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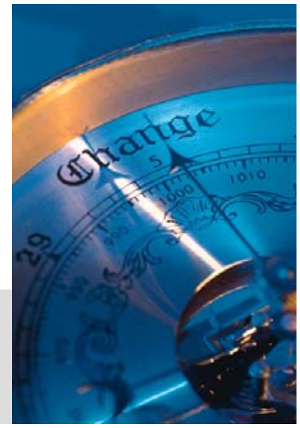

Missouri Diversionary Tactic

TO:	All Clients
FROM:	Kris Thorngren
RE:	Missouri Diversionary Tactic Symptom of a Larger Problem
DATE:	August 29, 2008

The state unemployment agencies continue to struggle to secure funding for costs associated with administration of the unemployment insurance program. Such funding was originally intended to come from federal unemployment tax payments made by employers, but the full amount of such payments has not been distributed to the state agencies in recent years. This shortfall increases the level of frustration for state UI directors, but it should also concern employers who pay the federal unemployment tax only to have a portion of such payments disappear into the federal black hole.

Missouri is the most recent example of a state which has had to find a creative way to secure the resources needed to operate the unemployment insurance program. On June 25, Governor Blunt signed HB 2041, which provides for a three year diversion of state UI taxes to pay for automation costs. An estimated $39 million will be diverted from employer UI taxes to a surtax over a three-year period.

On the surface, there appears to be no net tax increase, because UI taxes are reduced by the amount of the surtax. However, $13 million per year will not be credited to employer reserve accounts, and the net result will be higher tax rates. That is how the experience rating system works in a reserve ratio state. A decrease in tax payments credited to the employer's reserve account makes the reserve ratio smaller, driving up future tax rates.

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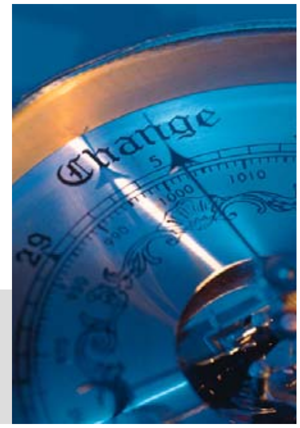

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HB 2041 requires that .05% of taxable wages be diverted to the “unemployment automation surcharge”. The Division of Employment Security may reduce the percentage so that the total will not exceed $13 million annually. Employers assigned a zero tax rate (yes, a zero tax rate is possible in Missouri) are exempt from the surcharge.

Missouri is certainly not alone in shifting UI taxes to surcharges. By our count, 31 states have surcharges, which are linked to unemployment taxes, but are not directly used to pay UI benefits or to improve the solvency of the state UI trust fund. The surcharges are used for such purposes as job training, design of UI information technology systems, payment of interest on federal loans, and general administrative costs. All of these costs, except for interest on federal loans, are intended to be funded by employers’ federal unemployment tax and distributed to the state agencies by coordination with the U.S. Department of Labor.

The question arises as to why the State of Missouri does not already have sufficient funds to pay for “unemployment automation” in light of the fact that Missouri employers have paid their federal unemployment tax. Section 320(a) of the Social Security Act states in part: “The Secretary of Labor shall from time to time certify to the Secretary of the Treasury for payment to each State which has an unemployment compensation law approved by the Secretary of Labor under the Federal Unemployment Tax Act, such amounts as the Secretary of Labor determines to be necessary for the proper and efficient administration of such law….” Section 302(b) states in part “Out of the sums appropriated therefor(e), the Secretary of the Treasury shall, upon receiving a certification under subsection (a), pay to the State agency charged with the administration of such law the amount so certified.” If Missouri has an approved unemployment compensation law, which it does, why has the Secretary of Labor not arranged for payments to Missouri of amounts necessary for the “proper and efficient administration” of the law? This system for distributing administrative funds to state unemployment agencies had been around since 1935. The problem is that the system is broken, or at least severely damaged, and this will be the topic of a future missive.

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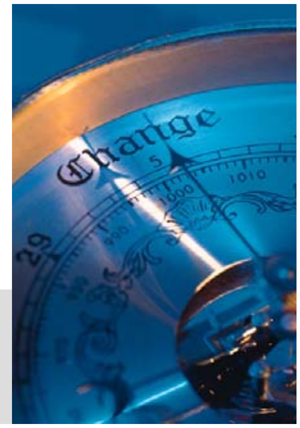

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According to our calculations, the total cost to Missouri employers will be in the range of $47 million even though it appears to be zero. The hidden $8 million cost (over and about the $39 million diversion) results from the way tax rates are calculated in Missouri. A reduction in tax payments credited to reserve accounts will increase future taxes by more than the amount of such reduction (approximately 21% more in Missouri). In other words, the loss of each $1 in reserve funds will cost about $1.21 in future taxes. This is how a cost which should be zero (because it is already funded by FUTA tax) and which appears to be no net tax increase becomes a $47 million "hit" over several years.

As always, please do not hesitate to contact me if there are any questions.

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