SFA BILL ANALYSIS

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

Senate Bill 68 (as reported without amendment)
Sponsor: Senator Fred Dillingham
Committee: Human Resources and Senior Citizens

Date Completed: 2-21-89

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 to employers of $28,400,000 from excess solvency tax revenues. The bill also would require legislative approval of expenditures from the administrative 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 Act provides that if at any time there is more money in the contingent fund than is needed to pay interest obligations for a "reasonable future period", funds may be transferred to the unemployment compensation fund, which is used to pay benefits and repay Federal loans, and credited 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 would have to be made by September 30, 1989, from excess solvency taxes and interest on contributions, penalties, and damages collected under the Act in the contingent fund. "Excess solvency taxes" would mean the balance of the solvency taxes in the contingent fund as of September 30, 1987, plus projected 1985 solvency tax revenues that 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 that were deferred and are payable through 1989.

If the $28,400,000 were not paid by September 30, 1989, payment would have to be made as soon as possible after that date. If the amount available for payment were less than the amount owned, payments would have to be made continuously each year, within six months after the end of the fiscal year, until the entire amount owed had been paid. Until that time, the contingent fund could not be used 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 reported by employers as of January 25, 1986, would provide the basis for proration of the payments. The payment to each employer would have to be reduced by any delinquent solvency taxes owed and by any penalties and interest on the delinquent amount. The payment to each employer could not exceed the amount actually paid by the employer for 1983, 1984, and 1985.

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.

Supporting Argument
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. Requiring legislative approval of expenditures from the Administration Fund also would be consistent with Executive Order 1986-7, which transferred budgeting, accounting, and other management functions for the MESC to the Director of the Department of Labor, and would be consistent with legislative control over other departmental appropriations.

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 was designed to benefit all employers.

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 or improved, 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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