At the end of 2011, it looked like employment was trending in a positive direction: both the number of unemployed persons and the unemployment rate was dropping. Employment was up – expanding by 1.9 million over the course of the year. Even manufacturing showed improvement, growing by 23,000 jobs in the last month of 2011. But, although moderate improvement can be seen at the national level, states are just beginning the monumental task of digging out of the fiscal hole caused by the recession. One of those tasks is to address unemployment insurance trust fund solvency. More than half of states borrowed billions from the federal government to fund unemployment insurance programs, and now employers in those states are facing tax increases as a result.

During the recession and following, unemployment insurance trust funds – the accounts used to pay out unemployment benefits – were depleted in more than half of states as unemployment rates skyrocketed and long-term unemployment hit record levels. In September 2006, Michigan became the first state in recent history to borrow money from the federal government so that it could continue to send out unemployment checks.

As of Dec. 29, 2011, 26 states plus the Virgin Islands were borrowing money from the Federal Unemployment Account to help pay growing claims for unemployment insurance benefits, with outstanding loans then totaling more than $36.4 billion. New York and California are among the top borrowers of federal funds, with a combined total of more than $13.2 billion in loans. Pennsylvania is close behind, having borrowed $3.2 billion. On a per-capita basis, state borrowing ranges from a low of $6.79 in Alabama and $21.99 in Kansas to a high of $303.27 in Indiana and $283.08 in Nevada.

Thanks to a provision in the American Recovery and Reinvestment Act, those states that borrowed funds over the past couple of years did so interest and penalty-free. That provision expired on January 1, 2011 and states that couldn’t pay off their debt quickly faced a number of consequences.

In September 2011, interest payments on outstanding loans came due at a rate of nearly 4.1 percent. That meant states that couldn’t repay had to find an estimated $1.1 billion in total interest payments in an already tough fiscal climate. Projected budget shortfalls for the 2012 fiscal year total $103 billion, according to the Center on Budget and Policy Priorities.

In addition to interest payments, states that have been borrowing from the federal fund since 2009 were required to pay off the outstanding balances on those loans in November 2011. Employers in states that did not make this payment or did not qualify for exemption faced an increase in their 2012 federal unemployment tax rates as a result. This year, 19 states were unable to pay off their 2009 balances by the November deadline. Employers in 18 of those states will see an effective 0.3 percentage point increase in their tax rate in 2012. Indiana failed to pay off its balance from 2008, making its loans two years past the repayment deadline, which means an effective tax hike of 0.6 percentage points.
Strategies to Reach Solvency

Michigan, which has been borrowing since September 2006, paid off its $3 billion in debt in late December after selling bonds to cover those costs. Although Michigan employers will be paying back the bond, paying off the debt eliminated some of the significant penalties and interest. Idaho also issued bonds to pay off its debt before an interest payment was due.

According to the National Employment Law Project, some states are taking steps to reduce unemployment costs by limiting benefits. Ten states enacted cuts and eligibility restrictions to benefits in 2011, ranging from reductions in the minimum and maximum amount of benefits that can be received weekly to narrowing definitions or classifications of who qualifies for benefits.

Six states—Arkansas, Florida, Illinois, Michigan, Missouri and South Carolina—have reduced the number of weeks one can receive state benefits below the historical standard of 26 weeks, something that hasn’t been done in more than 50 years.

Thirty-five states increased taxes on employers in 2010, and seven states enacted legislation to raise the taxable wage base on employers for unemployment taxes, according to a survey by the National Association of State Workforce Agencies.

[1] Three additional states—Alabama, Idaho and South Carolina—took out federal loans in 2009. However, both Alabama and Idaho repaid their outstanding balances by the deadline and thus avoided the tax increase. South Carolina qualified for an exemption from the increase (called credit reduction avoidance) per DOL’s regulations.

According to FFIS, “to qualify for credit reduction avoidance, a state must pay the amount that the credit reduction would produce prior to November 10 of the year for which avoidance is to apply, repay all loans received during the one-year period prior to November 10, or increase solvency for the taxable year through legislative action by an amount equal to or greater than the amount of the credit reduction, and not borrow from the federal fund for a three-month period (November 1-January 31).”

[2] The federal component of unemployment is funded by a 6 percent tax rate on the first $7,000 paid annually by employers to each employee. Employers in states that have unemployment programs approved by the Department of Labor and no outstanding loan balances may credit 5.4 percentage points against the 6 percent tax rate, so that the net effective federal tax rate becomes 0.6 percent. The “effective” tax increase indicated here is actually a decrease to the 5.4 percentage point credit applied to the tax rate.

[3] These changes are to state-level benefits only – federal benefits are calculated separately.