The Funding Problem

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The Funding Problem

State unemployment insurance (UI) programs have recently been experiencing financial problems of a magnitude unprecedented in their entire history. A series of severe and lengthy recessions since 1970 has caused benefit payments to exceed tax revenues by wide margins in many years, depleted trust fund balances and forced several states to borrow large amounts from the federal loan fund account in the Unemployment Trust Fund. During calendar year 1983, 27 states borrowed a total of $6.6 billion. The total outstanding debt at the end of the year was $13.3 billion.¹ During 1984, a year of strong economic growth, state indebtedness was reduced but still remained at $9.5 billion on December 31, 1984.

State UI programs, created in the 1930s,² were intended to be self-financing social insurance programs that levied payroll taxes on covered employers and paid benefits to eligible unemployed workers. Typical beneficiaries are laid-off workers who satisfy other eligibility criteria, e.g., they have sufficient employment or earnings prior to unemployment, are able to work, and available for work. Workers collect UI benefits for a limited time period until they are recalled, find another job, leave the labor force, or exhaust their benefits. Maximum regular benefit duration allowed under state laws is usually 26 weeks or less, but the actual duration of benefits drawn per claimant has typically averaged from 12 to 16 weeks during the last 10 years.
A unique feature of UI programs is their method of taxation.\(^3\) The original authorizing legislation (Title IX of the 1935 Social Security Act) provided for a Federal Unemployment Tax (or FUT) that was to equal 3 percent of payroll in covered employment and to be paid by all covered employers. The legislation also provided for a tax offset for state UI taxes paid, up to 90 percent of the FUT or 2.7 percent of payroll for employers in states that established acceptable UI programs. If employers paid UI taxes to the state at a rate of less than 2.7 percent, they could still receive full credit for the maximum FUT tax offset provided their reduced state tax rate was based on experience. Thus the net FUT tax rate which employers paid to the federal government was .3 percent. Originally the UI payroll taxes were levied on total payroll, but in 1940 the taxable wage base was set at $3,000 per employee to correspond with the wage base under the OASI (or Social Security) program.

This general arrangement for federal and state UI taxes has continued down to the present. In 1984, the net FUT tax rate was levied at a rate of .8 percent of taxable payrolls (wages up to $7,000 per covered employee), after the tax offset of 2.7 percent for state UI taxes. In 1985 the same net FUT rate continues to be in force, but the maximum offset doubles to 5.4 percent. Each state UI program must have a maximum tax rate of at least 5.4 percent.\(^4\) Thus, between 1938 and 1985, the net FUT tax rate has increased from .3 to .8 percent of taxable payroll, the gross FUT rate has increased from 3.0 to 6.2 percent and the tax offset has increased from 2.7 to 5.4 percent. The taxable wage base, set at $3,000 in 1940, is $7,000 in 1985.

State UI programs are influenced by both federal and state legislation. The individual states determine their own eligibility criteria, weekly benefit levels, and the number of weeks of benefits payable. In most states, weekly benefits are
50 to 60 percent of previous wages, but subject to a weekly benefit maximum. Maximum regular benefit duration payable is usually 26 weeks.

The UI payroll taxes levied by the states on covered employers are deposited in the Unemployment Trust Fund in the U.S. Treasury and credited to individual state trust fund accounts. The states draw on these accounts to make benefit payments. The federal unemployment tax revenues, now .8 percent of taxable payroll, are paid directly to the U.S. Treasury, and then allocated to various federal accounts in the Unemployment Trust Fund. This component of revenue (the Federal Unemployment Tax or FUT) pays for federal and state UI administrative costs, including the UI-related costs of the U.S. Employment Service (ES). Since 1970, a portion of FUT revenues has been allocated to finance the federal share of extended benefit (EB) costs. Between 1970 and 1983, the FUT tax rate has increased to pay for higher EB costs and increased costs of UI administration.

The employer payroll taxes imposed by the states to finance program benefits are experienced rated. Under experience rating, benefit payments made to former employees and to workers on temporary layoff are a major determinant of employer taxes. Experience rating was intended to reduce labor turnover by making employers financially liable for layoffs. Those with fewer layoffs pay less taxes. In practice, covered employers are only partially experience rated so that the cost of a given layoff may not be fully borne by the employer who initiates the layoff. Thus, an important fraction of state UI taxes (often up to half) is raised by flat rate levies applied to all covered employers. As with benefits, employer tax rates are determined by state legislation (although the minimum tax base per employee and the maximum statutory employer tax rates are influenced by federal legislation).
State UI programs are supposed to be fully self-financed. Trust fund balances act as cushions in financing benefit payments during recessions. After being drawn down, they are to be rebuilt in subsequent economic expansions when experienced rated employer taxes rise.

The actual management of state UI trust fund balances has departed substantially from the preceding description. In fact, there has been a rather steady erosion of UI trust funds dating from the late 1940s. During the 1970s, a financing problem in state UI became apparent, and it has become an even more serious problem in the present decade. Between 1972 and 1979, 23 of the 51 "state" programs (including D.C.) needed federal loans to continue payments for regular state UI benefits and the state share of extended benefits. From January 1, 1980 to December 31, 1984, more than $17.9 billion in loans were disbursed among 32 jurisdictions. Altogether, 38 states have borrowed at least once between 1972 and December 1984.

The state UI funding problem is the result of several distinct and identifiable factors. (1) The economy has experienced four separate recessions since 1969: in 1970-71, 1974-75, 1980 and 1981-82. Two of the recessions (1974-75 and 1981-82) were especially severe by historic standards. Frequent and severe economic downturns have caused very heavy demands for benefits between 1970 and 1983. (2) The recessions of the mid-1970s and the 1980s have had an unusual regional composition. States in the Northeast and Midwest have experienced worse unemployment problems than other states. As a result, the most serious funding problems have been concentrated in the so-called frost belt states. (3) Indexing for wage changes was introduced into many state programs in an asymmetrical manner during the 1960s and the 1970s. The benefit side was indexed to average wages while the taxable wage base was not indexed and changed only infrequently, e.g., the wage base for the Federal
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Unemployment Tax increased only in 1972, 1978 and 1983. As a result, tax revenues have tended to grow more slowly than benefit payments. The taxable wages that support the program now represent less than half of total wages in covered employment. (4) The scope of employer-financed benefit payments was broadened in 1970 with the creation of the Federal-State Extended Benefit (EB) program. Because of the high average rate of unemployment since 1972, benefit payouts under EB have exceeded original expectations. More details about each of these four contributing factors will be discussed later in this chapter under "Origins of the Funding Problem."

Trust Fund Balances and Loans to State UI Programs

Long Term Trust Fund Decline

Table 1-1 illustrates with aggregate data the funding situation for state UI programs over the post-World War II period. The seven years that are identified are years immediately prior to recessions. End of year aggregate trust fund balances for these years (column 1) ranged from $6.7 to $12.6 billion. In absolute magnitude the 1979 balance was not a great deal larger than the 1948 balance and less than that of 1953. Column 2 shows that as a percentage of covered wages and salaries the fund balance declined from 7.9 in 1948 to .9 percent in 1979.

Columns 3, 4 and 5 provide information on the benefit potential that the trust fund balances represent. The average benefit paid for a week of total unemployment appears in column 3. Weekly benefit levels that grew by about half between 1948 and 1959 and again between 1959 and 1969, nearly doubled between 1969 and 1979. High inflation coupled with indexation combined to produce rapid growth in weekly benefit levels during the 1970s. Average potential regular
## Table 1-1
### Aggregate State UI Trust Fund Balances and Related Measures
#### Pre-Recession Years 1948 to 1979

<table>
<thead>
<tr>
<th>Year</th>
<th>End-of-year net trust fund balance</th>
<th>Average weekly benefit paid</th>
<th>Average potential benefit duration (weeks)</th>
<th>Fund capacity at average entitlement (millions of persons)</th>
<th>Average covered employment (millions)</th>
<th>Person years-to-employment ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount ($ millions)</td>
<td>Percent of total covered payrolls</td>
<td>($ millions)</td>
<td>(weeks)</td>
<td>(1)/(3)x(4)</td>
<td>(5)</td>
</tr>
<tr>
<td>1948</td>
<td>7,603</td>
<td>7.9</td>
<td>19.03</td>
<td>21.1</td>
<td>18.94</td>
<td>33.08</td>
</tr>
<tr>
<td>1953</td>
<td>8,913</td>
<td>6.4</td>
<td>23.58</td>
<td>22.1</td>
<td>17.10</td>
<td>36.67</td>
</tr>
<tr>
<td>1957</td>
<td>8,659</td>
<td>5.0</td>
<td>28.17</td>
<td>23.4</td>
<td>13.14</td>
<td>39.67</td>
</tr>
<tr>
<td>1959</td>
<td>6,674</td>
<td>3.6</td>
<td>30.41</td>
<td>23.6</td>
<td>9.30</td>
<td>39.54</td>
</tr>
<tr>
<td>1969</td>
<td>12,550</td>
<td>3.4</td>
<td>46.17</td>
<td>24.4</td>
<td>11.14</td>
<td>52.36</td>
</tr>
<tr>
<td>1973</td>
<td>10,845</td>
<td>2.1</td>
<td>59.00</td>
<td>24.3</td>
<td>7.56</td>
<td>59.91</td>
</tr>
<tr>
<td>1979</td>
<td>8,623</td>
<td>0.9</td>
<td>89.67</td>
<td>24.0</td>
<td>4.01</td>
<td>71.35</td>
</tr>
</tbody>
</table>

**SOURCE:** Columns 1, 2, 3, 4 and 6 are from U.S. Department of Labor, *Unemployment Insurance Financial Data (1984).* Columns 5 and 7 are based on other data in the table.

a. Data exclude Puerto Rico and the Virgin Islands.

b. Payable under state regular benefit provisions, excluding federal-state shared extended benefits.
benefit duration (excluding extended benefits) for claimants (column 4) also has grown since 1948, but since 1969 it has remained close to 24 weeks.

Column 5 then shows the implications of growth in average weekly payment levels and potential duration on the benefit capacity of the trust fund balances. In 1948, the $7,603 million year-end balance could have financed benefits for nearly 19 million persons at average total benefit entitlement levels that year. By 1979 the trust fund could cover only 4 million persons at such levels, less than one-fourth of the 1948 capacity, so measured.

A proxy for the potential unemployment risk exposure of state UI is the level of covered employment. Between 1948 and 1979 it more than doubled, rising from 33 to 71 million (column 6). Thus, while the real level of the aggregate trust fund balance declined sharply, the potential volume of claims increased. Combined, these developments meant that the benefit cushion in the trust fund declined very dramatically over this time period. Column 7 expresses this cushion, as measured in column 5, as the fraction of annual covered employment that could be compensated by the existing trust fund. It fell from .572 to .056 during these 32 years. Thus, the ability of state UI programs to provide compensation benefits without immediate resort to higher employer taxes or emergency loans has declined in a precipitous manner over the post-World War II period. The real trust fund benefit cushion at the end of 1979 was about one-tenth of its 1948 level.

Perhaps the most interesting feature of table 1-1 is the steady downtrend in the trust fund reserve position as indicated in columns 2 and 7. The only noticeable slowdown in the long term downtrend occurred between 1959 and 1969. Most of this decade was characterized by steady and substantial economic growth. Even though the 1959 reserves had
been depleted by the 1958 recession, they still were somewhat more adequate than reserves 10 years later. If the 1969 aggregate trust fund balance was adequate, the 1979 balance clearly was not. The small cushion represented by the 1979 trust fund has been a major contributing factor behind the recent loans and the current indebtedness of the state UI programs.

With the full benefit of hindsight, it can be inferred that trust fund balances in the late 1940s were excessive for the needs of the program. Two ways to reduce excessive balances were through experience rated tax reductions and not raising the taxable wage base. After UI trust funds became depleted in the 1970s, it has not always been easy for states to raise employer taxes. One can speculate that the earlier situation of excess reserves followed by downward tax adjustments did not serve the UI system well when it later became necessary to increase average tax rates and tax bases.

Reasonable people may disagree in defining an adequate level of state UI trust fund reserves. Factors such as the average or usual level of state unemployment, the level and availability of benefits to the unemployed and the severity of a given recession are all relevant in assessing trust fund adequacy. One measure of adequacy has been developed by a committee of the Interstate Conference of Employment Security Agencies (ICESA). Their guideline involves a comparison of the trust fund reserve to the highest total of benefits for a 12-month period with each expressed as a proportion or ratio of total covered wages. The 12-month high benefit cost ratio is based on total payrolls for the period of those costs (or a year close to that period) while the reserve ratio is based on payrolls for the latest period. The reserve ratio is expressed as a multiple of the benefit cost ratio and is to be between 1.5 and 3.0. Under this guideline, a multiple of 1.5 (representing 18 months of benefits paid in an environ-
ment of unusually high unemployment) can be termed a minimum adequate level of reserves.

Table 1-2 presents detail on the distribution of reserve ratio multiples for 51 jurisdictions (the 50 states plus the District of Columbia) in 1969, 1973 and 1979. Also shown are medians of the 51 state multiples and multiples based on aggregate U.S. data. The table shows that most of the 1969 multiples exceeded the guideline. Thirty-five were 1.5 or larger and 15 of the remaining 16 fell between 1.00 and 1.49. The only state with a ratio below 1.0 was Michigan. In 1973, 21 state multiples exceeded 1.5 while 18 were less than 1.0. Of the 18, however, note that just 4 state ratios fell below .50. By 1979, only 2 state ratios exceeded 1.5 while 9 were negative and another 29 fell between 0 and .99. Using the 1.5 reserve ratio multiple guideline, the state systems went from a situation of at least minimum fund adequacy in 35 jurisdictions down to just 2 jurisdictions between 1969 and 1979.

For many states, the 1979 reserve ratio multiples in table 1-2 utilize data on benefit costs from the 1974-75 recession. Since that recession was unusually long and severe, it is instructive to note the distribution of reserve ratio multiples based on pre-1974 benefit cost experiences. The bottom line in the table shows these ratios for 1979. Although they are larger in several states, only 5 equal or exceed 1.5 while 31 are still smaller than 1.0. Thus, widespread reserve inadequacy is still present even when benefit experiences from pre-1974 recessions are used in the reserve ratio multiple calculations.

Based on the preceding, two broad statements about state UI trust fund balances can be made. (1) Aggregate data show clearly that between 1948 and 1979 the program evolved from a situation of trust fund overabundance to inadequacy. The measure of fund adequacy developed in column 7 in table 1-1, the ratio of person years of benefits to covered
### Table 1.2
State UI Reserve Ratio Multiples in 1969, 1973 and 1979

<table>
<thead>
<tr>
<th>Year</th>
<th>Negative</th>
<th>0.49</th>
<th>.50-99</th>
<th>1.00-1.49</th>
<th>1.50-1.99</th>
<th>2.00-2.99</th>
<th>3.00 and above</th>
<th>Median state ratio</th>
<th>Ratio for U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>15</td>
<td>14</td>
<td>13</td>
<td>8</td>
<td>1.84</td>
<td>1.68</td>
</tr>
<tr>
<td>1973</td>
<td>2</td>
<td>2</td>
<td>14</td>
<td>12</td>
<td>13</td>
<td>7</td>
<td>1</td>
<td>1.31</td>
<td>1.04</td>
</tr>
<tr>
<td>1979</td>
<td>9</td>
<td>12</td>
<td>17</td>
<td>11</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>.63</td>
<td>.41</td>
</tr>
<tr>
<td>1979 with pre-1974 benefit experience&lt;sup&gt;a&lt;/sup&gt;</td>
<td>9</td>
<td>10</td>
<td>12</td>
<td>15</td>
<td>4</td>
<td>1</td>
<td>0</td>
<td>.77</td>
<td>.44</td>
</tr>
</tbody>
</table>

**SOURCE:** Based on data in U.S. Department of Labor, *Unemployment Insurance Financial Data* (1984). Reserve ratio multiples are based on reserves measured at the end of the indicated years. Medians were computed at The Urban Institute.

<sup>a</sup> Cost ratios used in computing reserve ratio multiples are based on the highest benefit cost experiences for the years prior to 1974.
employment, reached a level in 1979 that was about one-tenth the size of its 1948 level. The critical period in this evolution was the years following 1969 when state reserve ratio multiples fell to levels that were generally below a suggested actuarial standard of 1.5. (2) The decline in trust fund reserves has been widespread and not confined to just a few states. Using the 1.5 minimum reserve ratio multiple guideline, the number of jurisdictions with inadequate trust fund reserves increased from 16 in 1969 to 49 in 1979. Widespread deficits, emergency federal loans and large debts are all direct consequences of inadequate state UI program funding.

Because funding has been inadequate, most UI programs have had to borrow at least once in the past decade. Of the 51 "states," i.e., the 50 plus the District of Columbia, 23 borrowed sometime in the 1970s while 32 borrowed sometime between January 1, 1980 and December 31, 1984. Altogether 38 different states have borrowed at least once between 1972 and December 1984. Over these 13 years a total of $23.4 billion was lent to insolvent state UI programs.

Although the present study focuses primarily on state fund insolvency and debt, one has to recognize the diversity of individual state experiences. Several states have never become insolvent while others have borrowed only relatively small amounts for brief periods. The programs that have been successful in avoiding major funding problems are examined in chapter 3. Despite the diversity of state experiences, it must be emphasized that the loss of fund adequacy has been a pervasive phenomenon. Only two states entered the 1980s with reserve ratio multiples of at least 1.5. Even after all UI indebtedness is eliminated, it will require substantial additional trust fund rebuilding to achieve a distribution of reserve ratio multiples approaching that which existed at the end of 1969. In other words, a long-run solvency problem will continue to exist even after all current indebtedness has been eliminated.
Trust Fund Insolvency and Debt

Table 1-3 displays aggregate annual data on loan activities and indebtedness since 1969. Columns 1 and 2 respectively show the start-of-year trust fund position of the programs (more precisely the reserve ratio multiple) and the annual unemployment rate for the civilian labor force. Because the 1974-75 recession followed closely after the 1970-71 downturn, very little trust fund rebuilding occurred in 1972 and 1973. As a consequence, benefit payments associated with the very high unemployment rates of 1975-77 caused a precipitous decline in the aggregate reserve ratio multiple and loans were required by many state UI programs. Loans of $4.5 billion were made in 1975-77 and for the entire 1972-79 period the total was $5.5 billion. Substantial loan repayments occurred in 1979, but $3.7 billion of debt remained at the end of that year as the economy entered another major recessionary period.

The recession of 1980 seriously impacted state UI programs whose trust funds were even more depleted than they had been in 1974-75. About $3.1 billion was borrowed in 1980-81. When unemployment then rose to even higher levels in 1982 and 1983, annual loans of $5.2 billion and $6.6 billion were required. More than half (27) of the state UI programs had to borrow in 1983. With practically nonexistent trust fund cushions large benefit payouts meant an immediate need for federal loans. State borrowing in 1983 equaled about one-third of all benefit payments made under regular state UI and EB programs.

The year 1983 was noteworthy not only for the amount of loans but also for the volume of loan repayments. The $3.9 billion of repayments was nearly three times the amount repaid in 1979, the second highest previous repayment year. A heavy volume of loan repayments occurred despite the fact that 1983 was a year of serious recession. Loan repayments
## Table 1-3
### Summary Data on State UI Trust Fund Adequacy, Loans, Loan Repayments and Debt, U.S., 1969 to 1984

<table>
<thead>
<tr>
<th>Year</th>
<th>Start-of-year reserve ratio multiple</th>
<th>Unemployment rate (percent)</th>
<th>States requiring loans (number)</th>
<th>Loans ($millions)</th>
<th>Loan repayments ($millions)</th>
<th>End-of-year debt ($millions)</th>
<th>End-of-year states in debt (number)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>1.72</td>
<td>3.5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1970</td>
<td>1.68</td>
<td>4.9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1971</td>
<td>1.51</td>
<td>5.9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1972</td>
<td>1.18</td>
<td>5.6</td>
<td>1</td>
<td>32</td>
<td>0</td>
<td>32</td>
<td>1</td>
</tr>
<tr>
<td>1973</td>
<td>1.00</td>
<td>4.9</td>
<td>2</td>
<td>62</td>
<td>0</td>
<td>94</td>
<td>2</td>
</tr>
<tr>
<td>1974</td>
<td>1.04</td>
<td>5.6</td>
<td>3</td>
<td>17</td>
<td>0</td>
<td>111</td>
<td>3</td>
</tr>
<tr>
<td>1975</td>
<td>.92</td>
<td>8.5</td>
<td>14</td>
<td>1,456</td>
<td>13</td>
<td>1,554</td>
<td>14</td>
</tr>
<tr>
<td>1976</td>
<td>.24</td>
<td>7.7</td>
<td>21</td>
<td>1,827</td>
<td>36</td>
<td>3,345</td>
<td>20</td>
</tr>
<tr>
<td>1977</td>
<td>.06</td>
<td>7.1</td>
<td>18</td>
<td>1,265</td>
<td>110</td>
<td>4,500</td>
<td>20</td>
</tr>
<tr>
<td>1978</td>
<td>.06</td>
<td>6.1</td>
<td>10</td>
<td>826</td>
<td>337</td>
<td>4,989</td>
<td>16</td>
</tr>
<tr>
<td>1979</td>
<td>.25</td>
<td>5.8</td>
<td>3</td>
<td>46</td>
<td>1,307</td>
<td>3,728</td>
<td>11</td>
</tr>
<tr>
<td>1980</td>
<td>.41</td>
<td>7.1</td>
<td>8</td>
<td>1,471</td>
<td>305</td>
<td>4,894</td>
<td>14</td>
</tr>
<tr>
<td>1981</td>
<td>.29</td>
<td>7.6</td>
<td>9</td>
<td>1,614</td>
<td>321</td>
<td>6,187</td>
<td>15</td>
</tr>
<tr>
<td>1982</td>
<td>.23</td>
<td>9.7</td>
<td>16</td>
<td>5,187</td>
<td>813</td>
<td>10,561</td>
<td>21</td>
</tr>
<tr>
<td>1983</td>
<td>-.10</td>
<td>9.6</td>
<td>27</td>
<td>6,632</td>
<td>3,914</td>
<td>13,279</td>
<td>21</td>
</tr>
<tr>
<td>1984</td>
<td>-.20</td>
<td>7.5</td>
<td>18</td>
<td>3,005</td>
<td>6,826</td>
<td>9,452</td>
<td>17</td>
</tr>
</tbody>
</table>

totaling $6.8 billion took place in 1984. Since the recent loans are interest-bearing, debtor states have been repaying them at a particularly rapid rate. Over 80 percent of total loan repayments in both 1983 and 1984 were made on interest-bearing debt. In contrast, loan repayments were of minor importance during 1975-77, the years of highest unemployment during the 1970s. Because of these recent repayments end-of-year indebtedness grew by only $2.7 billion (from $10.6 to $13.3 billion) between 1982 and 1983, while it declined by about $3.8 billion between 1983 and 1984. To better understand why large repayments occurred in a year of such high unemployment it will be useful to describe the repayment provisions of the federal laws, the costs of indebtedness and how these costs have increased in the 1980s.

Repayment of loans by the states can be made in two ways. (1) States can make voluntary payments from their trust fund accounts to the federal loan account. (2) Employers in debtor states may be subject to increased taxes under the Federal Unemployment Tax. As noted earlier, the basic net FUT rate is .8 percent. For states with outstanding loans, however, the FUT net rate is automatically raised by predetermined amounts and the proceeds are used to repay debts. These higher taxes can be termed FUT penalty taxes.

Penalty taxes are applied after a state loan has been outstanding on January 1 of two consecutive years. The penalty tax rate is .3 percent of federally taxable payroll in the first year of applicability and it rises by increments of .3 percent in subsequent years until the outstanding loan is fully repaid. (The FUT rate increases are really reductions in the amount of the tax credit allowed. Thus, the full tax offset of 2.7 percent prior to 1985 was reduced to 2.4, then to 2.1, and so on. After 1984, the full offset of 5.4 percent is reduced to 5.1, 4.8, etc.). Connecticut was the first state to need federal
loans (March 1972 was the first loan date), and its employers were subject to a .3 percent FUT penalty tax payable in 1975 (based on 1974 taxable wages).

Altogether, a total of 23 different states secured loans in the 1970s, but only 7 actually paid penalty taxes prior to 1980. Full implementation of the penalty tax provisions was twice deferred by legislation during the 1970s. Because it was viewed as inappropriate to impose penalty taxes in a period of high unemployment and low employer profits, federal amendments of the repayment provisions were enacted in 1975 (PL94-45) and 1977 (PL95-19) that deferred until 1978 and then until 1980 the full applicability of the penalty tax provisions. The loans made during the 1970s were not financially onerous for the debtor states for another reason. There were no interest charges on the outstanding debt.

Individual debtor states followed a variety of policies in repaying the loans. By the end of 1979, 12 of the 23 that had borrowed had completely paid off their loans by transfer from their reserve accounts, and 2 more completed their debt repayments during 1980. Although 12 of the 23 debtor states had fully repaid their loans by the end of 1979, about two-thirds of the principal ($3.7 of $5.5 billion) remained outstanding. Of the $3.7 billion debt, $3.2 billion was concentrated in just four states (Connecticut - $.4 billion; Illinois - $.9 billion; New Jersey - $.7 billion; and Pennsylvania - $1.2 billion). Besides these states, the other five that continued in debt past 1980 were Delaware, the District of Columbia, Maine, Rhode Island and Vermont. These states did little or nothing to repay their loans, even though the bulk of the lending occurred prior to 1978. Because of inflation, each year of repayment deferral reduced the real burden of their indebtedness.

The failure of some debtor states to make substantial loan repayments in the late 1970s was an important consideration
in subsequent federal legislative actions. First, a further deferral of FUT penalty taxes was not seriously considered in 1979 and the penalty took effect in nine states in 1980. The dollar amount of FUT penalty taxes rose from $60 million in 1979 to over $300 million in 1980. Second, the Reagan Administration in 1981 proposed that future loans would carry interest charges. This proposal was adopted as part of the Omnibus Budget Reconciliation Act of August 1981 (PL97-35). New loans made after March 31, 1982 carry an annual interest charge if not fully repaid within the same fiscal year. Interest was charged on the average outstanding loan balance, and the interest rate was the same as the rate paid on state UI trust fund investments (but subject to a maximum rate of 10 percent per year). Combined, these interest and FUT penalty applications meant that future loans would be more expensive and debt repayment would be more prompt.

The 1981 Omnibus Budget Reconciliation Act also contained provisions to limit FUT penalty taxes. Four solvency requirements were listed that, if met by a state, could limit the penalty taxes applicable during the years 1981 to 1987. The four requirements were: (1) to maintain unemployment tax effort; (2) not to reduce net solvency in the program; (3) to have the tax rate (based on total wages) at least equal the prior five-year average benefit cost rate; and (4) to avoid increases in total indebtedness after 1981. The last two requirements were applicable starting in 1983. States could limit FUT penalty taxes in 1981 and 1982 merely by not lowering employer taxes and not raising benefits or easing benefit eligibility. The FUT penalty rate was limited to .6 percent or to the pre-1981 rate if it exceeded .6 percent. Since FUT penalty taxes are payable in January of the year after they accrue, this legislation meant that a .6 percent penalty tax was levied in eight states in January 1982 and only in Connecticut was it higher.
The economic downturn of 1981-82, however, led to a renewed concern about the financial problems confronting debtor states. As unemployment increased in late 1981 and throughout 1982, it became clear that the higher costs of debt repayment would be experienced while the states were in the midst of a very severe recession. The Tax Equity and Fiscal Responsibility Act of 1982 (PL97-248, also known as TEFRA) contained provisions designed to lessen recession-induced economic hardships both for workers with long term unemployment and for state UI programs with financing problems. A program of Federal Supplemental Compensation (FSC) was created to provide extra weeks of long term benefits to workers exhausting their regular state UI or EB entitlements.¹⁶

Important TEFRA provisions focused on financing and debt repayment issues. (1) The Federal Unemployment Tax was modified in several ways. Starting in 1983, the taxable wage base was raised from $6,000 to $7,000 per covered workers and the net tax rate was increased from .7 to .8 percent of taxable wages. Also the gross federal UI tax rate was raised from 3.5 to 6.2 percent starting in 1985. This change doubles the maximum credit allowed employers for state UI taxes from 2.7 to 5.4 percent since the net FUT rate remains at .8. State tax rates may not be less than 5.4 except through experience rating and maximum state tax rates still less than 5.4 will have to rise to at least that level.

(2) Starting in 1983, debtor states could avoid FUT penalty taxes for their employers. To avoid these taxes, a state must (i) repay current year advances before November 10, (ii) pay from its reserves an amount toward reducing its prior debt equivalent to the potential penalty taxes, (iii) have a trust fund balance on November 1 equal to at least three months worth of benefits and (iv) enact a net increase in program solvency. Wisconsin, for example, which first obtained loans in 1982, will be able to avoid FUT penalty taxes in 1985.
because it satisfies these four TEFRA financial requirements. 17

Other TEFRA financial provisions were as follows. (3) It limited the potentially sharp increases in FUT penalty taxes (much larger than .3 percent) applicable after several years in debtor states that had not improved the financial solvency of their programs. (4) States with very high insured unemployment rates (IURs) were allowed to defer up to three-fourths of their annual interest payment due after the end of 1982. The deferred amounts were to be repaid in the subsequent three years and to accrue interest while they remained unpaid. The threshold IUR was 7.5 percent, a rate so high that only Michigan’s rate for the first six months of 1982 exceeded this level.

An examination of these TEFRA financial provisions shows they were intended both to improve overall state UI program solvency and to provide partial financial relief to some debtor states. Improved program solvency would result in some states from the tax base increase in 1983, the higher gross FUT tax rate in 1985 and from inducements for states to enact legislation. Penalty taxes could be avoided if solvency was improved. Avoidance of penalty taxes by paying the equivalent from the state fund permits the state to finance the repayment through an experience rated rather than a flat rate tax.

Because unemployment continued to rise throughout 1982, the volume of new loans rose sharply and exceeded $5 billion for the year. States faced the obvious prospect of high interest charges in 1983 and later years. In fact, since market interest rates remained high throughout 1982, it was apparent that interest payments would become increasingly burdensome. The legislation of 1981 and 1982 gave the states the ability to limit their FUT penalty taxes, but they could not reduce their interest payments. In states with large debts,
interest charges would soon exceed FUT penalty taxes, and high unemployment meant that increased borrowing was inevitable. The partial financial relief provided to Michigan with its unusually high IUR was not available to other states and even that relief had its price, i.e., interest accrued on the deferred interest payments.

The Social Security Amendments of March 1983 (PL98-21) contained provisions that addressed the costs of UI loans and indebtedness. For debtor state UI programs, interest and debt repayment terms were made potentially easier. If a debtor state maintained its tax effort and increased its net solvency in 1983 (or the first year of indebtedness) through tax increases and/or benefit reductions by 25 percent (and then by more in subsequent years), it would be allowed during fiscal years 1983, 1984, and 1985 to defer until later years at no cost 80 percent of the interest payments on federal loans made after March 31, 1982. Interest deferrals would also be allowed if taxes as a percent of a total payroll equaled or exceeded 2 percent in calendar year 1982. Only two debtor states were eligible under this alternative interest deferral criterion: Rhode Island and West Virginia.

A second financial inducement to improve net solvency was provided in the form of potentially lower interest rates. If net solvency was improved by 50 percent in 1983 (or the first year of indebtedness), the state would be eligible for a 1 percentage point reduction in the interest rate charged on interest-bearing debt, e.g., from 10 to 9 percent for 1982 loans.

The 1983 Social Security Amendments also addressed the potential costs of FUT penalty taxes. The four solvency requirements listed in the Omnibus Budget Reconciliation Act of 1981 were again introduced as criteria for limiting these taxes. In this 1983 legislation, however, any state satisfying all four requirements would be eligible for a permanent cap
(as opposed to a temporary cap lasting only until 1987) on FUT penalty taxes. Also, criteria were listed for reducing annual increments in penalty tax rates (to .1 or .2 percent per year) in states where some but not all of the four requirements were met. All of these provisions have the effect of allowing states to reduce and/or defer the financial obligations associated with their debts.

By charging interest on new loans, the federal government has provided the states with strong financial incentives to repay outstanding debts. If debts are repaid quickly, i.e., in the year that they are incurred, interest charges can be completely avoided. Voluntary repayments can be applied to interest-bearing debt even if the state has older debt incurred before April 1, 1982. The repayment activities of 1983 and 1984 previously noted in table 1-3 reflect this repayment behavior. Between April 1, 1982 and December 31, 1983, for example, new loans totaled $10.1 billion but only $6.4 billion was still outstanding at the end of 1983. As noted, loan repayments in the first nine months of 1984 totaled $5.9 billion. Compared to earlier periods, this is a very rapid rate of repayment, particularly considering that 1983-84 have been years of very high unemployment.

The interest costs and FUT penalty taxes when coupled with the potential financial relief provided by the 1983 Social Security Amendments give debtor states very strong inducements to modify their UI laws. Following the Amendments, legislation has been enacted or at least proposed in nearly all states with large debts. Chapter 2 will examine these legislative initiatives in some detail. Before moving on to the specifics of the changes, however, there are background issues regarding the origins of the funding crisis that need to be addressed.
Origins of the Funding Problem

The funding problem that state UI programs are currently experiencing has origins in the recent overall performance of the economy. Adverse economic developments coupled with key revenue and benefit features of UI programs have resulted in a persistent tendency for benefit payouts to exceed revenues since 1969. Four developments will be examined in subsequent paragraphs: (1) real GNP growth; (2) regional growth differentials; (3) recent inflation and (4) the Federal-State Extended Benefit (EB) program. All four have contributed to the funding problem.

Variations in Real GNP Growth Rates

Table 1-4 presents summary data on U.S. macroeconomic performance between 1949 and 1983. The starting point, 1949, is the year of the first post-World War II recession and a year when state UI programs had abundant, perhaps overabundant, trust fund reserves. Indicators in the table are organized roughly by decade with the exact time periods being 1949-59, 1960-69, 1970-79 and 1980-83. Although most are long time intervals, they do illustrate important contrasts in economic performance. The aggregate of state trust fund balances at the start of these four periods can be characterized respectively as overabundant, adequate, inadequate, and very inadequate. The aggregate reserve position, net of loans, declined sharply during the 1949-59 and the 1970-79 periods.

Annual rates of growth in the economy’s output of final goods and services (real GNP) averaged just above 3 percent in the 1950s and 1970s, more than 1 full percentage point below the 4.6 percent average of the 1960s. The latter period had just one recession (1960-61) and a prolonged period of economic growth between 1961 and 1969. Due to two recessions (1980 and 1981-82) the 1980-83 period had very low real growth.
### Table 1-4

Economic Performance and State UI Net Trust Fund Reserves
U.S. and Region, 1949-1983

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<tr>
<td>Real GNP growth rate</td>
<td>3.4</td>
<td>4.6</td>
<td>3.3</td>
<td>.7</td>
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<tr>
<td>Unemployment rate</td>
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<tr>
<td>All persons 16 and older</td>
<td>4.6</td>
<td>4.8</td>
<td>6.2</td>
<td>8.5</td>
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<tr>
<td>Men 25 and older</td>
<td>3.6</td>
<td>3.1</td>
<td>3.6</td>
<td>6.3</td>
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<tr>
<td>Real labor productivity growth rate</td>
<td>2.3</td>
<td>2.5</td>
<td>1.4</td>
<td>1.0</td>
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<td>Employment growth rate</td>
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<td></td>
<td></td>
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<tr>
<td>Total U.S.</td>
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<td>2.6</td>
<td>2.5</td>
<td>-.1</td>
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<tr>
<td>North</td>
<td>.8</td>
<td>2.1</td>
<td>1.4</td>
<td>-1.0</td>
</tr>
<tr>
<td>South and West</td>
<td>2.4</td>
<td>3.3</td>
<td>3.8</td>
<td>.9</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>2.4</td>
<td>2.2</td>
<td>6.3</td>
<td>7.3</td>
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</table>

Start of period net UI trust fund reserves as a percent of prior year payrolls

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<tr>
<td>Total U.S.</td>
<td>7.9</td>
<td>3.6</td>
<td>3.4</td>
<td>0.9</td>
</tr>
<tr>
<td>North</td>
<td>7.6</td>
<td>3.2</td>
<td>3.4</td>
<td>-0.1</td>
</tr>
<tr>
<td>South and West</td>
<td>8.5</td>
<td>4.2</td>
<td>3.5</td>
<td>2.0</td>
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</table>

**SOURCES:** Rates of GNP and labor productivity (output per man hour) growth and inflation (implicit price deflator for GNP) based on national income accounts data (for nonfarm business sector) from U.S. Executive Office of the President, *Economic Report of the President* (1984), table B-41, p. 267.


a. Economic performance indicators are measured as percentage changes and averaged over the indicated period; UI trust fund reserves are measured at the start of each period and expressed as a percentage of total covered payrolls in the previous year.

b. The "North" region includes states in the North East and North Central divisions as defined by the Census Bureau; the "South and West" includes all other states.
The effects of economic recessions are apparent not only in economic growth rates, but also in the average unemployment rates. Because high unemployment leads to increased demand for UI benefits, average unemployment rates have obvious implications for UI trust fund payouts. Since World War II the composition of U.S. unemployment has undergone a long run change with an increasing share of the total made up of younger persons and women, groups whose unemployment rates are typically higher than the rates experienced by adult men. This changing mix has tended to increase the economy's average unemployment rate in more recent years and to increase the minimum unemployment rate consistent with a full employment economy. Table 1-4 illustrates the importance of this mix effect by displaying two sets of average unemployment rates; the rate for all persons 16 and older and the rate for adult men 25 and older. The adult male unemployment rate, which is more comparable across time periods, clearly illustrates the economy's superior performance of the 1960s in comparison to the adjacent earlier and later decades. Since adult men are the demographic group most likely to be UI beneficiaries, movements in their average rate provide a useful gauge of the demand for UI benefits. Both average unemployment rates are very high in the 1980-83 period.

The data on real GNP growth rates and adult male unemployment rates convey similar messages. Frequent recessions in the 1950s and 1970s caused substantial drains on UI trust fund reserves. Because the system started the 1950s with excessive reserves, however, it emerged from the 1950s with generally adequate reserves, although 12 states had less than adequate reserves, including 3 in debt. Ten years later, aggregate reserves still seemed generally adequate, but 16 states had reserve ratio multiples that fell below 1.5. The excessive reserve cushion from the late 1940s was not present at the start of the 1970s, and, as a result, the
recessions of this decade necessitated borrowing by many state UI programs. Given the low reserves and very high unemployment rates of 1980-83, borrowing in this latest period has also been widespread.

**Disparities in Regional Rates of Economic Growth**

Output growth translates into employment growth as increased real production raises demand for labor and creates more jobs. The association between output growth and employment growth, however, is also influenced by labor productivity growth. For a given rate of output growth, a lower rate of productivity growth will imply a faster rate of employment growth. Table 1-4 documents the slowdown in labor productivity growth that occurred in the 1970s when average man hour productivity grew by 1.4 percent per year compared to averages of 2.3-2.5 percent in the preceding two decades. Because of the productivity slowdown average employment growth was nearly as fast in the 1970s as it had been in the 1960s, despite the slower pace of output growth. On average, employment grew by 2.5 percent per year in the 1970s compared to 2.6 percent in the 1960s. Since employment growth and productivity growth are very sensitive to short-run business cycle developments, their slow growth in 1980-83 reflects cyclical factors.

Over the entire period since World War II, there have been systematic differences in regional rates of economic growth. States in the South and West have consistently exhibited higher than average growth while states in the North have grown more slowly. Table 1-4 illustrates these regional differences with data on employment growth rates. The cumulative effect of the employment growth differentials over this 34-year period is quite dramatic. In 1948, states in the North had 63 percent of total U.S. employment, but by 1983 their employment share had declined to 47 percent.
Since 1970, the differences in regional growth rates have been especially pronounced. The first energy crisis of 1973-75 increased the relative costs of doing business in the North (so-called frost belt states) and hastened the pace of regional population and employment reallocations. Employment growth data in table 1-4 illustrate the increased regional disparities. As noted, employment growth for the U.S. as a whole was only .1 percent lower in the 1970s compared to the 1960s. However, employment growth during the 1970s was .7 percent lower in the North but actually .5 percent higher in the South and West when compared to the preceding decade. These wider regional disparities have persisted through the first four years of the present decade.

Given the way that UI programs are financed, increased regional growth disparities can have differential implications for trust fund balances in individual states. Consider some consequences of a company closing a plant in the North and simultaneously opening a plant in the South or West. The claims of laid-off workers are the obligation of the program in the state where the plant closure occurs. The closing will cause a loss of tax revenues as well as an increase in benefit claims. Even if the worker moves out of the state to find a new job, he or she can file an interstate claim that is the financial obligation of employers in the original state. New and expanding plants in the growing region pay taxes for new employees as soon as the workers are hired. For new plants, the employer taxes are not reduced by an experience factors so that trust fund reserves are accumulated quickly in the first few years of operation. New employees must work for a time before satisfying the monetary eligibility requirements for state UI benefits. Thus, when the regional distribution of employment changes, there is some tendency for UI trust funds to be reduced in regions that are losing employment while at the same time they are increased in regions where employment is growing.
To date there has not been a detailed study of how disparities in regional rates of economic growth affect state UI trust fund balances. It is clear from aggregate data in table 1-4, however, that employment growth disparities have been unusually wide in 1970-79 and 1980-83. It is also obvious in table 1-4 that the aggregate trust fund reserves of states in the South and West did not deteriorate as much during the 1970s as they did in the North. Reserves as a proportion of covered wages in the two regions were roughly equal in 1970: .034 in the North and .035 in the South and West. By 1980, however, reserves in the South and West were .020 of covered wages while the net reserve balance for the North as a whole was negative. In both the 1970s and in 1980-83 the bulk of loans to state UI programs has gone to states in the North.

Table 1-5 provides more detail on the regional aspect of state UI loan activities in the 1970s and in 1980-83. Column 1 displays the percentage breakdown of covered wages among the Census Bureau's four geographic regions and nine divisions. If funding problems were randomly distributed by state and region, these percentages would provide a rough guide as to how loans would be distributed. The actual percentage distributions of loans are then shown in columns 2 and 3. During the 1970s, loans were heavily concentrated in the North East with 17.6 and 41.5 percent going to New England and Middle Atlantic states respectively. Most of the remainder (28.4 percent) went to states in the East North Central division. The latter division accounted for 58.8 percent of all loans in the 1980s, a reflection of the current recession's severity in these heavily industrialized states. Thus, although states in the North were the main loan recipients in both periods, loans went mainly to Northeastern states in the 1970s and mainly to North Central states in the 1980s. Note also in columns 4 and 5 that per dollar of covered wages, New England was the largest user of loans in
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<tr>
<td>North East</td>
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<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
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<tr>
<td>New England</td>
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<td>58.8</td>
<td>0.8</td>
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<td>0.3</td>
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<td>2.7</td>
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<tr>
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<td>0.1</td>
<td>0.4</td>
<td>5.6</td>
</tr>
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<td>Pacific</td>
<td>15.4</td>
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<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>3.5</td>
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<tr>
<td>U.S. Total - percent</td>
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<td>100.0</td>
<td>100.0</td>
<td>6.0</td>
<td>1.6</td>
<td>2.5</td>
</tr>
<tr>
<td>U.S. Total - $ billions</td>
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<td>5.5</td>
<td>14.9</td>
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**SOURCES:** Columns (1)-(5) are based on U.S. Department of Labor, *Unemployment Insurance Financial Data* (1984) and unpublished data from the U.S. Department of Labor. Columns (6) and (7) which are based on annual averages from the Labor Department's Establishment Survey refer to non-agricultural wage and salary employment. Unemployment rates in columns (8) and (9) are based on the Labor Department-Census Bureau monthly household survey of the labor force. Data in columns (6) through (9) taken from *Employment and Earnings* (May 1984), pp. 128/151 and earlier U.S. Department of Labor publications.
the 1970s but a very minor user in the 1980s. It is clear that funding problems are now most severe in the East North Central states. All five (Ohio, Indiana, Michigan, Illinois and Wisconsin) have had to borrow in recent years.

Employment growth rates in the various regions and divisions are summarized in columns 6 and 7. As previously noted the South and West grew much faster than the national average in the 1970s (and, incidentally, even faster than their own growth rates of the 1960s) while the North East was the slowest growing region. The concentration of the 1980-83 downturn in the North Central region is indicated by the negative employment growth which is especially large in the East North Central division (-2.2 percent). Note also that New England grew faster than the national average in the 1980-83 period.

The contrasting experiences of the North East and North Central regions between 1970-79 and 1980-83 are also illustrated by the average unemployment rates in columns 8 and 9. During the 1970s, unemployment rates in the North East exceeded the national average while the East North Central division experienced roughly average rates. Their positions were exactly reversed in 1980-83 when the unemployment rate in the East North Central division was 2.3 percentage points above the national average. Especially noticeable in this period was the low unemployment in New England. Its average rate was lower than during the 1970s and 1.8 percentage points below the national average (6.7 versus 8.5 percent). It is clear from table 1-5 that in 1970-79 and again in 1980-83 loans went mainly to states in regions with high unemployment.

Following the economic downturn of 1981-82 there have been sharply higher unemployment rates in the major energy-producing states of the South (Louisiana, Oklahoma and Texas) and in (coal-producing) Kentucky and West
Virginia. For these five states, unemployment rates in 1980 were 6.7, 4.8, 5.2, 8.0 and 9.4 percent respectively. In 1983 the corresponding rates were 11.8, 9.0, 8.0, 11.7 and 18.0 percent. Because of sharp increases in unemployment four of the five energy-producing states have recently experienced UI funding problems. Louisiana and Texas borrowed $1.1 billion in 1983. Except for loans made to the State of Washington in the 1970s, these loans to Texas and Louisiana are the only large-scale advances made to states outside the North in either the 1970s or 1980-83. Table 1-5 shows that states in the West South Central division (Texas, Louisiana, and Arkansas) have accounted for 9.7 percent of total borrowing in the 1980-83 period. Although the scale of their borrowing has been generally small, it should be noted that nine southern and eight western states have had to borrow at least once since 1972.

The Pacific division contrasts with others in having both high employment growth and high unemployment, particularly during the 1970s. The absence of large-scale borrowing in this division could be evidence that high growth has favorable effects on state UI program financing. As noted above, the effects of high growth could operate either through the revenue side of the program, e.g., having more new firms contribute at a rate that exceeds their long-run average cost, or the benefit side, e.g., high growth leads to a delay in acquiring monetary eligibility and/or to less long term unemployment. Whatever the reason (or reasons), it is clear that states in the Pacific division have had fewer funding problems than states in other divisions with high unemployment.

The data in table 1-5 clearly show that UI trust fund problems have not occurred in a random manner across the economy. In both the 1970s and in 1980-83, loans have been concentrated in regions with high rates of unemployment and low rates of employment growth.
Inflation

The economy experienced much higher inflation rates in the 1970s than it did in the preceding two decades. Table 1-4, for example, shows that annual inflation rates (as measured by the implicit price deflator) averaged 2.4 and 2.2 percent during 1949-59 and 1960-69 respectively. Average inflation rates were more than twice as high in 1970-79 and 1980-83 (6.3 and 7.3 percent). The combination of both high inflation and high unemployment experienced during the 1970s was unusual, and the term stagflation became widely used to describe this situation. The OPEC oil price increases of 1973-75 and 1979-81 were an important cause for the economy's stagflation.

High rates of inflation have important implications for state UI financing. In many programs, increased wage inflation causes benefit payments to increase automatically and roughly by an amount that matches the higher inflation, while tax revenues do not keep pace. The institutional features of many programs that cause the asymmetric response are quite easy to describe. The weekly benefit maximum is often tied to an index of average earnings, e.g., the average weekly wage in manufacturing or the average for all covered employment. Thus, when inflation increases this is soon translated into higher weekly wages, a higher weekly benefit maximum and increased weekly benefits.

Indexation of the maximum weekly benefit became noticeably more widespread in the 1960s and 1970s. By 1971, half of the states had instituted indexation and 10 more followed suit later in the 1970s. In this same period there was a trend towards liberalizing the level of the maximum benefit relative to the average weekly wage. Thus, in 1971 the weekly benefit maximum equaled or exceeded 60 percent of the average weekly wage in only 8 states, but by 1983 the number had grown to 22. Both changes cause average weekly benefits to respond strongly to changes in average weekly wages.
Benefit data from the 1960s and 1970s illustrate this responsiveness. For the three years 1959, 1969, and 1979, average weekly benefits for the entire economy were $30.40, $46.17, and $89.68 respectively. The implied compound growth rate in weekly benefits over the 1960s and 1970s (4.3 and 6.9 percent respectively) exceed the inflation rates for the two decades as shown in table 1-4. When measured relative to average weekly wages in covered employment, i.e., the gross replacement rate, benefits became a somewhat larger fraction, increasing from .334 in 1959 to .344 in 1969 and then to .361 in 1979. During the 1960s and 1970s, the benefit side of UI could be described as being fully indexed. Thus when inflation increased sharply in the 1970s this meant that the financial obligation to pay benefits would have increased sharply even if unemployment rates of the 1970s had been no higher than those of the 1960s.

Increasing benefit obligations would not pose financial problems if UI tax revenues were also fully indexed to the inflation rate. Each state has an annual taxable wage base per covered employee. In most states in most years, this maximum has been the same as the taxable wage base for the Federal Unemployment Tax (FUT). Between 1940 and 1971 this maximum was $3,000 per worker. Because the federal maximum was unchanged for this long period while average wages were growing, taxable wages came to represent a smaller and smaller proportion of total wages. The ratio of taxable to total wages declined from .928 in 1940 to .453 in 1971. Several states raised their taxable wage bases above the $3,000 federal level in the 1960s and in 1970-71. The national ratio of taxable to total wages in 1971 would have been even lower than .453 had all states retained the $3,000 wage base.

During the 1960s there was an increasing recognition that the FUT taxable wage base was inadequate to finance benefits. Thus the base was raised to $4,200 in 1972 and then to $6,000 in 1978. Because of higher inflation during the
The Funding Problem

1970s, however, the ratio of taxable to total wages continued to decline. By 1982 taxable wages represented only .405 of total wages even though the wage base was twice its 1971 level. Even with an increase to $7,000 in 1983 and to higher levels in several states, taxable wages continue to represent less than half of all wages in covered employment.

Table 1-6 presents summary data on tax bases and average tax rates in state UI programs since 1960. It documents the downtrend in the ratio of taxable to total wages (column 2) and shows how the increases in the FUT maximum of 1972, 1978 and 1983 increased the ratio in those three years. Columns 3 and 4 respectively show the average tax rates on taxable wages and total wages. In the 1970s, the average rate on taxable wages did rise, but the tax rate on total wages was no higher than it was in the early 1960s. This clearly illustrates the effect of the long term downtrend in the ratio of taxable to total wages. Although average tax rates increased following the recessions of the 1970s, they did not increase enough to adequately replenish UI trust funds. Given the low taxable wage base per employee, even larger increases in statutory tax rates were needed.

Increasingly, individual states have recognized that the FUT taxable maximum is an inadequate base for employer UI taxes. Table 1-6 shows the number of states with maximums higher than the FUT maximum. By 1984, this number stood at 31. Although individual states have legislated higher maximums, they typically have not been set that much above the FUT taxable wage base. Thus, 23 states had maximums above $3,000 in 1971 but only 5 exceeded $4,200 in 1972. Note, however, after the next two tax base increases that 12 state maximums exceeded $6,000 in 1978 and then 24 exceeded $7,000 in 1983. Although 31 state maximums were above $7,000 in 1984, only 9 exceeded $10,000. Thus even among states that have legislated higher maximums there has been a reluctance to go too far beyond the FUT taxable maximum.
### Table 1-6
State UI Tax Data, 1960 to 1984

<table>
<thead>
<tr>
<th>Year</th>
<th>FUT taxable wage base (1)</th>
<th>Ratio of taxable-to-total wages (2)</th>
<th>Average tax rate on taxable wages (percent) (3)</th>
<th>Average tax rate on total wages (percent) (4)</th>
<th>States with tax bases above the FUT tax basea (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>3,000</td>
<td>.611</td>
<td>1.92</td>
<td>1.17</td>
<td>6</td>
</tr>
<tr>
<td>1961</td>
<td>3,000</td>
<td>.600</td>
<td>2.05</td>
<td>1.23</td>
<td>6</td>
</tr>
<tr>
<td>1962</td>
<td>3,000</td>
<td>.590</td>
<td>2.35</td>
<td>1.39</td>
<td>9</td>
</tr>
<tr>
<td>1963</td>
<td>3,000</td>
<td>.581</td>
<td>2.33</td>
<td>1.35</td>
<td>10</td>
</tr>
<tr>
<td>1964</td>
<td>3,000</td>
<td>.570</td>
<td>2.24</td>
<td>1.27</td>
<td>15</td>
</tr>
<tr>
<td>1965</td>
<td>3,000</td>
<td>.558</td>
<td>2.12</td>
<td>1.18</td>
<td>16</td>
</tr>
<tr>
<td>1966</td>
<td>3,000</td>
<td>.553</td>
<td>1.93</td>
<td>1.07</td>
<td>18</td>
</tr>
<tr>
<td>1967</td>
<td>3,000</td>
<td>.533</td>
<td>1.66</td>
<td>.89</td>
<td>18</td>
</tr>
<tr>
<td>1968</td>
<td>3,000</td>
<td>.517</td>
<td>1.49</td>
<td>.77</td>
<td>22</td>
</tr>
<tr>
<td>1969</td>
<td>3,000</td>
<td>.497</td>
<td>1.40</td>
<td>.70</td>
<td>22</td>
</tr>
<tr>
<td>1970</td>
<td>3,000</td>
<td>.477</td>
<td>1.37</td>
<td>.65</td>
<td>22</td>
</tr>
<tr>
<td>1971</td>
<td>3,000</td>
<td>.453</td>
<td>1.44</td>
<td>.65</td>
<td>23</td>
</tr>
<tr>
<td>1972</td>
<td>4,200</td>
<td>.517</td>
<td>1.65</td>
<td>.85</td>
<td>5</td>
</tr>
<tr>
<td>1973</td>
<td>4,200</td>
<td>.500</td>
<td>1.96</td>
<td>.98</td>
<td>4</td>
</tr>
<tr>
<td>1974</td>
<td>4,200</td>
<td>.475</td>
<td>1.97</td>
<td>.94</td>
<td>5</td>
</tr>
<tr>
<td>1975</td>
<td>4,200</td>
<td>.452</td>
<td>1.99</td>
<td>.90</td>
<td>10</td>
</tr>
<tr>
<td>1976</td>
<td>4,200</td>
<td>.465</td>
<td>2.50</td>
<td>1.16</td>
<td>20</td>
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<tr>
<td>1977</td>
<td>4,200</td>
<td>.451</td>
<td>2.83</td>
<td>1.27</td>
<td>23</td>
</tr>
<tr>
<td>1978</td>
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<td>2.72</td>
<td>1.35</td>
<td>12</td>
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<tr>
<td>1979</td>
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<td>.474</td>
<td>2.72</td>
<td>1.29</td>
<td>14</td>
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<tr>
<td>1980</td>
<td>6,000</td>
<td>.447</td>
<td>2.49</td>
<td>1.11</td>
<td>16</td>
</tr>
<tr>
<td>1981</td>
<td>6,000</td>
<td>.423</td>
<td>2.43</td>
<td>1.03</td>
<td>19</td>
</tr>
<tr>
<td>1982</td>
<td>6,000</td>
<td>.405</td>
<td>2.53</td>
<td>1.02</td>
<td>24</td>
</tr>
<tr>
<td>1983</td>
<td>7,000</td>
<td>.424</td>
<td>2.75</td>
<td>1.17</td>
<td>24</td>
</tr>
<tr>
<td>1984</td>
<td>7,000</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>31</td>
</tr>
</tbody>
</table>

**Sources:** Based on data taken from U.S. Department of Labor, *Unemployment Insurance Financial Data* (1984). Average tax rates in column (3) were computed at The Urban Institute. Data for 1983 are preliminary.

a. This column refers to the 50 states plus the District of Columbia.

NA = not available.
One obvious way to increase the responsiveness of UI taxes to inflation is to index the taxable wage base. Hawaii indexed its wage base in 1965 and several other states followed suit in the mid-1970s. Typically, the tax base is set to a specific percentage, say 67 or 100 percent, of the state's average wage in the previous (calendar or fiscal) year. By 1984 there were 14 states with taxable wage bases indexed to average wages. All nine states with tax bases above $10,000 in 1984 were states where the tax base was indexed. It is clear that indexing has led to larger increases in the tax base than have periodic legislated increases. In chapter 3 we will review the performance of states that have indexed their taxable wage bases to determine if they had less serious trust fund problems in the 1970s and 1980s when compared to the average experience of other states.

Considering the financing difficulties that state UI programs have had since 1970, it seems that stagflation poses especially serious problems. In a period of stagflation total benefit payments increase both because high unemployment raises weeks compensated and because inflation raises average weekly benefits. To the extent that the taxable wage base is fixed in nominal terms, most of the revenue adjustments must take the form of higher employer tax rates. In the aggregate, employer tax rates were not raised sufficiently in the 1970s and in 1980-83 to prevent the need for large scale U.S. Treasury loans. High inflation since 1969 has clearly played a role in the state UI funding problem.

**The Costs of Extended Benefits**

The Federal-State Extended Benefit (EB) program was enacted in 1970 (PL91-373) to provide up to 13 extra weeks of benefits to exhaustees during recessions. A set of trigger mechanisms was specified that would activate EB payments whenever state and/or national insured unemployment rates exceeded predetermined thresholds. Benefits were first
available in 1971, and they have been paid in every year since 1971.

The costs of the EB program are a shared federal-state responsibility with each paying for half of the total. The federal share of EB costs was originally projected to be covered by a .1 percent Federal Unemployment Tax contribution rate in 1970 and 1971 and then a .05 percent rate in later years. To cover the other half of EB costs, states were to tax employers using whatever method they desired. Some states have levied a flat rate tax, while others have experience rated EB costs.

In practice, EB has proven more costly than originally anticipated. Between 1971 and 1976 the federal half of EB costs totaled $3.4 billion while cumulative 1970-76 EB taxes were only about $1 billion. The deficit in the federal share of EB costs was made up by borrowing from the U.S. Treasury. To repay these Treasury advances a "temporary" increase of .2 percent in the FUT tax rate was imposed in 1977 and has been in effect in all subsequent years.

Financing the state share of EB costs has been difficult in several states. The initial federal actuarial cost projections, as reflected in the FUT tax rate increase of 1970, were so low that most states did not change their existing tax schedules. Raising UI tax rates is often controversial and difficult to accomplish, and in many states it was easier to avoid conflicts by retaining existing tax schedules. The impacts of high inflation and the subsequent recessions (with attendant increases in long duration unemployment) meant that a substantial new dollar volume of claims on state trust fund accounts resulted from the EB program.

The state share of EB costs has contributed to the volume of UI loans in the 1970s and 1980s. Employer EB-related contributions are a part of UI taxes in each state and extend-
ed benefit payments are debited either to individual employer accounts or to a noncharged benefits account. Large outlays for the state share of EB costs cause state trust funds to be drawn down in exactly the same manner as payments of regular state UI benefits. The cumulative state share of EB costs between 1971 and 1983 was $7.7 billion. Although there are no published estimates on the cumulative amount of state taxes earmarked to pay for EB, they certainly have been much less than the $7.7 billion of benefit payments. Thus, because of EB, deficits in state trust fund accounts between 1971 and 1983 have been larger than they would have been in the absence of this program.

Although EB payments undoubtedly have helped relieve economic hardships among the long term unemployed, it is now clear that the program was created just as state UI was entering a period of heavy demand for benefits. No major new additions to state UI taxes were mandated, and the new federal taxes mandated in 1970 were clearly inadequate to meet the federal share of actual EB costs. As a result EB payments have helped contribute to the UI funding problems recently experienced by several states.

Reviewing the four factors discussed above it does not seem surprising that a state UI funding problem emerged in the 1970s and has been even more severe in 1980-83. High unemployment, uneven regional growth rates, high inflation and unexpected costs of EB all have contributed to the recent tendency for benefit outlays to exceed revenues in state UI. The severity of the funding problem has varied widely from one state to the next. Chapter 2 will examine debtor state experiences and recent adjustments in some detail. Part of chapter 3 will focus on how some states have been able to avoid funding problems. Before descending to the level of individual state experiences, however, it will be useful to briefly review recent developments on the benefit side of state UI programs.
Benefit Payments Since 1970

State UI funding problems could originate from developments in program benefits or revenues or both. Table 1-7 presents national data useful for assessing aggregate benefit payments. Benefit data appear for three long periods (1949-59, 1960-69 and 1970-79) and annually for the years 1970 to 1983. Aggregate benefits as a percentage of total payroll (benefit cost rates), were very similar in the 1950s and 1970s (1.17 and 1.15 percent respectively). Slow growth due to frequent recessions in these decades contributed to a benefit cost rate that was considerably higher than during the 1960s.

Columns 2-5 then focus on four factors that are important in determining benefit payments. Besides the economy’s overall unemployment rate, there are three ratios (insured-to-total unemployment, weekly beneficiaries-to-insured unemployment, and weekly benefits-to-average weekly wages) to be considered. Variations in these four factors cause changes in aggregate benefit outlays with increases in any one causing benefit payments to be higher. Growth in the three ratios would suggest that UI programs were becoming more generous either in terms of benefit availability to the unemployed (columns 3 and 4) or the size of weekly benefits (column 5). Column 6 combines the (product of the) three ratios into an overall benefits index.

Unemployment rates have already been discussed. The average rate was higher in the 1970s than in the 1960s and very high in the 1980-83 period. There is a clear positive association between the annual data in columns 1 and 2.

Of the three components in the overall benefits index, the ratio of weekly benefits-to-weekly wages (often referred to as the gross replacement rate) demonstrates a clear upward trend. From the 1950s to the 1970s, the three-decade averages were .335, .346 and .364 respectively. This ratio has
Table 1-7
Measures of State UI Benefit Payments and of Contributing Factors, 1949-1983

<table>
<thead>
<tr>
<th>Time period</th>
<th>Benefit cost rate (^\text{a}) (percent)</th>
<th>Total unemployment rate (percent)</th>
<th>Ratio of insured-to-total unemployment</th>
<th>Ratio of average weekly beneficiaries-to-insured unemployment</th>
<th>Ratio of average weekly benefit-to-average weekly wage</th>
<th>Overall benefit factors index (3) x (4) x (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949-59</td>
<td>1.17</td>
<td>4.6</td>
<td>.498</td>
<td>.855</td>
<td>.335</td>
<td>.143</td>
</tr>
<tr>
<td>1960-69</td>
<td>1.00</td>
<td>4.8</td>
<td>.426</td>
<td>.854</td>
<td>.346</td>
<td>.126</td>
</tr>
<tr>
<td>1970-79</td>
<td>1.15</td>
<td>6.2</td>
<td>.413</td>
<td>.836</td>
<td>.364</td>
<td>.126</td>
</tr>
<tr>
<td>1970</td>
<td>1.01</td>
<td>4.9</td>
<td>.441</td>
<td>.840</td>
<td>.357</td>
<td>.132</td>
</tr>
<tr>
<td>1971</td>
<td>1.23</td>
<td>5.9</td>
<td>.429</td>
<td>.847</td>
<td>.365</td>
<td>.133</td>
</tr>
<tr>
<td>1972</td>
<td>.98</td>
<td>5.6</td>
<td>.379</td>
<td>.843</td>
<td>.361</td>
<td>.115</td>
</tr>
<tr>
<td>1973</td>
<td>.79</td>
<td>4.9</td>
<td>.374</td>
<td>.840</td>
<td>.365</td>
<td>.113</td>
</tr>
<tr>
<td>1974</td>
<td>1.07</td>
<td>5.6</td>
<td>.439</td>
<td>.833</td>
<td>.365</td>
<td>.133</td>
</tr>
<tr>
<td>1975</td>
<td>2.03</td>
<td>8.5</td>
<td>.503</td>
<td>.849</td>
<td>.371</td>
<td>.158</td>
</tr>
<tr>
<td>1976</td>
<td>1.39</td>
<td>7.7</td>
<td>.404</td>
<td>.819</td>
<td>.371</td>
<td>.123</td>
</tr>
<tr>
<td>1977</td>
<td>1.16</td>
<td>7.1</td>
<td>.380</td>
<td>.823</td>
<td>.364</td>
<td>.114</td>
</tr>
<tr>
<td>1978</td>
<td>.93</td>
<td>6.1</td>
<td>.380</td>
<td>.823</td>
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<td>.114</td>
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<tr>
<td>1979</td>
<td>.94</td>
<td>5.8</td>
<td>.397</td>
<td>.838</td>
<td>.361</td>
<td>.120</td>
</tr>
<tr>
<td>1980</td>
<td>1.34</td>
<td>7.1</td>
<td>.439</td>
<td>.854</td>
<td>.364</td>
<td>.136</td>
</tr>
<tr>
<td>1981</td>
<td>1.17</td>
<td>7.6</td>
<td>.368</td>
<td>.859</td>
<td>.359</td>
<td>.113</td>
</tr>
<tr>
<td>1982</td>
<td>1.72</td>
<td>9.7</td>
<td>.380</td>
<td>.878</td>
<td>.375</td>
<td>.125</td>
</tr>
<tr>
<td>1983</td>
<td>1.43</td>
<td>9.6</td>
<td>.311</td>
<td>.881</td>
<td>.368</td>
<td>.101</td>
</tr>
</tbody>
</table>

SOURCES: Data in columns (1), (4) and (5) taken from U.S. Department of Labor, *Unemployment Insurance Financial Data* (1984). Column (2) is based on the household labor force survey. Column (3) based on UI program data and household labor force data. Column (6) is the product of columns (3), (4) and (5). Data for 1983 are preliminary.

a. Benefit outlays as percent of total covered payrolls.
both a trend and a cyclical component. It rises in recessions as more experienced and high wage persons enter the pool of beneficiaries.\textsuperscript{28} From column 5 it is clear that weekly benefits in 1980-83 are more generous relative to weekly wages than they were two decades earlier. Note also, however, that this replacement rate was not noticeably higher in 1982-83 than it had been in 1975-76. It may be that the replacement has peaked in the early 1980s.\textsuperscript{29}

Insured unemployment includes regular state UI beneficiaries and claimants who are not yet collecting benefits, e.g., those serving a waiting period and some persons whose claims are in dispute. It excludes persons receiving EB, those who have exhausted benefits and persons who do not apply. If waiting periods were becoming shorter, the ratio of weekly beneficiaries-to-insured unemployment would rise. From table 1-7, however, it is clear there is no upward trend in this ratio. If anything, it declined somewhat in the 1970s in comparison to previous decades. This ratio also has a cyclical component so that increases in 1980 and 1982 are normal cyclical occurrences reflecting the increased average duration of claimants in benefit status.

The second obvious trend in the three ratios is the decline in the ratio of insured-to-total unemployment (column 3). Averages for the three decades were .498, .426 and .413 respectively. The downtrend is the result of many influences among which the changing demographic mix of unemployment is undoubtedly the most important. Younger persons and women have come to represent an increasing share of total unemployment. Since they are less likely to collect UI benefits than are adult men, this changing mix has caused the ratio of insured to total unemployment to decline.

This ratio also has a strong cyclical element. In recession, layoffs cause the mix of unemployment to change and job losers become a larger share of total unemployment. Since
they are the group most likely to collect benefits, this compositional change raises the ratio of insured-to-total unemployment. Between 1973 and 1975 the ratio increased from .374 to .503 and it also increased between 1979 and 1980.

An interesting research question has arisen regarding the behavior of insured unemployment since 1979. Regression analyses by Burtless (1983) and by Vroman (1984) have shown that insured unemployment has been lower than expected since 1979 and that the gap between insured and total unemployment grew successively larger in each year between 1980 and 1983. Note in table 1-7 that the column 3 ratio fell in 1981 and rose only modestly in 1982 despite the large increase in unemployment of that year. The ratio then fell sharply in 1983 even though the total unemployment rate was virtually unchanged from 1982. Contributing to the recent reductions in insured unemployment have been changes in UI laws and administrative practices as well as the unusually high level of benefit exhaustions since 1979.

Although it seems likely that state UI funding problems have contributed to recent declines in the ratio of insured-to-total unemployment, this has yet to be conclusively demonstrated by careful research. One effect of the recent reductions in this ratio, of course, is to lower total UI benefit outlays in 1980-83. A second element of reduced benefit availability is lower amounts of EB payments since 1981. Because of Reagan Administration changes in EB triggers these payments for long-term joblessness have been much lower, particularly in 1982-83.

The overall benefits index combines movements in the three ratios to produce a summary measure. The index was no higher in 1970-79 than it had been in 1960-69, and both were lower than the average index for the 1950s. The effects of the gradual rise in the replacement rate were more than
offset by the decline in the ratio of insured-to-total unemployment. Also note that the overall index was actually lower in 1982 than in 1975, and that the 1983 index is the lowest of any since 1970, more evidence that UI benefits have not been increasing relative to historic norms. Thus the high benefit payout rate observed since 1970 (column 1) has been due to higher unemployment and not to increased availability and generosity of UI benefits.

Summary

The state UI funding problem documented in the first part of this chapter has origins predominantly in high unemployment during 1970-79 and 1980-83, coupled with an insufficiently responsive revenue system. Also contributing to the funding problem have been unusually wide variations in regional growth rates, inflation and increased financial obligations posed by the EB program. Although borrowing has been widespread, even larger deficits would have been incurred in the 1980-83 period if there had not been recent reductions in insured unemployment (and associated regular state UI benefits) and cutbacks in EB payments.

NOTES

1. This amount refers to the debt arising from the payment of regular state UI benefits and the state share (half) of federal-state Extended Benefits or EB. Deficits in the Extended Unemployment Compensation Account (EUCA), a federal UI trust fund account used to pay the federal share of Extended Benefit costs and other temporary long-term benefits provided during 1971-73 and 1975-77, also gave rise to borrowing by this account from the U.S. Treasury. At the end of 1983 the EUCA debt was $6.2 billion making a total debt of $19.5 billion for the entire federal-state system of UI programs. Because the EUCA debt is gradually being repaid by earmarked federal payroll taxes, this component of indebtedness will not be examined in the present report.
2. The federal-state unemployment insurance system was established as the result of the Social Security Act of 1935 (PL 74-271). The Federal Unemployment Tax Act of 1939 (PL 76-379) details the federal payroll tax incorporating federal UI financing provisions that were originally in the Social Security Act. For one description of state UI see chapter 13 in Myers (1981).

3. For one concise description of UI financing provisions for the period from 1935 to 1978, see the Appendix in Mackin (1978). In addition to taxing employers, four states (Alabama, Alaska, New Jersey and Pennsylvania) also levied taxes on covered employees in 1984.

4. If a state maximum tax rate is lower, employers at that maximum receive less than the full offset since that maximum rather than experience determines their rate.

5. One of the federal trust fund accounts is the federal loan fund from which states with depleted reserves may borrow to continue to pay benefits.

6. There are 53 state UI programs in the United States, those in the 50 states plus the District of Columbia, Puerto Rico and the Virgin Islands. The latter two jurisdictions will be excluded from the analysis of the present report.

7. Prior to 1972, federal loans had been made to just three state UI programs. During the 1950s and early 1960s, loans were made to Alaska, Michigan, and Pennsylvania. These loans were fully repaid by the late 1960s.

8. Increments of .3 percent apply strictly in the first two years that FUT penalty taxes are paid by a debtor state. Provisions determining further increments after the second year have changed more than once. In 1984, for example, a debtor state may have a third year penalty tax rate of .6, .7, .8 or .9 percent.

9. Seven different states experienced a .3 percent FUT penalty tax rate for a single year. The states and years were as follows; 1974-Connecticut, 1976-Washington, 1977-Vermont, 1978-District of Columbia and Rhode Island, and 1979-Delaware and Pennsylvania. Penalty taxes are due in January of the year following the year to which they apply.

10. The 12 were Alabama, Arkansas, Florida, Hawai'i, Maryland, Michigan, Minnesota, Nevada, New York, Ohio, Oregon and Washington. Massachusetts and Montana completed their debt repayments in 1980.
11. In fact, not one of the four with the largest debts passed comprehensive legislation to improve the fiscal balance in their UI program prior to 1980. New Jersey, which did raise average employer tax rates in 1977-79 and indexed its taxable wages base in 1976, made small voluntary repayments in 1978 and 1979 and Connecticut did so in each year from 1976 to 1979. All of these repayments, however, were made in lieu of FUT penalty taxes and were not truly voluntary repayments.

12. Actual payment of FUT penalty taxes takes place at the end of January in the year following their accrual.

13. The rate applicable has been 10 percent. For one description of these legislative provisions see Hobbie (1982).

14. This legislation also changed the triggering mechanism used to activate EB programs in the states. Subsequent EB payments have been much lower than what would have been paid previously. Because half of EB payments are state financed, this change also helped improve the fiscal balance of UI programs.


16. The FSC program has no direct financial implications for the states as these long term jobless benefits are financed entirely from federal general revenues. The program was subsequently extended three more times and scheduled to last until the end of March 1985.

17. The 1983 Wisconsin legislative changes that satisfy these TEFRA financial requirements are described in chapter 2.

18. For a state forced to borrow in 1983, the increase in net solvency must be at least 25 percent in 1983 and then 35 and 50 percent in 1984 and 1985. Some states that have made adjustments, e.g., Michigan, made more than a 50 percent net solvency adjustment immediately in 1983. The change in net solvency is computed as the sum of two percentage changes: the increase in taxes and the reduction in benefits where both are measured as changes from a baseline projection based on prior UI laws.

19. To be eligible for lower interest rates in the second and third years of indebtedness, the increases in net solvency needed to be 80 and 90 percent respectively.


21. See, for example, Perry (1970).
22. Insured unemployment rates (or IURs) are measured as the ratio of insured unemployment to covered employment. The national trigger was eliminated in 1981 and the state trigger thresholds were also revised upward by the 1981 legislation.

23. Data on EB benefit payments are shown in U.S. Department of Labor (1984a). Estimates of annual tax payments by employers for the federal share of EB costs can be made from this same publication.

24. In 1983 a second "temporary" increase in FUT tax rates became effective. The FUT rate was increased by .1 percent to .8 percent of taxable payroll. Part of the increased tax rate was earmarked to pay for the federal share of EB costs.

25. Noncharged benefits are not assigned to individual employer trust fund accounts. They are treated as a common cost to all employers and are financed by flat rate state taxes.

26. Because of changes in the EB triggering mechanism enacted under the Reagan Administration, the EB program will be much smaller in the future. Thus it will not contribute to UI funding problems in future years.

27. Recall from table 1-4 that unemployment rates for men 25 and older were also very similar in the 1950s and 1970s.

28. For one time series analysis of the gross replacement rate see Hight (1980).

29. Until 1979, UI benefits were received as tax-free income. Thus when weekly benefits are considered in relation to after tax weekly wages, the net replacement rate probably rose more rapidly than the gross replacement between the late 1940s and 1978. Hight (1980) has examined both replacement rates. Because UI benefits have been taxable since 1979, this has definitely lowered net replacement rates in recent years.

30. For one analysis of reduced UI benefit payments in the 1980-83 period see Vroman (1984). The paper examines payments under regular state UI programs and extended jobless benefits under the EB and FSC programs.