GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

Legislative Fiscal Note

BILL NUMBER: House Bill 4 (Third Edition)

SHORT TITLE: UI Fund Solvency & Program Changes.

SPONSOR(S): Representatives Howard, H. Warren, Starnes, and Setzer

FISCAL IMPACT ($millions)					
	Yes (X)	**No ( )**	**No Estimate Available ( )**		
	FY 2013-14	**FY 2014-15**	**FY 2015-16**	**FY 2016-17**	**FY 2017-18**
REVENUES:					
UI Trust Fund	***See Assumptions and Methodology***				
UI Reserve Fund	***See Assumptions and Methodology***				
EXPENDITURES:					
General Fund	**$40.8**	**$13.6**			
Highway Fund	**$1.2**	**$0.4**			
Receipts	**$8.6**	**$2.9**			
State Subtotal	**$50.6**	**$16.9**			
Local Gov	**$50.8**	**$17.0**			
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Commerce; Local Governments; Nonprofits participating as reimbursing entities.					
EFFECTIVE DATE: Tax Changes Effective January 1, 2014. Benefit Changes and Reserve Funding Requirements Effective July 1, 2013.					

BILL SUMMARY:
House Bill 4 would make the following changes to the State unemployment insurance program (UI) to accelerate[1] the repayment of the $2.5 billion advance the State borrowed from the federal government to pay UI benefits:

[1] Simulations prepared by the Upjohn Institute suggest the UI Fund would have a positive credit balance in 2018 if the State did not change its laws and relied solely on federal tax increases for the payment of the debt. A simulation based on the changes proposed in the bill suggests the UI Fund would have a positive credit balance in 2015.

- Effective January 1, 2014, the bill would make the following tax rate changes: increase the minimum State unemployment tax (SUTA) rates from 0% to .06%, increase maximum SUTA tax rate from 5.7% to 5.76%; and compute SUTA tax rates based on a formula.
- Effective July 1, 2013, the bill would establish a new trigger for the collection and suspension of the surtax, which is equal to 20% of an employer's SUTA liability.
- Effective July 1, 2013, the bill would require a 1% reserve from all governmental entity and nonprofit employers that elect to finance benefits through reimbursement, and disallow refunds.
- Effective, July 1, 2013, the bill would restrict the use of revenues in the Employment Security Commission Reserve Fund and the Special Employment Security Administration Fund. The Employment Security Commission Reserve Fund would be restricted to the payment of benefits and refunds, administration costs for the collection of the surtax, and interest and principal payments on federal advances used to pay benefits. The Special Employment Security Administration Fund would be restricted to the temporary stabilization of federal funds, security for loans from the Unemployment Trust Fund, refund of interest overpayments, and payment of costs determined by US DOL to be ineligible for payment from the Employment Security Administration Fund.
- Effective July 1, 2013, the bill would make the following benefit changes: reduce the maximum duration of regular benefits from 26 weeks to 20 weeks and tie the duration of benefits to the seasonal adjusted unemployment rate; reduce the maximum weekly benefit amount (WBA) from $535 to $350; and change the calculation of the WBA from a formula based on the high quarter wage in the claimant's base period to the average of the last two quarters of that period.
- Effective July 1, 2013, the bill would restrict the optional triggers for the availability of extended benefits to those times when the benefits would be 100% federally funded. It does not change the mandatory trigger for extended benefits.
- Effective July 1, 2013, the bill would make the following programmatic changes: require a waiting week for each new benefit claim; repeal substantial fault; eliminate most good cause provisions for leaving work; and redefine suitable work as any work paying 120% of weekly benefit amount after 10 weeks of benefits.
- The bill would establish a Joint Legislative Oversight Committee on Unemployment Insurance.

Source: Research Division Summary

ASSUMPTIONS AND METHODOLOGY:
Unemployment Insurance (UI) Trust Fund
The UI Trust Fund is the source of funds used to pay unemployment benefits. Revenues for the Fund come from employer taxes and interest earned on balances. During economic downturns, the Fund is forced to borrow from the Federal Treasury to pay benefits if the balance in the Fund is not sufficient to pay unemployment benefits. Because of the high levels of unemployment experienced during the Great Recession, the Fund was forced to borrow, resulting in a current debt of $2.5 billion.

Simulation Model

The US Department of Labor maintains a model for states to use to simulate changes to UI programs and determine the impact on the UI Trust Fund through 2021. This model was used by the W.E. Upjohn Institute to estimate the impact of the proposed legislation on the State's UI Trust Fund. The model is not designed to simulate all of the changes in the proposal. Therefore, the results do not represent the total impact of the proposal; however, the major changes in the proposal are included in the simulation and are listed below. The impact of other changes in the proposal are discussed later in the note.

- Reduction in maximum weekly benefit from two-thirds of average weekly wage to $350
- Reduction in maximum duration of benefits from 26 weeks to a sliding scale ranging from 12 to 20 weeks based on the seasonally adjusted total unemployment rate.
- Weekly benefit amount based on most recent two quarters as opposed to high quarter wages.
- State Unemployment Tax (SUTA) rate tables changed to linear formula with triggered reductions based on UI Trust Fund balance as percentage of total insured wages.

Federal UI Tax (FUTA) Credit Reductions

The simulation incorporates the FUTA credit reductions that occur annually until the debt is paid. The credit reductions are decreases in the credit amount that the federal government allows against the federal unemployment taxes (FUTA) paid by employers. When states are in full compliance with USDOL guidelines, a credit of 5.4% is allowed against the 6.0% percent FUTA tax, resulting in an effective FUTA rate of 0.6% on a $7,000 taxable wage base, or $42 per employee. When a state has an outstanding UI debt for two consecutive Januaries, USDOL reduces the credit each year by 0.3%, or $21 per employee with wages of $7,000 or more. For tax year 2013, the FUTA credit reduction will be 0.6%, resulting in a total effective tax rate of 1.2%, and will increase by 0.3% for each year in which the State UI Trust Fund carries a negative balance.

Economic Variables

The simulation incorporates several economic assumptions used to determine the amount of benefits paid and taxes collected each year. Economic variables for labor force growth, wage growth, total unemployment rate and insured unemployment rate were obtained from Global Insight. The variables project a slowly improving economy with total unemployment improving from 9.32% in 2013 to 6.14 % in 2021.

Simulation Results

The simulation provides outputs for the UI Trust Fund balance for each year. Results indicate that the UI Trust Fund would have a positive balance beginning in 2015 and that a balance of $2.2 billion would be achieved by the year 2021 if the proposal is implemented.

State and Local Government Reserve Requirements

Part 3 of the proposed legislation requires that state and local governments maintain a 1% reserve fund in addition to reimbursing the State for benefits charged to the entities. The governmental units would begin paying into a reserve fund on a quarterly basis effective July 1, 2013. A quarterly assessment of 1% of taxable payroll would be assessed, with a final reconciliation payment due in January 2015. Benefits charged on behalf of governmental units would be charged against the 1% reserve, requiring additional payments to maintain the 1% reserve. As payments are made into the reserve, they would be swept to the Federal Treasury and credited to the UI Trust Fund.

Fiscal Research estimated the impact on the UI Trust fund of the reserve requirements by obtaining taxable payroll data from the NC Division of Employment Security. The total amount of taxable wages for State and local governments is approximately $13.5 billion. The reserve requirements represent 1% of this amount, or $135 million. This amount would be paid over a 1.5-year period beginning in July 2013 and ending in January 2015. It is expected that the majority of this amount would be received during fiscal year 2013-14. The first quarter calendar year payments are highest because taxable wages ($20,900 for 2013) begin to be exhausted in subsequent quarters. For purposes of this fiscal note, it is assumed that 75% of reserve requirements will be achieved in FY 2013-14, with the remainder in FY 2014-15.

The State portion of taxable wages was estimated by Fiscal Research as $67.5 million. Of this amount, $11.5 million is related to receipt-supported positions and $1.6 million is assigned to the Highway Fund, resulting in a net General Fund cost of $54.4 million. This amount includes the cost associated with State-funded teacher positions.

Because this estimate is based on budgeted FTE's (full-time equivalents), it does not fully account for part-time positions, but does include vacancies. For example, two half-time positions would be counted as one FTE; therefore the taxable wage would be calculated as if it is one employee.

The remainder of the $135.3 million in estimated reserve requirements, or $67.8 million, is attributable to local governments. 75% of this amount is assumed to be paid in FY 2013-14, with the remainder paid in FY 2014-15.

Table 1 below includes the impact of the changes included in the Upjohn simulation, the State and local reserve requirement, the FUTA contributions and the total impact on the UI Trust Fund for each year.

Table 1. Unemployment Insurance Trust Fund Projection

Calendar Year	Annual FUTA Per Employee with $7,000 wage base	Local and State Governments 1% Reserve Requirement	UI Trust Fund Balance per Upjohn Simulation*	Total UI Trust Fund Balance
2013	$84	$0	-$1,979,040,000	**-1,979,040,000**
2014	$105	$101,400,000	-$1,039,251,000	**-937,851,000**
2015	$126	$33,900,000	$31,961,000	**167,261,000**
2016	$42	$0	$788,634,000	**923,934,000**
2017	$42	$0	$1,299,829,000	**1,435,129,000**
2018	$42	$0	$1,722,516,000	**1,857,816,000**
2019	$42	$0	$1,945,499,000	**2,080,799,000**
2020	$42	$0	$2,042,186,000	**2,177,486,000**
2021	$42	$0	$2,130,556,000	**$2,265,856,000**

***Upjohn Simulation dated January 3, 2013.**

Other Changes
Several additional changes in the proposal are described here. While the USDOL model does not allow for simulation of these changes, the nature of the changes and potential impacts are discussed below.

Nonprofits
Currently, nonprofits are required to maintain a 1% reserve or provide a surety bond ensure payment of 1% of taxable payroll if the nonprofit is unable to pay benefits. While most nonprofits elect to use the 1% reserve, a small number of nonprofits post a surety bond. The change from surety bond to a reserve fund for these entities will result in a small increase in the UI Trust Fund.

Attached Claims
Under current law, employers may file UI claims for employees if the employees remain attached to the employer and there is an expectation that the employee will return to work within 6 weeks. There is no requirement that the employee search for work during this period. The proposal would only allow for attached claims if the employer has a positive UI balance; that is, benefits charged to the employer do not exceed UI taxes paid by the employer. Positive balance employers may elect to use attached claims only if they reimburse the UI Trust fund for the cost of benefits paid to employees.

It is expected that very few employers would utilize the attached claims process under the proposal. Employees laid off by employers, even if for a temporary period, would be able to file a UI claim and receive benefits; however, the requirements for receiving benefits would apply, including searching for work. It is not known how the elimination of attached claims would affect the number of workers filing for benefits. Unemployed workers who would have previously received benefits under the attached claims process may elect to file for benefits on their own. Because of the administrative burden on the employee, and the desire in many cases to return to work with the current employer, it is expected that this change would result in fewer UI claims and a reduction in benefits paid.

Other UI System Modifications
This proposal modifies additional components of the UI system, which were not modeled by the Upjohn Institute, but which are considered to likely have a positive impact on the Trust Fund. Such modifications include narrowing qualifications for benefit eligibility, suitable work, and good cause (see Research Outline for additional context).

Reserve Fund Limitations
The Reserve Fund is funded by a 20% surtax on State UI Taxes (SUTA). Under current law, the surtax is triggered when the balance in the Reserve Fund falls below $163 million. Under the proposal, the surtax would be charged until the UI Trust Fund has a balance of $1 billion. In addition, the Reserve will only be used for the following activities: principal payment of federal UI advances, interest payment on federal UI debt, UI benefit payments, administrative costs for surtax collection, and tax refunds. The fund would be capped at $50 million, or the amount used to pay interest in the previous year, whichever is greater.

SOURCES OF DATA: W.E. Upjohn Institute; NC Division of Employment Security; IHS Global Insight

TECHNICAL CONSIDERATIONS: None

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DATE: February 4, 2013

Official Fiscal Research Division Publication

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