemployment Account so that benefit payments continue. These loans are also referred to as Title XII loans from the Federal Unemployment Trust Fund.

Loans from the FUA must be repaid with interest. The principal of the loans is repaid over time from unemployment tax revenues when they become available. Federal law also provides for phased-in increases in Federal unemployment taxes that help to reduce this debt. This is implemented through reduction of the Federal Unemployment Tax Act (FUTA) credit. Interest payments, however, must be made from a separate fund source; they cannot be paid from the Unemployment Compensation Fund. Fund sources available to pay a portion of this interest cost consist of revenue from the State solvency tax and the balance in the Unemployment Agency Contingent Fund, Penalty and Interest Account. These are discussed further below.

Under the American Recovery and Reinvestment Act of 2009, interest was waived for almost two years ending December 31, 2010. Now that the waiver period has expired, interest is being charged. There is a possibility that Congress will extend the interest forbearance period, or consider some alternative relief for the 30 states that owe interest payments this year. If Congress does not act, failure to pay the interest could result in Federal penalties such as the possible loss of Federal funds that pay for unemployment administration and the imposition of higher Federal unemployment tax rates on Michigan employers.

Interest Payment Due

The UIA has estimated that an interest payment of approximately $111.0 million is due on September 30, 2011. This will cover the 9 months of interest from January 1, 2011 to September 30, 2011. The current payment estimate is lower than previously estimated primarily because less money was borrowed in 2010 than originally projected. The State was also able to repay a portion of the loans during 2010 with $66.4 million in revenue from the FUTA credit reduction and a $100.0 million additional payment applied to the loan balance. The actual payment will depend on the amount of additional borrowing during FY 2010-11. Table 1 shows the recent history of FUA borrowing and repayments.

Table 1

Loans Received from the Federal Unemployment Account
Calendar Years 2007 to 2010
(in millions)

	Net Federal Loans	Repayments & FUTA Collections Applied to Loan Balance	Balance Remaining at Year End
2007	$637.0	$502.4	$134.6
2008	1,354.9	717.0	772.5
2009	2,386.6	0.0	3,159.1
2010	717.7	166.4	3,710.4

Source: Michigan Department of Energy, Labor, and Economic Growth

Under current law, interest payments will continue until the $3.7 billion debt is retired, which depending on economic conditions could be multiple years. The interest payment due in FY 2011-12 is projected to increase over the FY 2010-11 level because it will cover 12 months of interest instead of 9 months. Also, the UIA expects to incur additional FUA loans in 2011. The actual interest payment will depend on the amount of additional Federal Unemployment Account borrowing and the Federal interest rate in effect for that year.

Funding Shortfall

Two primary sources of funds are available to apply to the interest payment. These are revenue from the State solvency tax and the balance of the Contingent Fund, Penalty and Interest Account. The State solvency tax is authorized by MCL 421.19a. Implementation of the tax was triggered in 2011 by the FUA loans. The tax requires employers with negative balances in their unemployment insurance experience accounts to pay up to $67.50 per employee in additional unemployment tax. The UIA has projected that the solvency tax will raise $44.6 million that will be available for the interest payment due September 30, 2011. The Contingent Fund, Penalty and Interest Account (established by MCL 421.10(6) primarily to receive revenue from penalties and interest paid by employers) is projected to have a balance available for the interest payment. Approximately $20.0 million is expected to be available for the September 31, 2011 interest payment.

In total, approximately $64.6 million has been identified to make this interest payment. This leaves a shortfall which is currently estimated at $46.4 million.

Legislative action may be required to appropriate funds to make up this shortfall. DELEG has statutory authority to use the Contingent Fund, Penalty and Interest Account and the solvency tax revenue for the interest payment without additional Legislative approval, however, supplemental appropriations would be required if General Fund/General Purpose (GF/GP) revenue or other State restricted funds were used for this payment. Section 19a of the Michigan Employment Security Act (MCL 421.19a(3)) provides that if the solvency tax revenue is insufficient to pay interest on Federal loans, the UIA "…shall recommend to the legislature that it appropriate an amount sufficient to meet the interest obligations due. Any amount so appropriated and used to pay federal interest obligations, and interest due on such state appropriation, if any, shall be repaid to the state as soon as possible from the solvency tax revenues in the contingent fund."

Summary

A FY 2010-11 interest payment of approximately $111.0 million on the State's loans from the Federal Unemployment Account is due on September 30, 2011. Funds currently projected to be available for this payment consist of $44.6 million from the solvency tax and $20.0 million from the Contingency Fund, Penalty and Interest Account. Unless Congress acts to extend the interest waiver, Legislative action may be required to fund the estimated shortfall of $46.4 million.

Please contact one of us at 3-2768 if you have additional questions.

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c: Ellen Jeffries, Director
Bill Bowerman, Associate Director