State Notes

TOPICS OF LEGISLATIVE INTEREST

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Unemployment Compensation in Michigan: An Update

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Recent changes to Michigan unemployment insurance (UI) law and the substantial Federal UI debt that the State has incurred will have long-term impacts on Michigan's unemployment insurance system. This paper examines changes in the UI system due to Public Act 14 of 2011 as well as the effect of Federal Title XII debt on Michigan's UI system as a whole. For additional detail and more background information on Michigan's UI program, please see the following Senate Fiscal Agency publications:

State Notes – Summer 2010: Solvency of Unemployment Compensation Fund - An Update
State Notes – November/December 2008: Michigan's Unemployment Compensation Fund

Public Act 14 of 2011

On March 28, 2011, Governor Snyder signed Public Act 14 of 2011 (PA 14), which made several changes to Michigan's UI system. Perhaps the most significant change from a fiscal standpoint is the reduction in the maximum number of weeks an individual can collect UI benefits. Presently, out-of-work individuals can collect up to $362 per week in benefits for a maximum of 26 weeks. The actual amount and duration of benefits are determined by a formula that is based on an individual's work experience and earnings. Public Act 14 reduces the maximum number of weeks that UI recipients can collect benefits to 20 weeks; this change will take effect for initial UI claims made after January 15, 2012.

According to calendar year 2010 data from the Unemployment Insurance Agency (UIA), approximately 75% of UI benefit recipients who collected the full amount of their UI entitlements were eligible to collect a full 26 weeks of benefits, and over 87% were eligible to collect 21 or more weeks of benefits. Additionally, the average weekly benefit amount (WBA) for 2010 was $281.69.

For purposes of illustration, if 2010 UI benefit payment data are used to make a projection for 2012, approximately $258.4 million in benefits will not be paid due to PA 14. This estimate assumes that recipients who will be affected by PA 14 receive the average WBA (for 2010) of $281.69. For years following 2012, again using 2010 data, the savings will be significantly higher: approximately $447.0 million. The reason for this difference is that during 2012, there will be a large number of recipients whose initial claims were made prior to January 15, 2012, and therefore will be unaffected by PA 14. For years after 2012, all UI benefit recipients will be subject to PA 14 so the savings will be higher during those years, assuming that unemployment levels remain relatively constant. Tables 1 and 2 illustrate these examples.

The major difference between Tables 1 and 2 is that Table 2 includes all recipients who stopped collecting benefits in 2010. Table 1 weighs the number of benefit expirations by the number of days in 2012 that a new benefit recipient could start receiving benefits and then exhaust them in the same year. This weighting can roughly be used to estimate the proportion that will expire in 2012 (again, using 2010 data). If similar data for 2008 and 2009 are used, the amounts saved for 2012 are $99.9 million and $242.4 million, respectively, and the amounts for years after 2012 are $172.9 million and $419.4 million.

Savings estimates for 2012 range from $99.9 million to $258.4 million, and savings estimates for subsequent years range from $172.9 million to $447.0 million, based on these data. Moving forward, then, it will be difficult to determine how much of the decline in benefit payments is due to the changes brought about by PA 14, and how much is due to other factors. Other factors could include, for example, changes in the unemployment rate and changes in the labor market with regard to how long individuals stay unemployed.

Table 1

2012 Projection Based on 2010 Data

Week Benefits Exhausted/Expired[1)]	Recipients Exhausting Benefits	Recipients Stopped Receiving But Not Exhausting Benefits	Amount of Benefits Not Paid
Week 21	5,024	4,081	$2,564,853.37
Week 22	4,674	4,780	$5,326,389.45
Week 23	4,488	3,429	$6,689,817.50
Week 24	4,230	4,103	$9,389,320.38
Week 25	3,954	3,347	$10,282,696.27
Week 26	132,615	N/A[2)]	$224,138,193.28
Total	**154,985**	**19,740**	**$258,391,270.24**

1) Expired indicates a recipient who stopped receiving benefits but whose entitlement was not exhausted. This would likely be a person who found a new job or otherwise became ineligible for continued benefit payments.
2) N/A because recipients who received benefits in their 26th week would have exhausted their benefits.

Source: UIA data and SFA projections

Table 2

2013+ Projection Based on 2010 Data

Week Benefits Exhausted/Expired[1)]	Recipients Exhausting Benefits	Recipients Stopped Receiving But Not Exhausting Benefits	Amount of Benefits Not Paid
Week 21	8,692	7,061	$4,437,462.57
Week 22	8,087	8,270	$9,215,206.66
Week 23	7,764	5,932	$11,574,078.72
Week 24	7,319	7,098	$16,244,498.92
Week 25	6,840	5,791	$17,790,131.95
Week 26	229,438	N/A[2]	$387,782,341.32
Total	**268,140**	**34,152**	**$447,043,720.14**

1) Expired indicates a recipient who stopped receiving benefits but whose entitlement was not exhausted. This would likely be a person who found a new job or otherwise became ineligible for continued benefit payments.
2) N/A because recipients who received benefits in their 26th week would have exhausted their benefits.

Source: UIA data and SFA projections

Borrowing to Pay for UI Benefits

Since 2006, Michigan has engaged in borrowing from the Federal government to pay its UI obligations. In 2006 and 2007, this borrowing was confined to short-term cash-flow loans to help align available State Unemployment Tax Act (SUTA) revenue with benefit payment obligations. These loans were repaid in the years in which they were issued. In 2008, however, the Unemployment Compensation Fund (UCF), the primary source of revenue used to pay benefits, became insolvent. The UCF's insolvency necessitated long-term borrowing.

The UCF is the repository of all SUTA tax revenue and is used to pay unemployment benefits. For much of the 1990s, the UCF ran a surplus, as SUTA tax collections exceeded UI benefit payments. The highest balance attained by the UCF during this time was approximately $3.0 billion in 2000. In 2001, however, the amount of benefits paid exceeded the amount of SUTA revenue collected for the first time since 1992, and in every year since 2001 the amount of benefits has exceeded SUTA revenue. In 2008, the $3.0 billion balance was eliminated.

Title XII of the Social Security Act allows states to borrow from the Federal Unemployment Trust Fund if SUTA tax revenue is insufficient to pay UI benefits. Michigan's highest balance of these loans was approximately $3.9 billion. As of the beginning of fiscal year (FY) 2011-12, data from the UIA show a balance of approximately $3.4 billion. The mechanism for repaying these loans is fairly straightforward: Federal Unemployment Tax Act (FUTA) revenue collected from Michigan employers by the Federal government will be credited toward the debt, and excess SUTA collections can be remitted as payment by the UIA. Depending on the amount of SUTA and FUTA revenue collected, as well as the amount paid in UI benefits, it is reasonable to expect that the State will take four to eight years to repay this debt. If the economy declines and Michigan is forced to take out additional Title XII loans, repayment could take longer.

Until Michigan fully repays its Title XII loans, the credit that Michigan employers receive on their FUTA taxes will decrease by 0.3% per year. The FUTA tax is administered by the Internal Revenue Service and is levied on the first $7,000 of wages paid to each employee. The nominal rate of the tax is 6.2%, but is partially offset by a 5.4% credit, yielding an effective tax rate of 0.8%. This reduction means that the cost of this tax will rise by $21 per employee[1] each year until Michigan's Title XII balance is repaid. Additionally, employers with negative balances in their UI experience accounts (employers whose former employees have collected more in benefits than the employers have paid in SUTA taxes) are subject to a solvency tax of $67.50[2] per employee, per year; approximately 15% of Michigan employers are subject to this tax. Solvency tax revenue is statutorily earmarked for the payment of interest on Title XII loans, and will be collected until those loans are fully repaid. Table 3 details how FUTA and solvency taxes will change for employers while Michigan has a Title XII loan balance.

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[1] FUTA taxes are levied on the first $7,000 of wages paid; $21 assumes employees make at least $7,000 annually.

[2] The solvency tax is formally calculated as a quarter of an employer's account building component (ABC) of the SUTA tax. The maximum rate of the ABC is 3% of the first $9,000 in annual wages, so the maximum solvency tax rate is 0.75%. However, since the solvency tax applies only to employers with negative balances, their ABC rates are typically at the maximum, which is why the amount is assumed to be $67.50.

Table 3

Changes in Annual FUTA and Solvency Taxes per Employee[1]				
Calendar Year	**FUTA Tax**	**Solvency Tax**	**Positive Balance Total[2]**	**Negative Balance Total[3]**
2012	$63.00	$67.50	$63.00	$130.50
2013	84.00	67.50	84.00	151.50
2014	105.00	67.50	105.00	172.50
2015	126.00	67.50	126.00	193.50
2016	147.00	67.50	147.00	214.50
2017	168.00	67.50	168.00	235.50
2018	189.00	67.50	189.00	256.50

1) Assumes employees earn more than $9,000 annually.
2) Total for employers who have a positive balance in their experience accounts, i.e. they have paid more in SUTA taxes than their former employees have received in benefits.
3) Total for employers who have a negative balance in their experience accounts, i.e., their former employees have received more in benefits than the employers have paid in SUTA taxes.

Source: UIA

The UIA estimates that over the next several years there will be approximately 845,000 employees who work for negative-balance employers. This number yields about $57.0 million in solvency tax revenue annually. This presents a problem, as the annual interest payments due on Michigan's Title XII debt are significantly higher than that amount. The Legislature appropriated $38.3 million in GF/GP funding for the FY 2010-11 interest payment. The total amount of this payment was approximately $106.0 million, consisting of $47.7 million from the Solvency Fund (the fund that the solvency tax is deposited into), $20.0 million from the Contingency Fund-Penalty and Interest Account, and $38.3 million from General Fund/General Purpose (GF/GP) revenue. For FY 2011-12, the payment is projected to be approximately $136.4 million; the increase in interest due is attributable to the fact that FY 2010-11 interest was calculated only for calendar year 2011, as during calendar years 2009 and 2010 interest on Title XII loans was forgiven under the American Recovery and Reinvestment Act. For FY 2011-12, the interest will be calculated on the entire fiscal year. Solvency tax collections are expected to be about $57.0 million, leaving a $79.4 million funding shortfall. Additionally, the Michigan Employment Security Act requires any State funds other than Solvency Fund money used to pay Title XII interest payments to be repaid as soon as possible. Because of that requirement, the first $38.3 million in solvency tax revenue collected in FY 2011-12 presumably will be used to repay the GF/GP funding used for the FY 2010-11 interest payment, leaving only $18.7 million for the FY 2011-12 payment.

Using information obtained from the UIA, Table 4 shows the projected balance of Michigan's Title XII loans, projected interest payments, and projected interest shortfalls for the next several years. The projections assume no significant changes to UI statutes and a low level of economic growth.

Table 4 shows a projected cumulative interest payment shortfall of approximately $238.5 million through 2018. The shortfall has no dedicated funding source in statute, and absent any legislative action that would dedicate funding for it, General Fund dollars might have to be used for the shortfall. These projections also take into account the changes made to UI policy by PA 14. Table 5 uses savings projections from PA 14 with UIA revenue, expenditure, and debt projections to compare the former UI milieu of a 26-week maximum to the current 20-week maximum. Since the savings from PA 14 are likely to be highly variable, the mean of $200.2 million from the three years of data used to calculate the savings was used for FY 2011-12, and a mean of $346.4 million was used for following years.

Table 4

Title XII Debt Projections (Figures in Millions)

Calendar Year	Year-End Title XII Balance	Interest Due	Solvency Tax Revenue	Interest Payment Shortfall
2012	$3,211	$136.4	$18.7[a)]	$117.7
2013	2,752	128.4	57.0	71.4
2014	2,323	110.1	57.0	53.1
2015	1,796	92.9	57.0	35.9
2016	1,124	71.8	57.0	14.8
2017	364	45.0	57.0	(12.0)[b)]
2018	0	14.6	57.0	(42.4)[b)]
Total	**N/A**	**$599.2**	**$360.7**	**$238.5**

a) It is reasonable to expect approximately $57.0 million to be collected in FY 2011-12, but the first $38.3 million presumably will be used to repay the GF/GP funding used to pay Title XII interest in FY 2010-11.

b) A negative shortfall would indicate a surplus of solvency tax revenue. Under current law, this surplus would be credited to whichever fund source was used to cover the solvency tax shortfalls in previous years.

Source: UIA

Table 5

Effects of Reducing Maximum Benefit Duration from 26 Weeks to 20 Weeks (Dollars in Millions)

		2012	2013	2014	2015	2016	2017	2018
20-Week Max.	Beg. Title XII Loan Balance	3,410	3,211	2,752	2,323	1,796	1,124	364
	SUTA Revenue	1,330	1,362	1,277	1,284	1,336	1,343	1,396
	Benefits Paid	1,331	1,174	1,193	1,173	1,152	1,144	1,124
	Net SUTA	(1)	188	84	111	184	199	272
	FUTA	200	271	345	416	488	561	634
	End Title XII Loan Balance	3,211	2,752	2,323	1,796	1,124	364	0
	Est. Interest Due	136.4	128.4	110.1	92.9	71.8	45.0	14.6
	Est. Solvency	57.0	57.0	57.0	57.0	57.0	57.0	57.0
	Interest Shortfall[1)]	79.4	71.4	53.1	35.9	14.8	(12.0)	(42.4)
26-Week Max.	Beg. Title XII Loan Balance	3,410	3,411	3,298	3215	3034	2,708	2,294
	SUTA Revenue	1,330	1,362	1,277	1,284	1,336	1,343	1,396
	Benefits Paid	1,531	1,520	1,539	1,519	1,498	1,490	1,470
	Net SUTA	(201)	(158)	(262)	(235)	(162)	(147)	(74)
	FUTA	200	271	345	416	488	561	634
	End Title XII Loan Balance	3,411	3,298	3,215	3,034	2,708	2,294	1,734
	Est. Interest Due	136.4	136.4	132.0	128.6	121.4	108.3	91.8
	Est. Solvency	57.0	57.0	57.0	57.0	57.0	57.0	57.0
	Interest Shortfall	79.4	79.4	75.0	71.6	64.4	51.3	34.8

1) A positive number here would indicate a shortfall in the amount of solvency tax revenue available to pay interest costs in that year. A negative number indicates a surplus in solvency tax revenue.

Source: UIA data and SFA projections

If the projections from Tables 4 and 5 are correct, Michigan should repay its Title XII debt sometime in calendar year 2018. This does not mean that Michigan's UI system will have a totally clean bill of health after 2018. An important function of the SUTA tax and the Unemployment Compensation Fund is that the Fund can accumulate a substantial balance in years with high levels of employment and economic activity. This balance is normally what is used to pay UI benefits in years when benefit payments exceed SUTA tax collections. However, when Michigan pays off its Title XII debt, regardless of when this happens, the Fund will have a very small balance, as excess SUTA revenue will likely have been used by the UIA to pay down the Title XII debt. This means that any economic downturn resulting in increased unemployment while Michigan pays down its debt or in the years following could necessitate further borrowing.

Conclusion

Public Act 14 of 2011 will reduce the potential duration of UI benefits for thousands of individuals in Michigan; it also will serve to help save employers millions of dollars in UI benefit costs. At this point, it is extremely difficult to predict exactly how much money PA 14 will save, going forward. Whatever savings are achieved will reduce cumulative employer costs and the State budget impact of repaying its Title XII loans.

While Michigan has a Title XII loan balance, interest will continue to accrue. The funding mechanism designed to pay this interest is structurally deficient and will not be able to meet future interest obligations. The Legislature will be forced to deal with this issue in one way or another in coming years.