Council Comments

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UNEMPLOYMENT COMPENSATION

THE FINANCIAL CONDITION OF THE MICHIGAN UNEMPLOYMENT COMPENSATION FUND—A PROGRESS REPORT

Late in 1982 the Michigan legislature adopted a comprehensive four-year unemployment compensation financing plan to increase revenues and reduce expenditures and to begin to reduce the unemployment debt which was $2.2 billion at the end of 1982. This Council Comments analyzes the progress that Michigan made in the first two years of the four-year plan.

The financial condition of the unemployment compensation fund is improving more rapidly than projected two years ago, when the state adopted a comprehensive fiscal rescue plan. While both revenues and expenditures are below projections, revenues exceeded expenditures in 1984 by about $550 million compared with a projected $58 million excess. The result is that the interest-bearing debt is being reduced much more rapidly than projected. As of December 31, 1984, the interest-bearing debt was $246 million compared to a projected $769 million. The interest-bearing debt will be eliminated in May 1985 instead of in 1986 as originally projected. There are a number of factors that have contributed to this improved outlook after the first two years of the four-year unemployment compensation financing package adopted in December 1982.

Benefit Expenditures

As shown in Table 1 on page 2, benefit expenditures in 1984 were less than half the level originally projected in 1982 ($596 million actual vs. $1,259 million projected). The primary reason for this is that while the nominal total unemployment rate in 1984 was slightly higher than the original projection (11.2% actual vs. 10.7% projected), insured unemployment (persons actually drawing benefits) was significantly lower than projected (rates of 3.2% actual vs. 6.2% projected). The net result was that instead of having an annual average of 204,000 insured unemployed as had been projected, there actually were an annual average of 102,000 insured unemployed drawing benefits in 1984, only half the number ‘ projected. The historic relationship between

TABLE 1

STATUS OF MICHIGAN UNEMPLOYMENT COMPENSATION FUND
(In Millions $)

	1983 Projected	1983 Actual	1983 Difference	1984 Projected	1984 Actual	1984 Difference
Revenues	$ 1,084	$ 834	$ -250	$ 1,317	$ 1,146	$ -171
Expenditures	(1,251)	(1,018)	+233	(1,259)	(596)	+663
Surplus (+) or Deficit(-)	$ -167	$ -184	$ -17	$ +58	$ +550	$ +492
Debt						
Interest-Bearing	$ 843	$ 800	$ -43	$ 769	$ 246	$ -523
Noninterest-Bearing	1,515	1,522	+7	1,399	1,240	+21
Total	$ 2,358	$ 2,322	$ -36	$ 2,168	$ 1,666	$ -502
Solvency Tax	$ 40	$ 39	$ -1	$ 90	$ 92	$ +2
Interest Due	75	63	-12	74	52	-22
Automation Project	18	10	-8	0	23	+23

*Original 1982 projections.

the total unemployment rate and the insured unemployment rate (50-60% of total rate) dropped in 1983 and 1984 to about 30%. This is a national phenomenon and cannot entirely be explained. In part, it can be attributed to the tightening of eligibility standards in response to the financial crisis that faced many of the state unemployment funds. Also, the duration and depth of the recession caused many workers to exhaust their benefits and prevented new entrants to the labor force from finding jobs. These people looking for work are counted in the total unemployment rate but not counted in the insured rate. Over a longer time span, structural changes toward a service economy with more part-time workers and demographic changes in the work force with more young workers and more women also impact the relationship between the total unemployment rate and the insured unemployment rate. In addition, the decline in the insured unemployment rate caused the extended benefits program to be triggered off which further reduced benefit payments below the level projected.

Unemployment Tax Revenues

Unemployment tax revenues in 1984 were also below the levels projected, but by less than $200 million ($1.1 billion actual vs. $1.3 billion projected - see Table 1). The primary reason for the shortfall in revenue was that growth in the labor force and growth in the number of persons employed in 1984 were about 300,000 below the levels originally projected. Lower levels of inflation and smaller wage increases than projected further reduced the taxable wage base. Finally, the Michigan Employment Security Commission believes that the limit on annual increases in an employer's tax rate (which will be phased out by 1986) had a greater impact than projected and thus reduced the growth in tax revenues.

Interest Costs, Automation Costs and The Solvency Tax

The accelerated repayment of the interest-bearing debt by May 1985 will reduce total interest costs for the 1983-1986 period by $79 million in addition to the $32 million saving from changes in federal and state laws in 1983. However, part of this saving in interest will be offset by the sharp increase in the cost of the unemployment compensation automation project, which is also financed from the solvency tax on negative balance employers. The automation project was originally projected in 1981 to cost $27 million and in early 1983 it was estimated that $18 million from the solvency tax would be required to complete the project. The current estimate is that the automation project will cost $81 million with $65 million of solvency taxes needed. The federal government, which is responsible for financing the administrative operations of the Michigan Employment Security Commission, has continued to refuse to pay for the automation project.

Thus, the solvency tax rate for 1985 has been established at 0.6 percent. This was the projection in 1983 after the state law was modified to reduce the solvency tax rates for 1985 and 1986. A rate of 0.3 percent would have been adequate to pay the reduced amount of interest due as a result of accelerating repayment of the debt. The extra 0.3 percent is for the automation project. Since the interest-bearing debt will be repaid in 1985, it now appears that there will be no solvency tax in 1986, although the 1983 projections indicated a 1986 rate of 0.5 percent.

Solvency taxes will be a total of $160 million lower than original 1982 projections because of the changes in federal and state laws in 1983 and the accelerated repayment of the debt, offset partially by the $47 million increase in solvency taxes used for the automation project. Interest costs will be $111 million lower than originally projected as a result of the changes in federal and state law and the accelerated debt repayment.

(Continued)

1985 Outlook

It is estimated by the Research Council that revenues in 1985 again will be $550 million higher than expenditures. After paying off the interest-bearing debt of $246 million, this would leave about $300 million which could be:

- applied to the noninterest-bearing debt, reducing it to about $1 billion by the end of 1985;
- held in the unemployment trust fund as a reserve to avoid future interest-bearing borrowing; and/or
- used to pay the employers' 1985 FUTA penalty taxes ($150 million) which will be payable in 1986.