The Florida Senate

Interim Project Report 2002-122 *October 2001*

Committee on Commerce and Economic Opportunities Senator Alex Diaz de la Portilla, Chairman

SOLVENCY OF THE UNEMPLOYMENT COMPENSATION TRUST FUND AND THE TAX "TRIGGER"

SUMMARY

Despite an unprecedented 125 months of economic expansion in the U.S. economy, the solvency of Florida's unemployment compensation (UC) trust fund has declined. Although there is no consensus on the appropriate level for trust fund reserves, the decline in the trust fund's solvency is confirmed by accepted measures. To improve trust fund solvency, a state's options are limited. Raising taxes, cutting benefits, or restricting eligibility to benefits are generally the available options.

An econometric forecasting model predicts the balance of Florida's UC trust fund will fall below the statutory "trigger" of 4 percent of the state's taxable payrolls within the next year. Accordingly, this tax trigger will automatically increase the payroll taxes on employers to replenish the trust fund's reserves.

Many states have experienced chronic problems with UC trust fund insolvency, causing them to borrow from the federal government to pay benefits and resulting in increased federal taxes to repay the loans. In response, these states have restricted eligibility to UC benefits to reduce benefit costs, thereby reducing the number of workers who are eligible to receive benefits and, consequently, jeopardizing the value of their UC programs as economic stabilizers. During the 44-year history of Florida's 4-percent tax trigger, the state's UC trust fund has never become insolvent. Whenever the UC trust fund's reserves have fallen below 4 percent of taxable payrolls, the tax trigger's automatic tax increase has ensured the trust fund's solvency. Because an automatic tax increase is the UC trust fund's self-correcting mechanism to ensure solvency, committee staff recommends the Legislature use extreme caution when considering proposals that modify the tax trigger.

A review of the UC trust fund inevitably extended to the taxes and benefits that flow through the fund and the policies that support them. Research revealed the UC program's value as a countercyclical economic stabilizer could be jeopardized if the trust fund's solvency continues to decline. Additionally, Florida's UC taxes are assessed using the "benefit ratio" method of experience rating, which causes a spike in UC taxes during and immediately after a recession to replenish the trust fund's reserves. By contrast, many states use the "reserve ratio" method, which gradually spreads the tax burden for a sudden rise in benefit experience over a longer period of time. Thus, the state's UC tax structure may also reduce the UC program's ability to assist the state's recovery from a recession. To improve the countercyclical value of Florida's UC program, committee staff recommends that additional study be conducted, including an evaluation of converting the existing tax structure from the benefit ratio method of experience rating to the reserve ratio method.

BACKGROUND

During the 2001 Regular Session, the Legislature considered several bills that would have expanded unemployment compensation (UC) benefits.[1] Concern emerged that expanding benefits would cause the balance of Florida's UC trust fund to fall below the statutory trigger of 4 percent of the state's taxable payrolls and, consequently, require a tax increase on employers. Predictions were also made that the fund balance's fall below the 4-percent tax trigger is imminent without the added impact of the proposed legislation, leading some to call for a reduction in the trigger to avert a tax increase. The Senate and the House of Representatives each passed legislation to reduce the tax trigger to 3.7 percent of taxable payrolls. Ultimately, however, the legislation was not enacted in both chambers in the identical form, and the tax trigger remained unchanged.

[1] *See, e.g.*, SB 500 (paying benefits to parents during family leave after the birth or adoption of a child) and SB 1740 (calculating benefits using an alternative base period for those claimants who do not qualify under the regular base period).

The purpose of this report is to analyze the solvency of the UC trust fund, to evaluate the short-run potential for the fund balance's trigger of an automatic tax increase, and to assess whether the tax trigger's statutory rate of 4 percent of taxable payrolls is optimal to protect the solvency of the fund while minimizing the taxes imposed upon employers.

National Unemployment Insurance System

The national unemployment insurance (UI) system was established as a direct result of the high unemployment experienced during the Great Depression of the 1930s. The UI system was created as a federal-state program, authorized by both the Social Security Act of 1935 and the Wagner-Peyser Act. The Federal Unemployment Tax Act of 1939 (FUTA) later amended the program and governs it today. The UI system's primary objectives are: (1) to give workers temporary and partial insurance against income loss resulting from unemployment and (2) to assist the countercyclical stabilization of the economy during recessions by maintaining workers' purchasing power.

There are 53 "state" UC programs, inclusive of the 50 states, Puerto Rico, the Virgin Islands, and the District of Columbia. Each state UC program is executed through state law by state employees, and each state establishes its own policies governing benefit eligibility, the amount and duration of weekly benefits, and the state tax structure. State programs are, however, subject to approval by the U.S. Department of Labor under federal requirements in the FUTA.

To fund the UI system, the Internal Revenue Service charges each liable employer a federal unemployment tax of 6.2 percent on the first $7,000 of each employee's wages. If, however, a state program meets the federal requirements and has no delinquent federal loans, the state's employers are eligible for up to a 5.4-percent tax credit, making the net federal tax rate 0.8 percent. To receive the maximum federal tax credit, states must establish a taxable wage base for state UC taxes at least equal to the federal taxable wage base – currently $7,000. The federal tax rate of 0.8 percent is comprised of a permanent tax of 0.6 percent and a temporary surtax of 0.2 percent. The federal tax is used primarily to finance state and federal UC program administration and to provide loans to states with insolvent UC trust funds. The 0.2-percent surtax was added in 1976 to help the national UI system replenish the funds used to provide federal loans to state UC programs. The U.S. Congress extended the surtax in 1987, 1990, 1991, 1993, and 1997. The surtax is currently scheduled to expire in 2008.

Forward Funding and State Trust Fund Solvency

The federal UI system originally operated on the basis that benefits would be forward funded. That is, tax rates and benefit levels were established with the intention that the system would accumulate reserves during economic expansions and, thereby, have sufficient reserves to pay benefits during economic recessions. According to the U.S. General Accounting Office (GAO), this approach was used during the first 30 years of the UI system. However, GAO observed that, throughout the most recent three decades, many states have gradually eroded the forward-funding principle by relying on federal loans to pay benefits during recessions due to inadequate trust fund reserves.

In contrast to forward funding, repayment of federal loans as the means to finance UC benefits is known as the "pay as you go" approach. Before 1982, the federal government provided interest-free loans to pay UC benefits in states with insolvent trust funds. However, under the Omnibus Budget Reconciliation Act of 1981, the U.S. Congress mandated that loans to state UC trust funds after March 1982 carried interest charges with an annual interest rate of up to 10 percent. After a state UC trust fund borrows from the federal government, if the loan becomes delinquent, the federal tax credit for the state's employers is reduced until the loan is repaid. Thus, employers in states with insolvent trust funds are faced with multiple tax increases: increased state UC taxes to restore solvency of the state UC trust fund and increased federal taxes to repay federal loans.

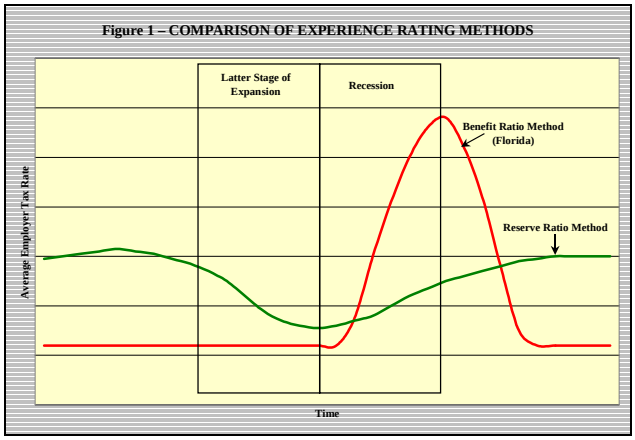
State Tax Structures and Experience Rating

Every state's UC tax structure uses "experience rating" to set tax rates. Experience rating varies the tax rate of each employer based upon its past experience in laying off workers, thereby charging the highest tax rates to employers who lay off the most workers. Most states use one of two methods for experience rating: "reserve ratio" or "benefit ratio."[2] Under the reserve ratio method, an employer's cumulative UC tax payments are compared to the cumulative benefits charged to the employer. On an annual computation date, the state determines the employer's "reserve" – the difference between its cumulative contributions and benefit charges. The reserve is then divided by the employer's average annual taxable payroll during the computation

[2] *See* Marc Baldwin, *Beyond Boom and Bust: Financing Unemployment Insurance in a Changing Economy* 7-11 (National Employment Law Project Apr. 2001).

period (usually the three years before the computation date). The result is the employer's "reserve ratio." The lower the reserve ratio, the higher the tax rate. Thirty-three states use the reserve ratio method.

Under the benefit ratio method, the benefits charged to an employer are compared to its taxable payrolls during the same period. For a given computation period (usually three years), the employer's benefit charges are divided by its taxable payroll. The result is the employer's "benefit ratio." The higher the benefit ratio, the higher the tax rate. Seventeen states, including Florida, use the benefit ratio method.



SOURCE: Robert Tannenwald and Christopher J. O'Leary, *Unemployment Insurance Policy in New England: Background and Issues*, New England Economic Review 9 (May/June 1997).

Because calculations under the reserve ratio method include an employer's tax payments, each employer has an account that builds a surplus of contributions over benefit charges during periods of economic expansion, which is then drawn down during recessions. After a surge in benefit charges, an employer's tax rate rises gradually, but then remains at a higher level for a longer period of time and falls slowly in response to improving conditions. By contrast, the benefit ratio method is closer to the "pay as you go" approach, in which taxes increase rapidly after a surge in benefit costs. Tax rates then fall steeply after the benefit charges have been "paid off." Figure 1 illustrates the difference between the two methods. The benefit ratio curve spikes during a recession and plummets when the economic recovery is complete. By comparison, the reserve ratio curve is flatter and spreads the cost of benefit charges over a longer period. Because the reserve ratio method avoids rapid tax increases during recessions (when employers are least able to pay higher taxes), the reserve ratio method is more effective as a countercyclical tool to stabilize the economy than the benefit ratio method.

Florida's Unemployment Compensation Program

Florida's UC program was created by the Legislature in 1937 (ch. 18402, L.O.F.), and the first benefits were paid to eligible workers in 1939. The program is currently administered by the Agency for Workforce Innovation (AWI).

The state's UC taxes are based upon the first $7,000 of each employee's wages – the minimum wage base allowed under federal law. New employers are assigned an initial tax rate of 2.7 percent. After 10 or 11 calendar quarters of payroll history (depending on when the employer became liable for UC taxes), the employer earns a tax rate from 0.1 to 5.4 percent of the $7,000 wage base. Each employer's tax rate varies and is set using the benefit ratio method of experience rating. State UC taxes are collected by the Department of Revenue under contract with AWI and are deposited in the UC trust fund, which may be used solely for the payment of benefits. As of July 31, 2001, the trust fund's balance was approximately $1.97 billion.

To receive UC benefits, claimants must meet certain monetary and non-monetary eligibility requirements. For example, claimants must have worked during the first four of the previous five calendar quarters, earned at least $3,400 in that period, and be unemployed due to layoffs or otherwise through no fault of their own. They must also be ready, willing, and able to work and actively seeking work. Qualified claimants may receive benefits equal to 25 percent of their wages, but a claimant's total benefits are capped for any period of unemployment within a range from a minimum cap of $850 to a maximum cap of $7,150. Benefits are paid weekly, ranging from a minimum of $32 to a maximum weekly benefit amount of $275 for up to 26 weeks, depending on the claimant's length of prior employment and wages earned.

In calendar year 2000, AWI processed 367,325 initial benefit claims, and 224,212 claimants received initial benefit payments. Florida claimants received about $648 million in total benefits during calendar year 2000, with individual claimants receiving average weekly benefits of approximately $218 for an average of about 13 weeks.

History of Florida's UC Tax Trigger

When Florida's UC program was established in 1937, the initial tax rate for each employer was 2.7 percent of the total wages paid by the employer. The original tax structure used experience rating by discounting future tax rates for employers whose contributions exceeded

benefit charges after three years of benefit experience. Because separate accounts were maintained for each employer and because cumulative contributions were compared to cumulative benefit charges, Florida's original tax structure more closely resembled the reserve ratio method of experience rating than the benefit ratio method that is used today.

The 1937 law also created the UC trust fund. To ensure that sufficient reserves were available to pay benefits, no employer was allowed a discount from the 2.7-percent tax rate based upon benefit experience unless the total assets in the trust fund exceeded the total benefits paid from the fund in the prior year. Further, no employer was allowed a tax rate of less than 2 percent unless the trust fund's balance was at least twice the benefits paid from the fund in the prior year. Thus, from its inception, the UC program provided a means to establish trust fund solvency.

During the first 20 years of Florida's UC program, the Legislature routinely adjusted the trust fund's solvency target, denying discounts to employers whose benefit experience otherwise warranted a tax rate reduction in order to maintain trust fund solvency. For example, in 1955, the law withheld a tax rate reduction based upon benefit experience for all employers unless the UC trust fund's balance exceeded $15 million or twice the amount of benefits paid from the fund in the prior year, whichever was greater.

After these early years of interim solvency targets, the Legislature established the current tax trigger in 1957 (ch. 57-247, L.O.F.). The law imposed an automatic tax increase on all employers if the trust fund's balance fell below 4 percent of taxable payrolls on December 31 of each year (positive fund balance adjustment factor). Conversely, if the trust fund's balance grew beyond 5 percent of taxable payrolls, the law granted an automatic tax reduction for all employers (negative fund balance adjustment factor). Because legislative records from this period are limited, there is no way to ascertain the Legislature's reasoning behind establishing the tax trigger as a range between 4 and 5 percent of taxable payrolls. Nevertheless, this policy has stood for more than four decades and remains in effect today, except the tax trigger is now calculated using the trust fund's balance on June 30 of each year. *See* s. 443.131(3)(e)1.c., F.S.

Since the tax trigger was established in 1957, a negative fund balance adjustment factor has been applied during 15 tax years, automatically reducing employer taxes in each of those years. During this period, a positive fund balance adjustment factor has automatically increased UC taxes nine times. The most recent instance the tax trigger raised taxes was in 1984, in the aftermath of the 1980 and 1981-82 recessions. The tax trigger cut taxes each year from 1986 to 1991, but leveled off during the 1990-91 recession. The tax trigger has not altered tax rates since 1991.

During the history of Florida's tax trigger, the UC trust fund has never become insolvent. In the aftermath of the 1973-75 recession, the state anticipated the UC trust fund's reserves were insufficient to pay benefits. Consequently, the state twice borrowed funds from the federal government – $10 million in 1976 and $32 million in 1977. However, Florida's trust fund remained solvent and the loans were each repaid in less than one year. With the exceptions of 1976 and 1977, Florida has never sought a federal loan, making this state one of only a few to avoid serious and chronic problems with trust fund insolvency.

METHODOLOGY

To conduct this interim project, committee staff examined the historical cash flow of Florida's UC trust fund to evaluate the 4-percent tax trigger; studied the existing research and analyses of the trust fund, including the impact of severe recessions on the fund balance; reviewed the requirements of the Federal Unemployment Tax Act; and drew upon the combined expertise in this policy area of the Agency for Workforce Innovation, the Department of Revenue, the Financial and Economic Analysis Policy Unit in the Governor's Office of Policy and Budget, and the business community. With the assistance of the Legislature's Office of Economic and Demographic Research, committee staff also used an econometric forecasting model to evaluate the short-run potential of an automatic tax increase caused by the tax trigger.

FINDINGS

There is no consensus on what constitutes an appropriate level of trust fund solvency.

During an interview, one staff member in the Governor's office said that solvency of the UC trust fund is "subjective" and balances the relative risk that the state will experience a severe economic recession. Quoting the Florida Department of Labor and Employment Security, the Governor's office wrote in 1996 that the level of trust fund solvency is ultimately a "political decision as much as actuarial."[3] The literature supports these views and asserts there is no consensus

[3] Office of Planning and Budgeting, Executive Office of the Governor, *Unemployment Compensation Program: A Review*, Executive Summary (Sept. 1996).

on what constitutes an appropriate measure of trust fund solvency.[4]

Nevertheless, the most commonly accepted measure of trust fund solvency is the *High Cost Multiple* (HCM). The HCM estimates how long trust fund reserves would last during a recession equivalent to the most severe recession experienced by the state since 1958 (*i.e.*, 1975 for Florida). Multiplying the HCM by 12 roughly estimates how many months of benefits could be paid during such a severe recession. The U.S. General Accounting Office, the U.S. Department of Labor, and the Interstate Conference of Employment Security Agencies (now known as the National Association of State Workforce Agencies) have each recommended an HCM of 1.5 as the solvency target. This standard would require enough trust fund reserves to pay benefits for 18 months at the highest 12-month rate of benefit payments the state has ever experienced.

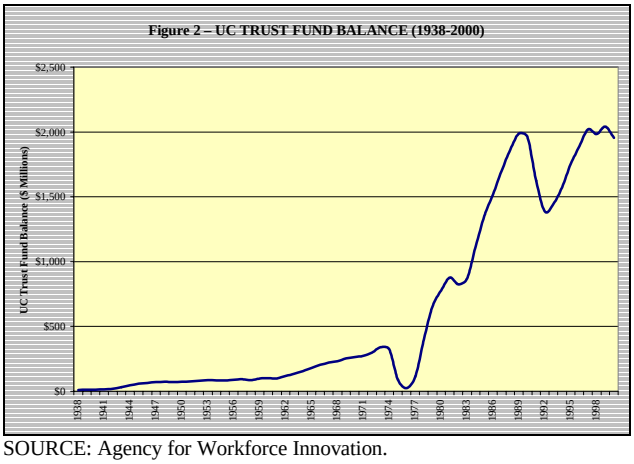
The *Average High Cost Multiple* (AHCM) is a second measure often used to express trust fund solvency. The AHCM estimates how long trust fund reserves would last during a recession equivalent to the average of the three calendar years with the highest benefit costs in the past 20 years (*i.e.*, 1991, 1992, and 1982, respectively, for Florida). In 1995, the former Advisory Council on Unemployment Compensation recommended an AHCM of 1.0. This standard would require adequate trust fund reserves to pay benefits for one year (based upon the average of the three highest annual rates of benefit payments in the past 20 years).

Each state currently establishes its own policy on trust fund solvency. Some states have maintained adequate reserves, but many state UC trust funds have experienced chronic problems with insolvency, causing those states to borrow billions of dollars from the federal government. The U.S. Congress has not established an official standard for trust fund solvency. In 1999, however, Rep. Sander M. Levin (D-Mich. 12th) introduced H.R. 1830, which would have required states to maintain trust fund reserves at an AHCM of 1.0.

Following a national trend, the solvency of Florida's UC trust fund has declined.

Since the late 1980s, the U.S. General Accounting Office (GAO) has persistently warned of a long-term national decline in state UC trust fund solvency and an erosion of the forward funding approach to UC program financing.[5] GAO has also reported massive federal loans to insolvent state trust funds and observed that, to regain solvency, some states raised employer taxes. Many other states reduced benefit durations or restricted benefit eligibility requirements. These latter state reactions to the federal incentives for state trust fund solvency implemented in the 1980s (*e.g.*, charging interest on federal loans) have diminished the effectiveness of the UI system as a countercyclical economic stabilizer by reducing workers' purchasing power in a severe economic recession.

In 1996, the Legislature's Office of Program Policy Analysis and Government Accountability (OPPAGA) reported that the capacity of Florida's UC trust fund to pay benefits declined from 1989 to 1995 and may not have been sufficient to pay benefit costs during a severe recession.[6] In response, the Department of Labor and Employment Security (which administered the UC program during that period) agreed the trust fund had inadequate reserves in the event of a severe recession. OPPAGA identified three options for the Legislature to improve the UC trust fund's solvency: (1) periodically raise the taxable wage base (currently the first $7,000 of each employee's wages), (2) change the basis of the UC tax structure from taxable wages to total wages, and (3) periodically increase the tax trigger (*e.g.*, increase the range of the tax trigger from 4 to 5 percent of taxable wages to the higher range of 5 to 6 percent). As of this report, the Legislature has not implemented any of these options.



SOURCE: Agency for Workforce Innovation.

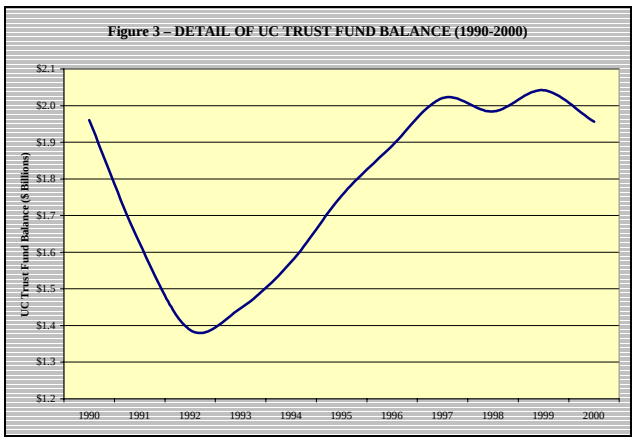
The balance of Florida's UC trust fund has generally grown throughout its history, increasing steadily during

[4] Wayne Vroman, *Topics in Unemployment Insurance Financing* 12 (W.E. Upjohn Institute for Employment Research 1998).

[5] *See, e.g.*, GAO, *Unemployment Insurance: Trust Fund Reserves Inadequate* (GAO/HRD-88-55) (Sept. 1988); GAO, *Unemployment Insurance: Trust Fund Reserves Inadequate to Meet Recession Needs* (GAO/HRD-90-124) (May 1990).

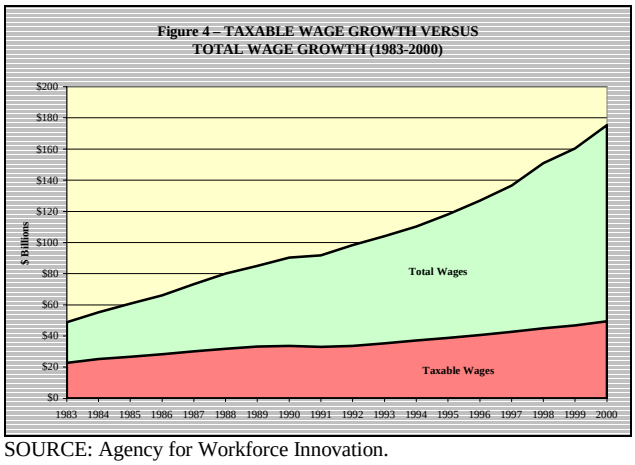
[6] OPPAGA, *Review of the Unemployment Compensation Program Administered by the Department of Labor and Employment Security*, No. 95-37 (Feb. 1996).

periods of economic expansion, but declining significantly during recessions. In Figure 2, the upward curve demonstrates increases in wage rates and rising population over time. The curve also shows troughs that correspond to the 1973-75 recession, the back-to-back 1980 and 1981-82 recessions, and the 1990-91 recession. Beginning in 1997, the curve leveled off and hovers at approximately $2 billion in reserves.



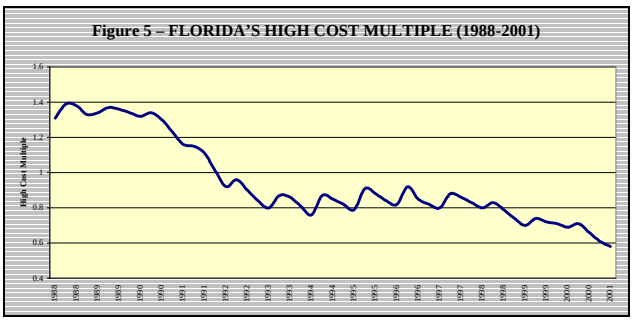
SOURCE: Agency for Workforce Innovation.

Figure 3 depicts a more detailed view of the trust fund's balance throughout the last decade. After the trust fund recovered from the 1990-91 recession, the fund's balance showed steady growth until 1997. The balance then declined slightly, but recovered and grew through 1999, and then declined again. The leveling off of the trust fund's growth and these brief declines are most likely attributable to temporary tax reductions and benefit increases enacted in 1997 and 1999 (chs. 97-29 and 99-131, L.O.F.), which affected tax rates and benefit amounts in 1998 and 2000.



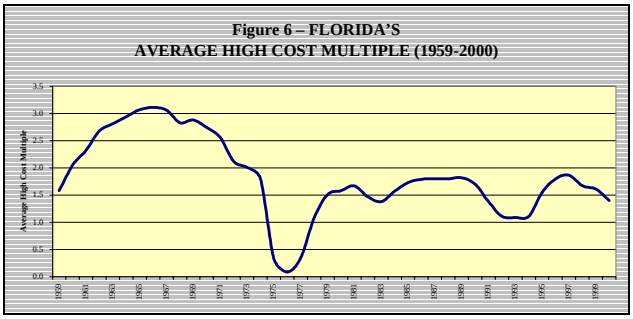
SOURCE: Agency for Workforce Innovation.

Despite the long-term growth in the UC trust fund's balance, the potential demands on the trust fund have also grown significantly. The state's taxable wage base has remained static at the $7,000 federal minimum since 1983. In 1983, taxable wages ($23 billion) accounted for about 47 percent of total wages ($49 billion). Today, total wages have grown to more than $175 billion, but taxable wages ($50 billion) account for 28 percent of that amount. Figure 4 illustrates the growing disparity between taxable wages and total wages, which is important because UC benefits are paid based upon each worker's total wages. As this disparity increases, the UC trust fund can support fewer workers.



SOURCE: U.S. Department of Labor.

The declining solvency of the UC trust fund observed by OPPAGA has worsened in recent years. The trust fund's HCM has fallen to a historic low of 0.58 in 2001 (*see* Figure 5), representing the capacity to pay less than seven months of benefits during a recession equivalent to Florida's benefit costs in 1975. The state's HCM has not approached the recommended value of 1.5 since the 1980s.



SOURCE: U.S. Department of Labor.

The trust fund's AHCM hovered between 1.67 in 1981 and 1.87 in 1997 and reflected temporary declines resulting from the back-to-back 1980 and 1981-82 recessions and the 1990-91 recession (*see* Figure 6). Following the temporary tax reductions and benefit increases in 1998 and 2000, the AHCM has declined to 1.39 in 2001, reflecting that the trust fund has enough reserves to pay less than 17 months of benefits in a recession equivalent to the average of the three most severe recessions in the past 20 years. Although the AHCM remains above the recommended 1.0 standard, recent declines in the measure could foreshadow future difficulty if the trust fund's solvency continues to decline.

The UC program's value as a countercyclical economic stabilizer could be jeopardized if the solvency of the UC trust fund continues to decline.

The historic and more recent declines in the solvency of Florida's UC trust fund have led to an erosion of the forward funding approach to UC program financing in this state. The increasing disparity between taxable wages and total wages continues to diminish the relative capacity of the UC program to assist in the recovery of the state following a recession. Moreover, Florida's UC program assesses taxes using the benefit ratio method of experience rating, causing tax rates to spike during and immediately after economic recessions and, thereby, reducing the UC program's effectiveness as a countercyclical economic stabilizer.

Reduced trust fund solvency, use of the benefit ratio method of experience rating, and the increased disparity between taxable wages and total wages have eroded Florida's ability to prepare for a severe recession, increased the likelihood the state will need federal loans to pay benefits, and generally led to the state's movement toward the "pay as you go" approach to UC program financing.

Further, as the UC trust fund's solvency declines, there is an ever-increasing danger the UC program's effectiveness as an economic stabilizer will further be diminished. Research by the U.S. General Accounting Office (GAO) revealed that as a state's UC trust fund solvency declines, its *recipiency rate* (percentage of total unemployed receiving benefits) also declines.[7] The research demonstrates that states facing declining trust fund solvency have tightened benefit eligibility requirements to reduce benefit costs. By reducing the number of workers who are eligible to receive benefits, these state UC programs have seen significant declines in their ability to assist unemployed workers and in their effectiveness as countercyclical economic stabilizers. If the solvency of Florida's UC trust fund continues to decline, the Legislature would most likely be confronted with the difficult choices that led other states to restrict benefit eligibility.

From the fourth quarter of 1998 through the first quarter of 2001, Florida had an average recipiency rate of about 25 percent and ranked on average 44th of the 53 state programs.[8] Florida's low recipiency rate reflects that access to UC benefits in Florida is significantly more restrictive than in other states. Furthermore, Florida's UC taxes are also comparatively low. According to the U.S. Department of Labor, in calendar year 2000, Florida ranked 47th out of the 53 state UC programs in its average employer tax rate. From 1994 to 2000, Florida's UC taxes have consistently been below the national average. Of the state programs, Georgia, Nebraska, New Hampshire, Oklahoma, South Dakota, and Virginia are the only six states that have consistently reported UC tax rates at or below Florida's rates.[9] Because Florida's UC taxes are low compared to other states, Florida's businesses enjoy a competitive advantage in markets engaged in interstate commerce. However, Florida's rising total wages and static taxable wage base ($7,000) have led to a decline in the relative value of the state's UC taxes.

Because the percentage of unemployed workers who receive benefits is already low in this state, any reduction in Florida's recipiency rate would likely reduce the UC program's ability to assist the state's recovery from a recession. If the UC trust fund's solvency continues to decline and the Legislature is confronted by the difficult choices that led other states to restrict benefit eligibility, the UC program's ability to sustain workers' purchasing power in a recession could be reduced, thereby seriously jeopardizing the program's value as a countercyclical economic stabilizer.

The UC trust fund's balance will likely fall below the 4-percent tax trigger within the next year.

The U.S. economy has experienced an unprecedented 125 months of economic expansion since March 1991; however, the economy has slowed throughout 2001, and many analysts now foresee the economy will fall into recession related, in part, to the terrorist attacks of September 11, 2001, on the World Trade Center and the Pentagon.

To predict whether an automatic tax increase is imminent due to the UC trust fund's fall below the 4-percent tax trigger, the Trust Fund Forecasting Model was used. The model is a multi-equation regression based upon equations created using standard least squares regression methods. Using quarterly data, the model estimates the trust fund's balance on June 30 of each year. The Legislature's Office of Economic and Demographic Research (EDR) compiled the data and ran the model, which was originally developed by the Financial and Economic Analysis Policy Unit in the Governor's Office of Policy and Budget.

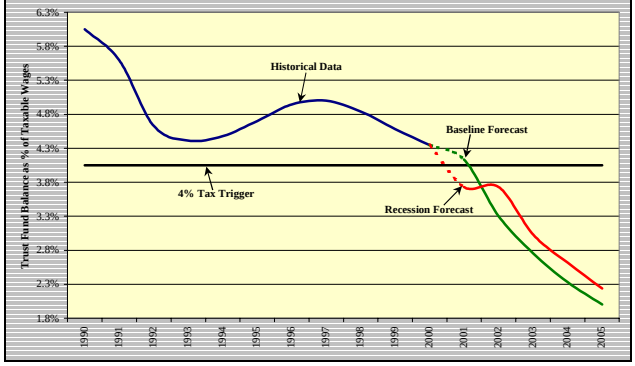
[7] GAO, *Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized* (GAO/HRD-93-107) (Sept. 1993).

[8] U.S. Department of Labor, *UI Data Summary* (1998-2001).

[9] U.S. Department of Labor, *ET Handbook No. 394* (1994-1999); Baldwin, *supra* footnote 2, at appendix 4.

To run the Trust Fund Forecasting Model, EDR obtained UC-specific data from the Agency for Workforce Innovation. General economic variables were obtained from the Florida Economic Estimating Conference's August 2001 state economic forecasts. These forecasts are based upon national forecasts published by DRI•WEFA (an econometric forecasting firm that combined the former Standard & Poor's DRI with WEFA, Inc.). The model used both a baseline economic forecast and a more pessimistic recession forecast. According to DRI•WEFA, the baseline forecast has a probability of 55 percent, while the recession forecast has a probability of 35 percent.

Figure 7 – THE TAX TRIGGER (1990-2000) and TRUST FUND FORECASTING MODEL (2001-2005)



SOURCE: Agency for Workforce Innovation (UC-specific data), Florida Economic Estimating Conference and DRI•WEFA (econometric forecasting data), and the Legislature's Office of Economic and Demographic Research and the Financial and Economic Analysis Policy Unit of the Executive Office of the Governor (Trust Fund Forecasting Model) (Aug. 2001).

Using the baseline economic forecast, the Trust Fund Forecasting Model predicts that Florida's UC trust fund's reserves will fall below the 4-percent tax trigger within the next year. Under the recession forecast, the trust fund could fall below the tax trigger even sooner. Figure 7 displays that the baseline forecast falls to 3.3 percent by June 2002. The recession forecast would likely fall to 3.7 percent before the end of 2001. That is, under the pre-terrorist-attack economic forecasts, the UC trust fund's balance will likely fall below 4 percent of the state's taxable payrolls by June 30, 2002, when an automatic tax increase would likely be triggered. Because UC tax rates are calculated annually and take effect on January 1, the tax increase would not affect tax rates until January 1, 2003.

The 4-percent tax trigger has kept Florida's UC trust fund solvent for more than four decades.

Despite the decline in the solvency of Florida's UC trust fund and the national trend of trust fund insolvency and chronic borrowing from the federal government, Florida's UC trust fund is one of a few state trust funds that have remained solvent. From 1974 to 1979, 25 state UC programs needed federal loans. During this period, Florida received two federal loans, but promptly returned the funds because the UC trust fund had adequate reserves to pay benefits. Thirty-two states needed federal loans from 1980 to 1987, and seven states borrowed from 1990 to 1995.

During its 44-year history, Florida's 4-percent tax trigger has consistently stabilized the UC trust fund through automatic tax increases, protecting both the state and employers from the dangers of trust fund insolvency. With the exceptions of 1976 and 1977, Florida has never sought a federal loan, making this state one of only a few that have demonstrated consistent trust fund solvency throughout the history of the national UI system.

RECOMMENDATIONS

Committee staff recommends that, if, as this report predicts, the trust fund's balance falls below the 4-percent tax trigger within the next year, causing an automatic tax increase on employers, the Legislature should observe that the tax increase is neither arbitrary nor capricious, but is the self-correcting mechanism that has ensured the UC trust fund's solvency for more than four decades.

It is further recommended that the Legislature use extreme caution when considering proposals that modify the tax trigger to avert a tax increase or accommodate a future tax rate reduction.

Although the focus of this interim project centered on the tax trigger, a review of the UC trust fund inevitably extended to the taxes and benefits that flow through the fund and the policies that support them. Committee staff recognizes the state's UC tax structure and benefit policies have significant impacts on both the business community and other constituencies. Because these policies were beyond the initial scope of this report, committee staff does not make a specific recommendation relating to the finding that the UC program's value as a countercyclical economic stabilizer could be jeopardized if the solvency of the UC trust fund continues to decline. Committee staff instead recommends that additional study be conducted to examine ways of improving the countercyclical value of Florida's UC program, such as conversion of the tax structure from the benefit ratio method of experience rating to the reserve ratio method.