ISSUE REVIEW

Iowa Legislative Fiscal Bureau

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Status of the Unemployment Compensation Trust Fund

ISSUE

The balance in the Unemployment Compensation Trust Fund has remained approximately $700 million since the beginning of FY 1995. This ***Issue Review*** examines some options available to the General Assembly for reducing the tax costs to Iowa employers and the impacts the alternatives would have on the solvency of the Trust Fund.

AFFECTED AGENCIES

Department of Employment Services

All Iowa employers participating in the Unemployment Insurance Program

CODE AUTHORITY

Chapter 96, Code of Iowa

BACKGROUND

Prior to 1987 Iowa utilized a reserve ratio system for charging employers and collecting unemployment insurance taxes. [*Reserve Ratio: (Total Historical Contributions - Total Historical Benefits Paid) / Three-Year Average Taxable Wages.]* That system reviewed the entire history of an employer's contributions to the Unemployment Compensation Trust Fund and benefits paid from the employer's account, in relation to the employer's total taxable wage base to establish a ranking of the employer. The employer with the highest positive ratio received the lowest tax rate.

That system had the potential of providing a disincentive for employers with a low tax rate to create additional jobs. As total taxable wages increase, the formula produced a lower net ratio and could result in the employer paying higher taxes.

Under that system, the Trust Fund went bankrupt in 1982 and remained insolvent through mid-year 1985. This resulted in the borrowing of $396.0 million from the federal government and charges of an additional $25.0 million in interest were incurred during this period.

In 1987 the General Assembly created the current method to determine an employer's tax rate. The new system is called a benefit ratio array. (*Benefit Ratio: Employer's Five-Year Average Benefit Charges / Employer's Five-Year Average Taxable Payroll.)* Under this system the past five-year average of benefits paid are compared to the five-year average taxable wage base to produce a benefit ratio. An employer maintaining a stable or decreasing level of chargeable benefit payments, but increasing the level of employment could improve the relative ratio compared to other firms. This could result in a potential tax rate reduction for an employer.

Enactment of the current system has enabled the State to increase the Trust Fund reserve to a financially sound level. Several factors built into the current system assure a continuing positive balance in the Trust Fund should Iowa experience another recession similar to that experienced in the early 1980s. Attachment A is a history of Trust Fund balances as of December 31 of each year and interest earned or paid on the balance from 1978 through 1994.

CURRENT SITUATION

According to the Department of Employment Services, Tax Table 8 (the lowest existing tax table) is projected to remain in effect for 1995 and 1996. Utilizing this Table, 54.5% of Iowa eligible employers receive a zero tax rate and approximately 80.0% of employers are taxed at 1.0% or less.

All eligible employers (approximately 49,000) are ranked in relation to respective benefit ratios from lowest to highest and then the list is divided into 21 groups or ranks. Each ranking contains approximately 4.76% (1/21st) of the total taxable wages reported by the group of employers for the four calendar quarters immediately preceding the rate computation date (July 1 of each year).

Employers whose benefit ratios place them in Rank 1 are assigned the corresponding contribution (tax) rate from the rate table that is in effect at the time. Currently, Tax Table 8 is in effect (see Attachment B). For 1995, an employer in Rank 1 would currently be assigned a zero tax rate, while an employer in Rank 19 would be assigned a tax rate of 2.0%.

Two groups of employers are taxed separately, but will come under the tax tables after building up sufficient experience and establishing a history of benefit payments. These are:

- New non-construction employers are charged the lowest rate allowed by federal law which is 1.0% (11,000 employers).
- New construction employers are charged 7.0% (1,900 employers).

The assigned tax rate is applied to a taxable wage base. The taxable wage base is that part of an employee's wage upon which an employer must pay job insurance taxes. This is either two-thirds of the statewide average yearly wage or the taxable wage base for the federal unemployment tax, whichever is greater.

Indexing the tax base to the statewide average yearly wage is an important factor in maintaining the solvency of the Trust Fund because the benefit payments are also indexed to wages. If the wage base increase results in a revenue increase and benefit payments remain low, employer taxes may be lowered by triggering a lower tax table. The tax base for 1995 is $14,200 and is projected to be $14,700 for 1996.

The Department has developed a possible Tax Table 9 which is included in Attachment B. Utilizing the current Tax Tables and the possible new Tax Table 9, the Department generated estimates of contributions to, interest on, and payments from the Trust Fund using two scenarios (optimistic and middle-of-the-road economic assumptions) in October 1995. Assumptions within the scenarios include:

- Optimistic Assumptions (see Attachments C and D).
  - Growth of average weekly wage of 4.5% per year beginning in 1995.
  - Growth in covered employment of 3.0% per year beginning in 1995.

  - Interest paid on Trust Fund balance of 8.0%.
  - The insured unemployment rate would be 1.39% for 1995, 1.30% for 1996, and 1.60% for the remainder of the period.

- Middle-of-the-road Assumptions (see Attachment E).
  - Growth of average weekly wage of 4.0% for 1995.
  - Growth of average weekly wage of 3.5% beginning in 1996.
  - Growth of covered employment of 2.5% for 1995.
  - Growth of covered employment of 2.0% beginning in 1996.
  - Interest paid on Trust Fund balance of 7.0%.
  - The insured unemployment rate would be 1.40% in 1995, 1.60% in 1996, 1.85% in 1997, and 2.10% for the remainder of the period. (Between 1972 and 1994 the insured unemployment rate averaged approximately 2.35%.)

Based on these assumptions the optimistic model under current law would result in Tax Table 8 remaining in effect through 1998 and then Tax Table 7 is projected for 1999 through 2003.

Under the optimistic model with the addition of Tax Table 9, for 1995 and 1996 Tax Table 8 would be applied, Tax Table 9 projected for 1997, Tax Table 8 projected for 1998, and Tax Table 6 or 7 projected for 1999 through 2003.

Under the middle-of-the-road model, Tax Table 8 would remain in effect through 1997, Tax Table 7 projected for 1998, and Tax Table 5 or 6 projected for 1999 through 2003. Under this scenario Tax Table 9 would not be applied.

Attachments C - E provide estimates of the Trust Fund balance, expected interest, projected Tax Tables, projected contributions, and projected benefits to be paid under the various scenarios.

The Trust Fund had a balance of $702.0 million as of October 19, 1995. This balance is projected to grow to $710.0 million by the end of the 1995 calendar year. For the following two years the Department estimates the balance in the Trust Fund will be within a range of $744.0 million to $689.0 million for 1996 and $748.0 million to $641.0 million for 1997 (optimistic and middle assumptions respectively) with no changes to the Tax Tables. If Tax Table 9 were adopted by the General Assembly and the optimistic projections held, the new Tax Table would be implemented for 1997 and the balance at the end of 1997 would be $702.0 million.

The Trust Fund generated $44.0 million in interest during 1994 and is estimated to generate $47.0 million for 1995. Benefit payments for 1994 totaled approximately $150.0 million and are estimated to be $159.0 million for 1995. If collections had been suspended during either of those years, assuming no increase in the level of unemployment benefits paid and stable interest rates, the Trust Fund would have experienced a loss of $106.0 million and $112.0 million, respectively.

ALTERNATIVES

The General Assembly has several alternatives to consider related to the Fund.

- Eliminate the collection of unemployment taxes from eligible employers who are currently paying contributions, for a specified period. (Note: Under current federal law all employers cannot be given a zero rate.) This would likely result in implementing a significantly higher tax table when the moratorium ended, resulting in both a higher rate of tax for most employers and the payment of taxes by employers currently not having to pay due to their employment history.

- Require the creation of an additional Tax Table 9. Based on actuarial data the Department estimates it is unlikely this Table would be implemented in the near future. However, if the Iowa economy remains strong and employment expands with a reduction or no change in the level of unemployment, it is likely that Table would be implemented, providing a reduced tax rate for those employers still paying this tax.
- Same as above, except require the new Tax Table 9 be implemented for a year. This may result in a higher tax table being implemented earlier in the following years than under current law, and increase the number of Iowa employers paying taxes and require those currently paying taxes to pay at higher rates.
- Require the Department to collect taxes at the current rate but place a specified percentage in a separate fund for use in job training or related purpose. To meet federal requirements a reduced tax rate could be specified for the Trust Fund with the remainder of the tax collected going to the new fund. Alternatively, a reduced tax table could be created and the surcharge increased by an off setting amount, which could be dedicated to a job training fund. Again, this may result in a higher tax rate table being implemented earlier than under current law, resulting in taxation of employers that currently pay no taxes.
- Maintain current law. The current system provides a fairly stable and easily understood tax structure and rating system. The volatility caused by the recession similar to the one that occurred in the early 1980s can be accommodated with yearly rate table adjustments. Additionally, employers that place the most burden on the system are required to pay the most taxes.

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Status of the Unemployment Compensation Trust Fund

History of the Unemployment Compensation Trust Fund As of December 31

Year	Trust Fund Balance	Interest Earned	Tax Table Applied
1978	$ 92,824,000	$ 3,300,763	2
1979	151,821,000	6,823,433	2
1980	110,169,000	11,784,964	3
1981	96,452,000	9,986,469	3
1982	-63,343,000	5,047,640	3
1983	-126,340,000	0	2
1984	-37,388,000	0	1
1985	49,285,000	909,347	1
1986	142,517,000	6,451,586	1
1987	276,850,000	15,963,360	1
1988	418,625,000	26,928,968	3
1989	506,681,000	38,265,756	5
1990	562,428,000	46,065,953	6
1991	582,552,000	48,781,525	6
1992	603,963,000	46,617,689	6
1993	643,786,000	44,750,018	6
1994	696,430,000	43,882,453	7

ATTACHMENT B

Current Unemployment Tax Tables 1 - 8 and Possible Table 9

Rank	Current Tax Tables 1	2	3	4	5	6	7	8	Possible New Table 9
1	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
3	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%
4	0.4%	0.3%	0.3%	0.2%	0.1%	0.1%	0.1%	0.1%	0.0%
5	0.6%	0.5%	0.4%	0.3%	0.3%	0.2%	0.1%	0.1%	0.1%
6	0.9%	0.8%	0.6%	0.5%	0.4%	0.3%	0.2%	0.1%	0.1%
7	1.2%	1.0%	0.8%	0.6%	0.5%	0.4%	0.3%	0.2%	0.1%
8	1.5%	1.3%	1.0%	0.8%	0.6%	0.5%	0.3%	0.2%	0.1%
9	1.9%	1.5%	1.2%	0.9%	0.7%	0.6%	0.4%	0.3%	0.1%
10	2.1%	1.8%	1.4%	1.1%	0.8%	0.6%	0.5%	0.3%	0.2%
11	2.5%	2.0%	1.6%	1.3%	1.0%	0.7%	0.5%	0.3%	0.2%
12	3.0%	2.4%	1.9%	1.5%	1.1%	0.9%	0.6%	0.4%	0.2%
13	3.6%	2.9%	2.4%	1.8%	1.4%	1.1%	0.8%	0.5%	0.3%
14	4.4%	3.6%	2.9%	2.2%	1.7%	1.3%	1.0%	0.6%	0.4%
15	5.3%	4.3%	3.5%	2.7%	2.0%	1.6%	1.1%	0.7%	0.4%
16	6.3%	5.2%	4.1%	3.2%	2.4%	1.9%	1.4%	0.9%	0.5%
17	7.0%	6.4%	5.2%	4.0%	3.0%	2.3%	1.7%	1.1%	0.6%
18	7.5%	7.5%	7.0%	5.4%	4.1%	3.1%	2.3%	1.5%	0.8%
19	8.0%	8.0%	8.0%	7.3%	5.6%	4.2%	3.1%	2.0%	1.1%
20	8.5%	8.5%	8.5%	8.0%	7.5%	5.8%	4.3%	2.8%	1.6%
21	9.0%	9.0%	9.0%	9.0%	8.5%	8.0%	7.5%	7.0%	5.4%

Note: Federal Government requires one group to pay 5.4%.

Unemployment Compensation Trust Fund Projections
Optimistic Projection Current Law

Year	Trust Fund Balance	Interest Earned	Total Benefits	Total Contributions	Tax Table Applied
1995	$ 710,400,000	$ 47,000,000	$ 158,500,000	$ 125,500,000	8
1996	743,600,000	56,600,000	160,000,000	140,100,000	8
1997	748,200,000	58,500,000	209,500,000	153,000,000	8
1998	748,800,000	58,700,000	224,200,000	165,100,000	8
1999	789,000,000	59,200,000	241,700,000	223,300,000	7
2000	839,900,000	62,600,000	259,500,000	246,500,000	7
2001	889,000,000	66,400,000	279,400,000	265,300,000	7
2002	941,400,000	70,500,000	303,600,000	285,700,000	7
2003	1,001,400,000	74,800,000	326,100,000	307,500,000	7
2004	1,131,400,000	80,600,000	351,900,000	399,600,000	6

Unemployment Compensation Trust Fund Projections
Optimistic Projection with Tax Table 9

Year	Trust Fund Balance	Interest Earned	Total Benefits	Total Contributions	Tax Table Applied
1995	$ 710,400,000	$ 47,000,000	$ 158,500,000	$ 125,500,000	8
1996	743,600,000	56,600,000	160,000,000	140,100,000	8
1997	701,600,000	57,700,000	209,500,000	107,300,000	9
1998	691,900,000	54,600,000	224,200,000	158,800,000	8
1999	727,400,000	54,500,000	241,700,000	223,300,000	7
2000	825,300,000	58,500,000	259,500,000	297,600,000	6
2001	936,500,000	66,500,000	279,400,000	327,300,000	6
2002	1,000,500,000	74,700,000	303,600,000	293,200,000	7
2003	1,065,500,000	79,700,000	326,100,000	307,500,000	7
2004	1,130,900,000	84,700,000	351,900,000	331,000,000	7

Unemployment Compensation Trust Fund Projections
Middle-of-the-Road Projections

Year	Trust Fund Balance	Interest Earned	Total Benefits	Total Contributions	Tax Table Applied
1995	$ 709,900,000	$ 47,100,000	$ 158,200,000	$ 124,500,000	8
1996	689,400,000	48,300,000	191,800,000	125,800,000	8
1997	640,600,000	46,400,000	231,600,000	133,700,000	8
1998	590,600,000	42,700,000	275,600,000	181,700,000	7
1999	579,500,000	39,800,000	291,300,000	241,100,000	6
2000	625,400,000	39,900,000	306,600,000	311,500,000	5
2001	677,100,000	43,100,000	324,000,000	335,800,000	5
2002	733,200,000	46,900,000	345,100,000	354,600,000	5
2003	737,900,000	50,100,000	363,200,000	314,400,000	6
2004	728,800,000	49,900,000	383,900,000	323,700,000	6