SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 976 (Substitute S-2 as reported)
Sponsor: Senator Fred Dillingham
Committee: Human Resources and Senior Citizens

Date Completed: 9-22-88

RATIONALE

The Michigan Employment Security Act provides for the imposition of a "solvency tax" on negative balance employers (i.e., employers whose workers received more in unemployment benefits than the employers paid in unemployment taxes). Revenue from the solvency tax was deposited in a "contingent fund" and generally used to repay Michigan's Federal unemployment insurance interest-bearing debt. Approximately $46.4 million in solvency tax revenue, however, also was used to help fund the automation of Michigan's Unemployment Insurance System to computerize benefit payments and employer contributions. The tax revenues were tapped when it became evident that the Federal funds that were originally expected would not be available to help finance the project. According to a 1985 report by the Senate Labor Committee which investigated complaints of massive cost overruns and poor performance of the computer system, the project had been characterized by mismanagement within the Michigan Employment Security Commission (MESC) and insufficient accountability of MESC staff. Reportedly, certain expenditures allocated to the project were not in fact incurred for that purpose and many now claim that employers should be refunded at least the difference between the amount of solvency tax money originally needed for the project ($18 million) and the amount actually spent ($46.4 million) and that MESC should be made more directly accountable to the Legislature.

CONTENT

The bill would amend the Michigan Employment Security Act to provide for the pro rata repayment of excess solvency tax revenues to employers. "Excess solvency taxes" would be defined as the balance of the solvency taxes in the Contingent Fund as of September 30, 1987, plus projected 1985 solvency tax revenues which were deferred by employers as a result of the deferment of Federal interest obligations under the Social Security Act, minus 1984 and 1985 Federal interest obligations which were deferred under the Social Security Act and which are payable through 1989. The bill also would require legislative approval of expenditures from the Administration Fund, and legislative appropriation of money deposited into that Fund, and would delete language allowing solvency tax revenues to be used for the administration of the unemployment insurance automation project.

The Michigan Employment Security Act provides that, if at any time there are more funds in the Contingent Fund than are needed to pay interest obligations for a "reasonable future period", the Michigan Employment Security Commission may transfer the funds to the Unemployment Compensation Fund, which is used to pay benefits and repay loans from the Federal government, and credit them to the experience accounts of negative balance employers (to offset a portion of benefits paid to their employees).

The bill would delete this transfer provision and require instead that $28,400,000 be paid on a pro rata basis to employers liable for the solvency tax for 1983, 1984, or 1985. The payment to each employer, however, would be reduced by any delinquent solvency taxes owed and by any penalties and interest on such delinquent amount. The amount of the reductions would be applied to the employer's account. The payment to each employer could not exceed the amount actually paid by the employer in 1983, 1984, and 1985. The payment would have to be made to these employers by January 1, 1989, from excess solvency taxes and interest on contributions, penalties, and damages deposited in the Contingent Fund. If payment were not made by January 1, 1989, the payment would have to be made as soon as possible after that date. If the amount available for payment were less than the amount owed, payments would have to be made continuously each year, within six months of the end of the fiscal year, until the entire amount owed had been paid. Further, until the entire amount had been paid, the Commission would not be allowed to use the Contingent Fund for any purpose other than the payment of Federal interest obligations and refunds of interest, damages, and penalties erroneously collected under the Act. The total solvency tax liability for 1983, 1984, and 1985 as reported by employers as of January 25, 1986, would provide the basis for prorating the payments.

MCL 421.10

FISCAL IMPACT

The bill would require the State to pay the excess solvency taxes, $28,400,000, to private sector employers who made solvency payments during the 1983, 1984, or 1985 calendar years. These funds would no longer be available for costs related to the unemployment insurance automation project.

ARGUMENTS

Supporting Argument

The bill would bring a measure of equity into the unemployment insurance taxation system by returning to negative balance employers the amount of solvency tax revenue spent on cost overruns for the unemployment insurance automation project. By paying a tax originally designed for a completely different purpose, negative balance employers have been unfairly burdened with financing the lion's share of a project whose costs skyrocketed dramatically over original projections and whose benefits affect all employers. Further, by providing for legislative oversight of the Administration Fund, the bill would make the MESC more accountable to the public and would help eliminate conditions that contributed to the gross mismanagement of the unemployment insurance automation project.

Opposing Argument

Mandating the payment to negative balance employers of $28,400,000 would be premature and could have serious long-range consequences for the MESC. The $28.4 million is the difference between the $46.4 million in solvency tax revenue spent on the automation project and the original cost estimate of $18 million for the project: the solvency tax account is currently estimated at only $16 million. The additional $12.4 million would have to come from the General Fund, a grant from the Federal government, or the penalty and interest fund. The possibility of obtaining a Federal grant or General Fund revenue is always tenuous.

The penalty and interest fund, on the other hand, is used to make up for Federal funding shortfalls and pay such administrative expenses as computer leasing costs and branch office rent, and to avert layoffs. Should the entire amount of this Fund be paid to employers, the MESC would be left with virtually no cash flow to balance its budget. Furthermore, the penalty and interest fund is made up of payments from all employers who are delinquent, but the bill would require that it be paid only to negative balance employers.

Response: It would be equitable if the penalty and interest fund were paid only to negative balance employers, who have had to finance most of the costs of a project that benefits all employers.

Opposing Argument

Requiring legislative approval of the expenditure of all funds, including Federal funds in the Administration Fund, may be considered by the U.S. Department of Labor to be contrary to the Federal Unemployment Tax Act (FUTA) and the Social Security Act. The Department of Labor has interpreted provisions in these Acts to mean that only the Secretary of Labor may determine how Federal funds are to be spent. A State legislative change in the distribution of expenditures of Federal funds could result in Michigan's failure to comply with FUTA and the Social Security Act. If that occurred, Michigan's employers could lose their FUTA tax credit (estimated at approximately $1.2 billion for 1989) and the Agency could lose its Federal administrative grants (estimated at approximately $130-135 million for FY 1989).

Response: Simply requiring legislative approval for the expenditure of Federal funds would not necessarily result in the State's failure to comply with Federal law. The State's continued compliance would depend entirely on how the Legislature appropriated the funds, what types of rules, restrictions or eligibility or performance criteria the appropriations were conditioned upon, if any, and whether the funding levels and conditions were inconsistent with Federal legislation.

Opposing Argument

The solvency tax revenues were designed to be used to automate the unemployment insurance system and to the extent that the project still needs to be finished, the tax revenues should continue to be used for that purpose. The most appropriate way to obtain funds to reimburse negative balance employers who have borne more than their fair share of the costs of this project is to pursue legal remedies against the consultants on the project and the company that installed the faulty system in the first place.

Response: Pursuing legal action against the consultants and the company could take years, and conceivably could cost more than the employers would be awarded or than they would collect in refunds—hardly an equitable or cost-effective solution. Moreover, the contract for the project may not have included any performance criteria, reporting requirements or other conditions that would enable the State or others to obtain monetary and legal remedies for cost overruns and misallocation of funds.

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