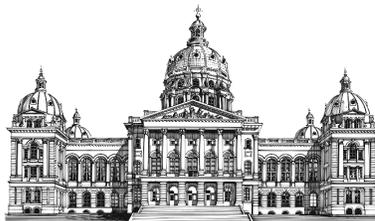


Iowa Legislative Fiscal Bureau

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Unemployment Compensation Reserve Fund

ISSUE

The Department of Employment Services (DES) has proposed creating an Unemployment Compensation Reserve Fund. Interest earned on the Fund could be used for administrative costs of the DES and the Administrative Contribution Surcharge (ACS) Fund could be allowed to sunset at the end of FY 1994 as scheduled.

AFFECTED AGENCIES

Department of Employment Services

CODE AUTHORITY

Chapter 96.7(12), Code of Iowa

BACKGROUND

In 1987 Iowa created the ACS Fund to keep local job service offices open because of the decline in federal funds for administrative support. Iowa employers pay an unemployment tax surcharge equal to 0.1% of federal taxable wages which is deposited in the ACS Fund. The ACS generates approximately \$6.0 million per year.

The current formula for determining employers' unemployment tax rates is based on the last 10 years of benefit payout experience. In the early 1980s, unemployment and benefit payouts in Iowa were high. As the experience of those high payout years recedes, employers' tax rates are reduced and fewer dollars will be generated to pay benefits. If employer contributions are reduced and demand for benefit payouts increase significantly, the Unemployment Trust Fund could become insolvent.

CURRENT SITUATION

The ACS Fund is scheduled to sunset at the end of calendar year 1994. In the FY 1994 budget request the DES has proposed creating an Unemployment Compensation Reserve Fund which would eliminate the need for the ACS Fund. The Reserve Fund would be used:

- To pay benefits through loans to the Federal Unemployment Trust Fund. As security for loans from the Federal Unemployment Trust Fund.

- To pay interest required on advances borrowed from the federal government to pay benefits.

Application of the Federal Temporary Emergency Surcharge in Iowa could be eliminated. The Temporary Emergency Surcharge is imposed on employers when this State owes interest on a loan from the federal government to pay benefits.

The Reserve Fund would be funded by a diversion of an established percentage of all employers' unemployment insurance contributions. The diversion percentage has not been determined and will vary. If the Fund is authorized to begin in March 1993, it would reach the maximum allowable balance of \$250 million during the third quarter of 1994. This plan would allow employer tax contribution rates to stabilize, i.e. rates would not decrease any further, nor would they increase as dramatically as the current formula allows in an extreme recessionary period. It would allow zero-rated employers to again pay zero. This plan would not decrease unemployment benefit payouts.

Interest earned on the Reserve Fund would be deposited in the Special Employment Contingency Fund (also known as the Penalty and Interest [P & I] Fund) and would be used by DES to pay administrative costs, thus eliminating the need for the ACS Fund.

Advantages of the proposal include:

- Allows Iowa to accumulate a \$250 million reserve while keeping employers' rates stable.
- Eliminates the Federal Temporary Emergency Surcharge and the ACS.
- Provides administrative funding to offset federal shortfalls.
- Eliminates the need for a cost allocation plan to provide for the collection of tax once the Reserve is accumulated.
- Stabilizes employer contribution rates to avoid dramatic increases or decreases.
- Keeps \$250 million of Iowa employers' tax dollars in Iowa and away from reallocation by the federal government.

Disadvantages include:

- Prevents employers' contribution rates from decreasing rapidly and removes the balance of the Reserve Fund from the formula used to determine employers' contribution rates. This could also be viewed as an advantage since it will have the effect of stabilizing employer contribution rates.
- Removes the Reserve Fund balance from the federal treasury where it would receive a higher rate of interest.

Three states (North Carolina, Idaho, and Oregon) currently have a state unemployment compensation reserve fund. North Carolina's fund has been in effect since 1987.

ALTERNATIVES

- Create an Unemployment Compensation Reserve Trust Fund and allow interest from the Reserve Fund to be deposited in the P & I Fund. The money in the P & I Fund could be used for administrative costs and eliminate the need for the ACS Fund. Allow the ACS Fund to sunset as scheduled at the end of FY 1994.
- Extend or eliminate the sunset of the ACS Fund and continue to collect the Surcharge to offset federal funding shortfalls.

BUDGET IMPACT

The ACS Fund is expected to generate revenues of \$6.33 million in FY 1994 and \$3.0 million in FY 1995 (the sunset is at the end of calendar year 1994). If the Unemployment Compensation Reserve Fund is authorized early enough the first contributions can begin in March 1993, to generating interest income of approximately \$460,000 in FY 1993, \$8.88 million in FY 1994, \$14.97 million in FY 1995, and \$15 million annually thereafter. The projected interest earnings could vary if it becomes necessary to make transfers to the Federal Unemployment Trust Fund.

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