New Jersey Policy Research Organization Foundation

NJPRO

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Facts for Discussion

Committed to **Quality Research** on Behalf of **New Jersey** Employers

NJ Unemployment Insurance Trust Fund Diverted Revenues, Low Balance Threaten Fund's Health

Why New Jersey Employers Should Care

Since 1993, New Jersey has diverted $4.6 billion in payroll tax revenues from its Unemployment Insurance (UI) Trust Fund to help balance the State budget and pay for hospital charity care. In addition, the State has increased unemployment benefit levels. These actions have pushed the fund balance to a 20-year low.

During the FY07 budget battle, the legislature and Governor recognized the frailty of the fund and avoided a diversion. This is the first time in recent history that the fund remained untapped in a fiscal crisis. However, the low fund balance could trigger a $300-$600 million tax increase on New Jersey employers in 2007. The UI Trust Fund has barely enough money to cover current demands for unemployment benefits. Any future diversions or a sharp increase in the state's unemployment rate would lower the balance, possibly triggering the tax increase on employers. Business and labor groups agree that the state can ill afford to divert any more UI tax revenues from the fund.

How We Got Here

During the mid-1970s, the federal government provided New Jersey with an interest-free loan to help pay its unemployment-benefit obligations. In the late 1970s and early 1980s, the State began diverting contributions from the UI Trust Fund to pay back the federal loan. In 1981, the federal government started charging interest on these loans, and New Jersey and other states

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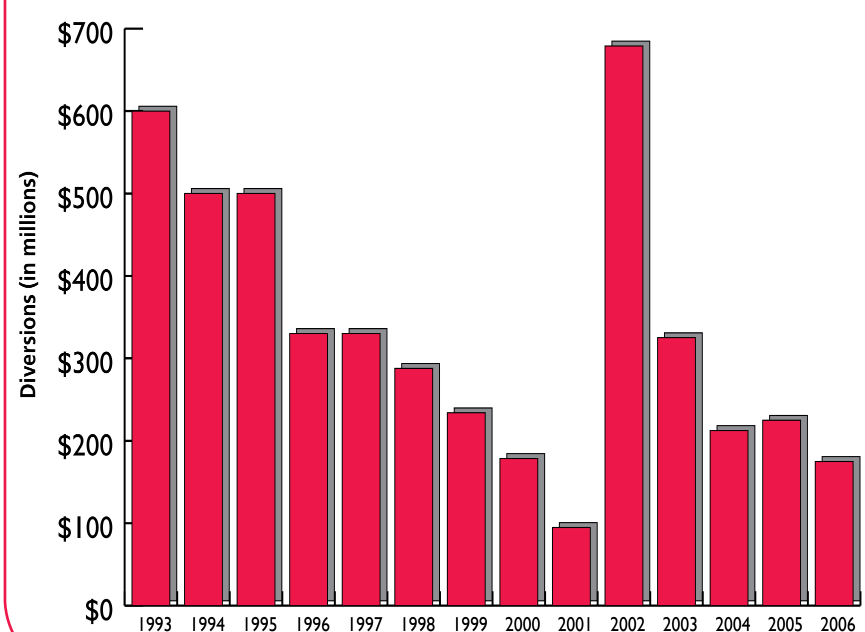
Background

Unemployment insurance was created in 1935 as part of the Federal Social Security Act solely to pay partial wages to workers who lose their jobs. The program is intended to build up funds during economic expansions so they are available to pay unemployed workers during economic downturns. The New Jersey unemployment insurance system started paying benefits to laid-off workers in 1937.

Unemployment insurance has been a successful partnership between the federal and state governments. The program is based on federal law and administered by each state government under state law. Unemployment benefits are financed with payroll taxes paid by employers and, in New Jersey and two other states, by a much smaller payroll tax on employees.

New Jersey's Trust Fund is also supplemented with federal funds. UI revenues are deposited in the NJ Unemployment Insurance Trust Fund, an interest-bearing US Treasury account administered by the NJ Department of Labor and Workforce Development (NJDOL).

UI Fund Diversions 1993-2006
$4.6 Million Diverted to Pay for Hospital Charity Care



A Lesson from New York

Faced with insolvency in its Unemployment Insurance Trust Fund at the end of 2002, New York State borrowed $350 million per month in federal loans and increased annual payroll taxes an average of $360 per employee in order to pay its unemployment benefits. Trust Fund insolvency and failure to repay the loans promptly doubled the unemployment taxes paid by New York employers.

How We Got Here *(cont'd. from page 1)*

tightened their eligibility requirements for unemployment benefits.

In 1984, New Jersey raised benefit levels—indexing them to average weekly wages. To pay for the higher benefits, the State imposed a 10 percent surcharge on employers and imposed ongoing tax increases on employers and workers. The New Jersey business community supported these measures because they were intended to make the Trust Fund solvent and were tied to provisions disqualifying benefit claims by workers dismissed for misbehavior.

The Trust Fund did not remain on solid ground for long. Between 1995 and 2003, the State expanded benefits. It lowered the minimum weekly earnings-qualification level to $101, and it extended the regular-benefit collection period to 26 weeks. The State also removed the 10 percent surcharge imposed on employers so New Jersey employers could pay lower UI tax rates.

Even as benefits were being expanded and tax contributions reduced, the Legislature began its annual practice of diverting UI tax revenues to pay for unrelated State budget expenses. Most notably, the Legislature diverted UI revenues to finance 14 years of uninsured medical care at hospitals, known as charity care. The first diversion was made in 1993, when the Legislature redirected $600 million for charity care. These diversions, which occurred under the watch of both political parties, significantly lowered the size of the fund balance. (See Chart on page 1.)

While making these diversions, the Legislature also lowered the threshold for triggering a payroll tax increase and reduced UI taxes paid by employees. These actions reduced the Fund's income.

The diversions of the fund began in 1993, when the legislature approved a $600 million health care diversion. In subsequent years additional diversions were taken—1994 $500 million, 1995 $500 million, 1996 $330 million, 1997 $330 million, 1998 $288 million, 1999 $233.9 million, 2000 $178.6 million and 2001 $94.9 million.

In spite of the charity-care diversions, the fund balance rose during the economic boom of the 1990s, protected by low unemployment rates. By the end of 2001, the fund balance had reached a historical high of $3.1 billion.

But the diversions continued, putting increasing strain on the fund's resources. At the same time, weekly benefit levels for unemployed workers continued to rise, with the maximum weekly benefit rate hitting a high of $521 in 2006. By 2005, the fund balance had fallen to $900 million, a 20-year low. Fourteen years of continuous diversions (totaling more than $4.6 billion) and ever rising benefit levels had taken their toll. The solvency of the fund was threatened.

Comparing New Jersey to Other States

How does the New Jersey's unemployment insurance program compare with those in neighboring states? Comparing unemployment insurance programs is difficult because each state has flexibility in setting eligibility standards, benefit levels, collection periods, and tax rates.

- New Jersey employers have a lower unemployment tax rate (0.4%) than employers in New York (0.5%), and in Connecticut and Pennsylvania (0.9%). However, New Jersey employers pay unemployment taxes on a higher wage base ($23,500) than Connecticut ($15,000), New York ($8,500) and Pennsylvania ($8,000).
- New Jersey's eligible unemployed workers collect higher weekly benefits (a maximum of $521) than workers in Connecticut ($465), Pennsyl-

vania ($478), New York ($405) and Delaware ($330).
- A higher percentage of unemployed workers collect unemployment benefits in Connecticut (75%) and Pennsylvania (62%) than in New Jersey (57%) and New York (47%).
- New Jersey, Pennsylvania and Alaska are the only three states where employees pay unemployment taxes.

The Options

The continued diversion of UI tax contributions from New Jersey's Trust Fund to pay for other State-budget expenses creates significant risks:

- If the Fund balance falls below a certain level, it could trigger a $300-$600 million increase in employer payroll taxes.
- Failure to replenish the Fund balance could lead to insolvency, which could activate a federal role.
- If the balance remains low, the Fund will lose a significant source of revenues from its interest-bearing account with the US Treasury.

New Jersey has several options for replenishing the fund. The State can:

- Take a federal loan
- Issue State revenue bonds
- Increase UI tax rates or reduce benefits
- End the UI Fund diversions

Let's take a look at the consequences of each of these options.

Take a federal loan

Federal law allows a state with inadequate reserves in its Unemployment Insurance Trust Fund to obtain a loan from the federal account. These loans, however, carry a relatively high interest rate, currently 6 percent. The interest on the loan cannot be paid from the Unemployment Insurance Trust Fund, so the state must levy a separate solvency tax on employers to pay the interest on the loan. If a state fails to repay the loan in a timely manner, the federal government will impose an escalating surcharge on employer-paid unemployment taxes. In short, a federal loan means higher payroll taxes for employers.

Issue State revenue bonds

To cover their insolvent UI funds, the states of Arkansas, California, Massachusetts, Minnesota and North Carolina sold state revenue bonds. Texas and Illinois issued revenue bonds to repay their federal loans. While avoiding the higher cost of federal loans, these states still had to pay underwriting and legal fees, as well as insurance and administrative costs. In most cases, the selling of revenue bonds did not return their trust funds to solvency.

Increase UI tax rates or reduce benefits

Raising UI taxes on employers and their employees or reducing benefits paid to the unemployed are highly unpopular ways of returning UI funds to solvency. Besides, raising taxes and lowering benefits during an economic slowdown undermine the very goal of an unemployment insurance system, which is to create a healthy balance during periods of economic growth in order to fund jobless benefits during recessions.

End the UI fund diversions

The simplest and most straightforward option is to end the diversions. The Legislature should do what it originally intended when it created the State's current unemployment insurance system in 1984: dedicate all UI tax revenues to the Trust Fund. This will restore the financial health of the UI Trust Fund and avert the need for a tax hike or benefit reduction. Ending diversions requires no extraordinary action and carries no interest costs, surcharges, fees, or other penalties associated with other means of avoiding insolvency. It is important to note that the current FY 07 budget did not raid the UI Fund.

New Jersey has diverted $4.6 billion in payroll-tax revenues from its Unemployment Insurance (UI) Trust Fund since 1993. This has left the Fund balance precariously low, and it could trigger a $300-$600 million tax increase on employer unless the diversions are ended.

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About the

NJPRO

Foundation

The New Jersey Policy Research Organization (NJPRO) Foundation is an independent public policy research affiliate of the New Jersey Business & Industry Association. NJPRO produces innovative, timely and practical research. NJPRO is New Jersey's leading policy organization conducting research on behalf of New Jersey employers. Governed by an independent Board of Trustees, NJPRO is a nonpartisan, tax exempt organization. NJPRO depends on the support of companies, individuals and foundations for its income.

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Assessing the Trust Fund's Health

Analysts use two different measures to evaluate the fiscal health of unemployment insurance trust funds. Either measure reveals New Jersey's fund to be in poor health.

High-Cost Multiple (HCM).

The HCM method creates a ratio from the biggest unemployment insurance payouts over any 12-month period and the current trust fund balance. It does not take into account incoming revenues. It measures for how long a trust fund could pay benefits during an employment recession without additional payroll tax contributions. The U.S. Department of Labor sets 1.5 as a healthy HCM ratio. At the end of 2004, New Jersey's HCM ratio was an extremely unhealthy 0.2.

Average High-Cost Multiple (AHCM).

Instead of using the worst recession in program history, the more moderate AHCM measure takes an average of the three worst recessions over the previous 20 years. Many experts accept an AHCM ratio of 1.0 as a standard for solvency, indicating that trust fund reserves will meet benefit demands without additional income. The National Employment Law Project recommends that states below this level increase unemployment taxes or otherwise improve trust fund reserves. New Jersey's AHCM ratio was 0.36 at the end of 2004, well below what is considered healthy.

Conclusion

When the State Legislature restructured the State's unemployment insurance system in 1984, it had a simple plan in mind. During economic good times, the balance in the UI Trust Fund would swell. During economic downturns, the fund—still flush with money from the good times— could pay unemployment benefits for large numbers of unemployed workers. This system had an added benefit. Employers, who had paid into the fund during periods of profitable growth, would not be forced to pay higher UI taxes during a recession.

Unfortunately, over the last two decades the Legislature has tinkered with this system and undercut its own plan for success. Over the last 14 years, the Legislature has diverted $4.6 billion in UI funds, primarily to pay for hospital charity care. At the same time, it has increased benefit levels and reduced the fund's income. These actions have pushed the fund balance to a low of $900 million, leaving the fund with barely enough resources to meet its obligations.

If the UI payroll taxes paid by employers and their employees are dedicated exclusively to their originally intended purpose, the payment of unemployment benefits, the Fund balance will grow.