Financial Outlook

Wisconsin Unemployment Insurance Program

Report prepared for the Governor and Legislature, pursuant to s. 16.48, Wisconsin Statutes

Roberta Gassman, Secretary
Department of Workforce Development
February 2009
UCD-8967-P (R. 1/09)

FINANCIAL OUTLOOK

INTRODUCTION

The Financial Outlook report for the Wisconsin Unemployment Insurance (UI) program assesses the condition of the Wisconsin UI Reserve Fund. The Reserve Fund is the repository of the monies used to pay Unemployment Benefits to eligible claimants. It is financed primarily by taxes assessed on wages paid by Wisconsin employers. This report on the status of the fund is provided by the Wisconsin Department of Workforce Development to the Governor and the Legislature in January of odd-numbered years.

The report comes at a crucial time in the history of the country and the Wisconsin UI program. For the first time since 1983, due to the national economic crisis and its impact on all states, insolvency in the Reserve Fund will require our state to borrow from the federal government in order to meet its obligation to pay unemployment benefits. Wisconsin is one of approximately 30 states that will be forced to pursue this option this year. Wisconsin's borrowing will begin in February 2009 and continue throughout the year. Additional borrowing is likely in 2010.

HISTORY

Legislation establishing the Wisconsin UI program was passed by the Legislature in 1932 and signed by Governor Phillip La Follette. Wisconsin's law, a classic expression of "The Wisconsin Idea," was the first in the nation and became the template for the national UI provisions of the Social Security Act of 1935. The Social Security Act was one of the cornerstones of the New Deal and a key element in the effort to lift the United States economy out of the great Depression.

Wisconsin's UI program has been a national leader throughout its long history. The Reserve Fund has been solvent for most of that time. The sole exception was the period from 1983-1987, when our state was dramatically affected by a prolonged and serious national recession. Manufacturing was particularly hard-hit during this period and for a while the Great Lakes region was referred to as the "Rust Belt." Wisconsin's UI Reserve Fund became depleted in 1983, and the state was required to borrow from the federal government. In the four years between 1982 and 1986 Wisconsin borrowed $737 million from the federal government and paid $125 million in interest charges. Table 1 provides an overview of the Reserve Fund solvency since 1979.

TABLE 1. THE WISCONSIN UNEMPLOYMENT RESERVE FUND
(All amounts in million$)

YEAR	TAX RECEIPTS	INTEREST & OTHER	TOTAL RECEIPTS	BENEFIT PAYMENTS	SURPLUS OR DEFICIT	FUND BALANCE DEC. 31
1979	286	30	316	221	95	462
1980	233	38	270	480	-210	252
1981	215	33	248	452	-204	49
1982	221	2	223	688	-465	-416
1983	301	-3	298	519	-221	-637
1984	562	3	565	347	217	-419
1985	571	2	573	406	167	-252
1986	643	5	648	352	296	43
1987	630	28	658	304	354	397
1988	567	48	615	266	349	746
1989	511	77	588	302	286	1032
1990	417	96	513	341	171	1204
1991	350	100	450	480	-30	1174
1992	358	90	448	437	11	1185
1993	391	85	476	394	82	1267
1994	418	87	505	377	128	1395
1995	421	98	519	418	101	1496
1996	415	102	517	471	46	1542
1997	419	105	525	445	80	1621
1998	414	110	524	452	72	1693
1999	431	113	544	466	77	1771
2000	442	117	559	515	44	1815
2001	432	110	541	791	-249	1566
2002	430	254*	684	949	-265	1301
2003	497	65	562	932	-370	931
2004	596	45	641	795	-154	777
2005	687	38	725	752	-27	750
2006	684	36	720	753	-33	717
2007	649	33	682	845	-163	554
2008#	630	18	648	997	-349	205

*Includes one-time federal Reed Act distribution of $166 million of which $3 million to $4 million have been spent for purposes including apprenticeship administration, UI administration, and bank service costs, as allowed under federal law, each year beginning in 2004. These expenditures are included above as reductions to the "Interest and Other" column.

Preliminary totals

During the 1983-87 crisis the Legislature acted to strengthen the Reserve Fund by increasing revenues and freezing benefits. As a result of those changes and the strong national economy of the 1990's, the balance in the Fund grew to $1.8 billion on December 31, 2000. It has declined every year since then. Preliminary data indicate that the fund declined by

$336 million in 2008. The reasons for this pattern are not difficult to understand. Program revenues have been relatively static while benefits have increased as the result of rising wages and payrolls and periods of high unemployment. In July 2007 the Department issued a report entitled **Unemployment Insurance Reserve Fund Stability** that described in detail the reasons for the consistent decline in the Fund balance.

WISCONSIN ACT 59

The Unemployment Insurance Advisory Council and the Legislature took steps in 2008 to address the issues of Reserve Fund solvency. After a strong bi-partisan vote in the Legislature, Governor Doyle signed Act 59 on March 5, 2008. Act 59 took three steps to strengthen the UI Reserve Fund.

First, the bill increased the wage base to which UI tax rates apply. The wage base had not increased for more than twenty years, even though wages had been rising steadily during that period. Until the passage of Act 59, taxes were assessed against the first $10,500 of each employee's wages. The new law increases the wage base to $12,000 in 2009, $13,000 in 2011, and $14,000 in 2013. This policy change will generate an additional $60 million in revenue in 2009, and similar amounts in subsequent years.

Second, the bill shifted taxes from the "basic rate" to the "solvency rate." Most employers pay both basic taxes and solvency taxes. An employer's "basic rate" is calculated according to its experience in laying off workers and tax receipts are credited to the account of the individual employer. An employer that consistently lays off workers will pay a higher tax rate than an employer that rarely lays off workers. Under the new law, basic rates range from 0% to 8.5%.

Solvency taxes benefit the system as a whole and are not credited to the account of an individual employer. Solvency tax rates are not related to experience and range from 0% to 1.9% under the new law. Increasing solvency tax rates will strengthen the overall system.

To understand this change it is first necessary to distinguish between "positive balance" employers and "negative balance" employers. Employers who pay more in taxes than the system pays out in benefits to its workers are positive balance employers. Employers who generate more benefits than tax revenue are negative balance employers. The bill decreased the basic tax rate of positive balance employers by .2% and increased solvency taxes for those employers by the same amount. For negative balance employers, the bill decreased the basic tax rate by .4% and increased solvency taxes by the same amount.

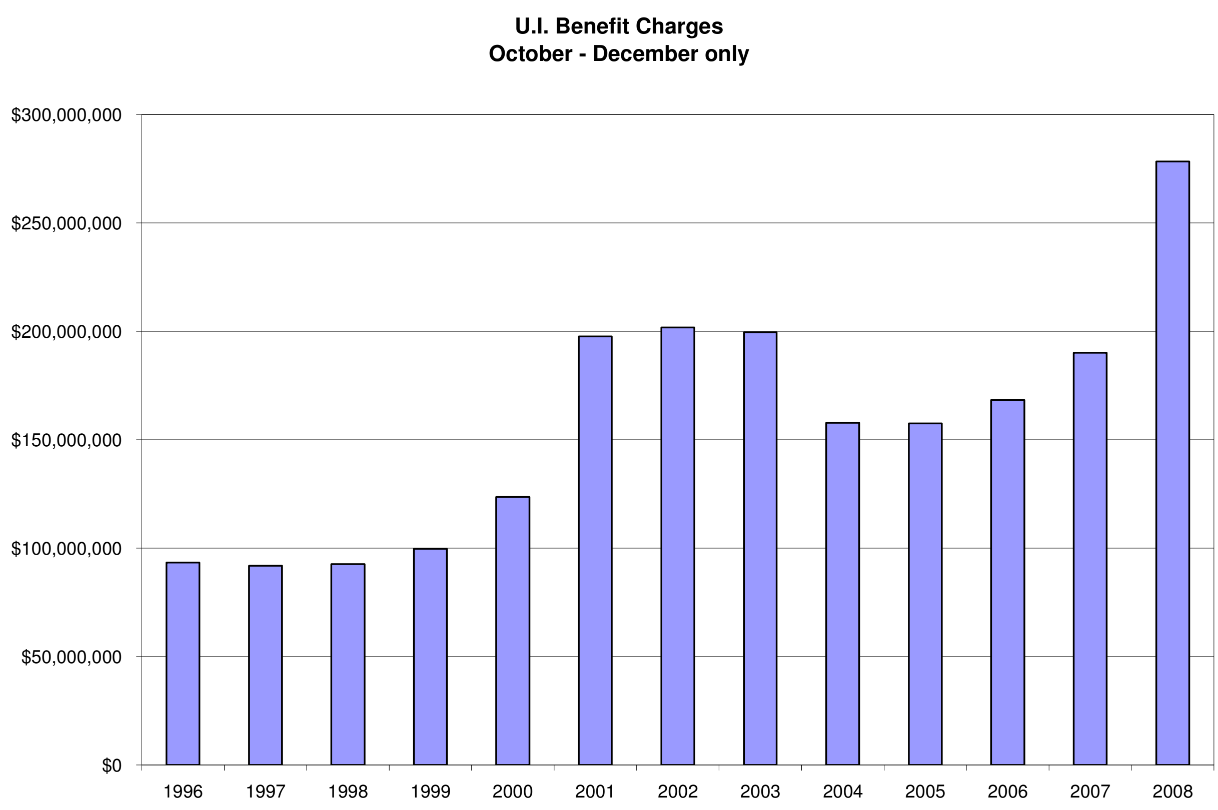
The effects of these changes are twofold. The solvency of the Reserve Fund is enhanced by shifting resources away from individual employer accounts into the fund as a whole. Overall revenue to the fund is increased by about $55 million annually when the provisions take full effect.

Thirdly, in addition to increasing revenues, Act 59 increased the amount of total base period wages claimants must have earned to qualify for benefits. Under prior law, individuals claiming benefits were required to have total base period wages of at least 30 times their weekly benefit rate. The new law tightens qualifying standards by raising the total wage requirement to 35 times the weekly benefit rate. The practical effect of this change is to reduce the number of eligible claimants and reduce benefit expenditures by approximately $5 million per year. Maximum weekly benefits were not increased at all in 2008 and increased by only $8 per week in 2009.

RECENT TRENDS IN CLAIMS AND RESERVE FUND EXPENDITURES

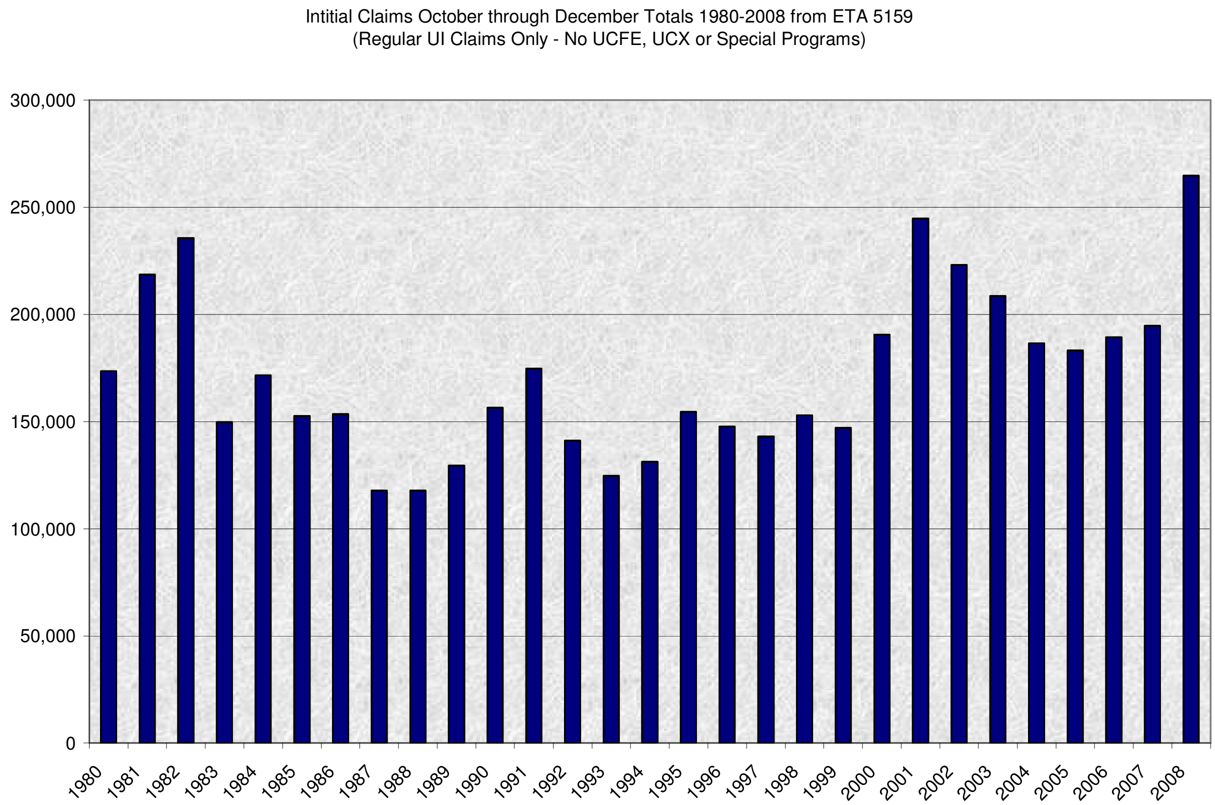
The changes in Act 59 strengthened the UI Reserve Fund. At the time the bill was signed, in March of 2008, initial claims for UI benefits were down 1.6% compared to the same period in 2007. Many economists were predicting a mild downturn that would not necessarily become a recession. In the months that followed, those predictions have proven to be very optimistic. Growth in claims in 2008 compared to 2007 was significant. For the year, there were 15% more claims in 2008 than 2007, but all of the growth came after the bill was signed. By the winter of 2008, claims were routinely up 40-50% over the same week in 2007. Table 2 shows fourth quarter benefit charges since 1996. In 2008, fourth quarter expenditures were $77 million higher than they were in 2002, at the height of the last recession.

TABLE 2



A similar pattern is evident in table 3. It shows that initial claims volume in the last quarter of 2008 was higher than any previous year going back to 1980. This table reflects initial claims only and does not include claims for benefits which are federally funded and do not draw down the Reserve Fund.

TABLE 3



CURRENT STATUS OF THE RESERVE FUND

Given the national economic crisis and its impact on unemployment, on December 31, 2008, the balance in the UI Reserve Fund was approximately $222 million and falling. More than anything, the sheer volume of UI benefit claims is producing the challenge of solvency in the UI Reserve Fund. The dramatic spike in claims is unprecedented in the recent history of the program and is driven by a national recession that is shaping up to be much deeper and of longer duration than most economists were predicting just a year ago. Many other states are experiencing an explosion of claims even more significant than Wisconsin's. As a result, the federal government has provided two benefit extensions since July of this year and more are expected. These extensions, which can add as many as 20 weeks to a 26-week claim, are paid for by the federal government and are traditional during economic downturns.

2009 will be a particularly difficult year for the Reserve Fund, notwithstanding the revenue increases enacted in March and longstanding policy which mandates higher UI tax rates as the balance in the Reserve Fund declines. The UI law requires that when the balance in the UI Reserve Fund is below $300 million on June 30, the system must move to

Schedule A in the tax tables for the subsequent tax year. Since the Reserve Fund balance will surely be below $300 million on June 30, 2009, Schedule A will be in effect for 2010. This schedule has tax rates higher than the current schedule (Schedule B) and will generate an additional $90 million for the system in 2010. Act 59 changes will add at least $100 million to the Reserve Fund in 2010, for a total of $190 million of additional revenue to the Fund. This increase is significant, but will not be sufficient to meet our benefit obligations.

THE SOLVENCY ACCOUNT

The primary driver in the Reserve Fund shortfall is claim volume related to the recession, but there are other issues as well. The UI Reserve Fund balance is the result of two subsystems running side-by-side. The larger of the subsystems consists of the basic taxes collected from individual employers whose tax rates are determined by their layoff history. Employers who regularly lay off workers pay higher tax rates than those who lay off workers less often. Tax rates for individual employers are adjusted annually based on tax payments and benefit payouts in the previous year. In good economic times, this system works well to provide funding for benefits that are charged to individual employers. In a deep recession, the system does not perform as well. Table 4 illustrates the point.

TABLE 4: Employer Accounts – Revenue and Expenditures 2001-2008
(All amounts in million$)

Year	Basic Taxes	Net Benefit Charges	Surplus or Deficit
2001	366	554	-188
2002	371	630	-259
2003	430	593	-163
2004	521	474	47
2005	577	482	95
2006	569	469	100
2007	536	533	3
2008	519	609	-90

The smaller of the subsystems consists of solvency taxes and interest utilized to fund benefits that are paid but not charged to a specific employer. The UI program keeps track of these expenditures through the accounting mechanism of the "solvency account" (also referred to as the balancing account).

Revenue to the solvency account comes from solvency taxes, Reed Act funds, and interest. Charges to the solvency account come from benefits paid for by the Reserve Fund as a whole, and not charged to a specific employer. Table 5 gives a picture of the operation of the solvency account.

TABLE 5: Solvency Account Revenue and Charges - 2001-2008
(All amounts in million$)

Calendar Year	2001	2002	2003	2004	2005	2006	2007	2008
Opening Balance	376	314	308	101	-95	-218	-349	-515
Charges	236	319	339	316	272	282	312	371
Revenue	174	313*	132	120	149	151	146	129
Difference	62	6	207	196	123	131	166	242
Closing Balance	314	308	101	-95	-218	-349	-515	-757

*Revenue for 2002 includes a one-time Reed Act distribution of $166 million.

The changes made by Act 59 will reduce the annual shortfalls in the solvency account when they begin to take effect in 2009. The transfer of revenues from employer accounts to the solvency account will address some of the gap. Over the longer run, the new revenue generated by increasing the wage base will also reduce charges to the solvency account. As policy decisions are made during the coming year, closing the remaining gap between solvency account charges and revenues will be essential in order to strengthen the Reserve Fund over the long term.

FINANCIAL PROJECTION: THE OFFICIAL FORECAST

Assumptions for Financial Projection

In addition to assessing the Fund as it stands at the end of 2008, financial projections are made for both short and long range planning purposes. According to the economic forecast prepared for December 2008 by Global Insight, Inc. and used by the Wisconsin Department of Revenue in making the State's revenue projections and by the Wisconsin Department of Administration in biennial budget planning, the present recession will continue through the second quarter of 2009. Gross domestic product is projected to decline for four consecutive quarters with the largest annualized decline of 5.0% occurring in the fourth quarter of 2008.

As a result of present uncertainty and lack of confidence due to the challenged national economy, employers are reducing both capital spending and employment. Consumers are also spending less. Real (inflation-adjusted) consumption in the third quarter of 2008 decreased by 3.7%. A larger decline of 4.5% is expected in the fourth quarter. The official forecast provided by the Wisconsin Department of Revenue (DOR) projects higher total unemployment rates than in any year since 1983. It assumes that the total unemployment rate in the United States starts at 8.2% in 2009, rises to 8.6% in 2010, and gradually declines to 8.1% in 2011, 7.5% in 2012, and 7.1% in 2013. The rates of interest used to compute earnings on the balance in the Unemployment Reserve Fund range from 3.9% to 5.4%. These interest rates are based on the Congressional Budget Office's most recent semiannual forecast of federal interest rates paid when determining budgeted expenditures.

This Financial Outlook report does not show what would happen in extended periods of economic dislocation. While these have occurred on five or six widely separated occasions in American history, they are not within the purview of this report.

Financial Projection under Current Law

Table 6 shows the opening balance for each year, receipts to the Fund, expenditures from it, and the year's closing balance. The year-end balance at the bottom of each yearly column is carried forward to the next year as that year's opening balance.

Taxes and interest earnings are the usual receipts credited to the Fund. However, if the Fund is depleted and borrowing from the federal government occurs, the balance in the Fund may be restored through proceeds from reductions in federal unemployment tax credits.

A Federal Unemployment Tax Act (FUTA) credit reduction results in the imposition of additional federal taxes on employers under certain conditions. Specifically, a credit reduction applies when the December 31 balance of a state's reserve fund is negative for two consecutive years and loans are not repaid before November 10th of the following year. The credit reduction applies to federally taxable wages in that following year and would be paid with each employer's federal taxes due on the next January 31. The credit reduction may be avoided by enacting state legislation that reduces benefits or increases state taxes by an amount equal to the estimated credit reduction. Proceeds from a credit reduction, regular state UI taxes, and interest earnings, if any, must be used to pay benefits and not for other purposes.

Benefits are shown in the tables as expenditures. They are shown as amounts subtracted from the reserve.

A second category of expenditure in the table is labeled non-benefit charges. It consists of funds previously distributed from the federal unemployment trust fund and available for expenditure on employment related programs and administrative costs.

The scenario is based on the State's December 2008 economic forecast used for preparing state revenue estimates and budget planning. The official forecast projects substantial unemployment throughout the forecast period, with benefits ranging from $894 million to $1.648 billion during the forecast period. The highest tax schedule takes effect in 2010 and remains in effect throughout the remainder of the forecast period. State taxes increase and reduce funds borrowed from the federal government but do not completely repay loans during the period. FUTA tax credit reductions of $55 million and $110 million occur in 2012 and 2013 respectively.

TABLE 6. BASED ON DOR FORECAST
(All amounts in million$)

	2007	2008	2009	2010	2011	2012	2013
Opening Balance	717	554	222	-696	-1231	-1245	-948
Taxes	649	628	730	1008	1224	1260	1235
Interest	37	20	---	---	---	---	---
FUTA Credit Reduction	---	---	---	---	---	55	110
Benefits	-845	-953	-1648	-1543	-1238	-1018	-894
Non-benefit charges	-4	-27	---	---	---	---	---
Closing Balance	554	222	-696	-1231	-1245	-948	-497

Interest payments for borrowing are not shown in the table because they must be derived from a source other than the Unemployment Reserve Fund. The source of past interest payments has been a special assessment on employers.

In past reports the Department has included more than one scenario in its projections. This year, we are providing only one projection based on the official DOR forecast. If the economy declines at a faster rate than predicted by the official forecast, the status of the Reserve Fund will deteriorate more rapidly. If the economy recovers faster than expected, then the projections would presumably improve. To create additional scenarios based on arbitrarily selected assumptions does not seem wise in an economic environment that makes projections of any kind problematic.

BORROWING FROM THE FEDERAL GOVERNMENT

Every scenario requires Wisconsin's UI program to borrow from the federal government as allowed by law and as done by Wisconsin in the past to cover the cost of benefits. Many other states will be taking this action as they try to cope with the effects of the current recession. The federal government is required to provide the necessary loan funds and has policies in place to prompt action by the states to pay back the loans and shore up their reserves.

The current balance in the UI Reserve Fund is sufficient to fund benefits until some time in February 2009. When the Reserve Fund is depleted, Wisconsin will borrow funds from the federal government sufficient to cover benefit costs for February, March and April. The amount of initial borrowing is currently estimated to be from $300-400 million. The loan will be paid back when first quarter revenues are collected in late April and early May. Additional borrowing will be needed in May, June and July and in subsequent three-month periods throughout 2009. If, as the official scenario predicts, the employment effects of the recession linger, then borrowing is likely in 2010 and subsequent years.

Policy Recommendations

The projections in this report predict deficits in the UI Reserve Fund stretching into 2013 and beyond. The fact that the unprecedented increase in benefit claims over the course of the last few months is a national phenomenon does not diminish the need for Wisconsin to act to protect its commitment to providing support to families and individuals struggling to survive in very tough times.

There is a need to act soon, since the DOR projection indicates that 2009 will be the peak year for benefit expenditures. DWD will support the UI Advisory Council's legislative efforts to ensure the UI program is able to meet its obligations to pay benefits.

It will also be necessary to examine with care the expenditure side of the UI ledger. Benefits that do not serve the basic purposes of the program should be carefully considered. The department will continue to support UIAC efforts to reduce administrative costs for this program.

The primary focus must be on responding to the recession, and there should be an effort to strengthen the long-term solvency of the fund. The basic principle is straightforward: any commitment to pay benefits must be matched by the revenue needed to pay for them. This is particularly true in the case of benefits paid by the Reserve Fund as a whole and not charged to a specific employer.

All UI recipients who are not expected to be re-employed or "called back" by their current employer should be required to register and submit their employment history and skills on DWD's Job Center of Wisconsin website, allowing employers seeking certain skilled employees the opportunity to know of their availability.

Finally, Wisconsin should bear in mind its role as the birthplace of Unemployment Insurance. We have a special obligation to take a lead role in looking to the future of the UI program not only in Wisconsin, but in the nation. At times like this, when the national economy is in crisis, we expect the federal government to come through with extended benefits, and they do. The national system Washington supplements is a patchwork of differing tax rates, benefit levels and rules. Would a national system with uniform taxes and benefits serve us better, in good times and bad? This is a serious question that deserves a national debate as we seek new ways to better to serve unemployed workers and their families.