Colorado
Legislative
Council
Staff

ISSUE BRIEF

Number 03-04 | A Legislative Council Publication | February 20, 2003

FEDERAL UNEMPLOYMENT ASSISTANCE AND THE REED ACT DISTRIBUTION OF 2002

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The federal Temporary Extended Unemployment Compensation Act (TEUCA) was part of the federal economic stimulus legislation enacted March 9, 2002. The act was intended to help states deal with higher unemployment due to the economic downturn by providing a Reed Act distribution of $8 billion to the states to be used for state unemployment insurance (UI) programs. The act also provided federally funded UI benefits to individuals who are unable to find work after having exhausted their regular state unemployment benefits.

The $8 billion distribution is the largest Reed Act transfer of money from the federal government to the states. Colorado received $142.7 million of this money, which was deposited in the state's UI Trust Fund. This *Issue Brief* provides background information on the structure of the UI system, as well as information on the Reed Act, including how the $8 billion Reed Act distribution can be used by states and the impact of Colorado's share on its UI system.

Overview of the UI System and the Reed Act

The UI system is designed to accumulate and hold funds during favorable economic times and provide cash benefits to unemployed individuals during economic downturns. The intent of the UI system is to help maintain economic stability by safeguarding some of the income and purchasing power of unemployed workers. Colorado's unemployment rate increased from 2.7 percent at the beginning of 2001 to 5.7 percent in February of 2002. It averaged 5.3 percent in 2002.

Employers pay both federal and state unemployment taxes to support state UI programs, which provide partial wage replacement for workers who lose their jobs through no fault of their own. State unemployment taxes are levied on employers and are primarily used to pay UI cash benefits. These taxes are *experience-rated* so employers with more former employees receiving UI benefits are taxed at a higher rate. In December 2002, Legislative Council Staff estimated that the average state unemployment tax rate will be about 1.15 percent in 2003. This rate applies to the first $10,000 in wages a Colorado employer pays to each employee.

Federal unemployment taxes, known as FUTA taxes, are collected by the state through employer payroll taxes. Employers in Colorado generally pay 0.8 percent on the first $7,000 of wages paid to each employee. This money is transferred to the federal government and deposited in the federal Unemployment Trust Fund. A percentage is annually appropriated back to the states mainly to support state administration of UI programs. FUTA also pays one-half of the cost of extended unemployment benefits (during periods of high unemployment) and provides for a fund from which states may borrow, if necessary, to pay benefits.

Colorado receives approximately 43 cents on average for every dollar that is collected by the federal government in FUTA taxes for the administration of its UI, employment services, and labor market information programs; the state received $45.2 of the $126.6 million in FUTA taxes it paid in 2000. On average, the federal government pays back about 46 cents to the states. The remainder is typically used by the federal government to help offset the federal deficit or pay for other priorities of Congress.

The Reed Act. The Reed Act was part of the federal law that established the basic structure of the federal Unemployment Trust Fund. The Reed Act requires that any money in the trust fund exceeding a statutory ceiling be transferred back to the states. However, because of the economic downturn, the federal government distributed the

$8 billion out of the trust fund as a set dollar amount without regard to the statutory ceiling. Each state's share of the total $8 billion is based on its proportionate share of FUTA taxable wages for calendar year 2000.

The 2002 Reed Act Distribution's Impact on the State UI Trust Fund and UI Taxes

Colorado's statutory unemployment tax rate structure is based partly on the level of its UI Trust Fund balance. The state tax rates increase as the amount of money in the trust fund falls below certain levels. Therefore, any decisions on how the state will use its $142.7 million may impact the unemployment tax rate charged to employers if the money is appropriated out of the trust fund. The lowest tax rate structure is used when the fund balance is above $450 million. If the fund balance were to fall below this amount, a higher tax rate would be used.

After running a deficit during the recession in the 1980s, the state UI Trust Fund balance grew to $794.1 million in FY 2000-01. However, as a result of the state's higher unemployment, the amount of benefits paid increased from $183.2 million in FY 2000-01 to $486.8 million in FY 2001-02, a 165.7 percent increase. Table 1 shows the amount of money in Colorado's UI Trust Fund from FY 2000-01 to FY 2002-03, including how much money is used to pay for benefits and the amount of revenue, mostly from state UI taxes, the fund receives.

Table 1: Colorado's Unemployment Insurance Trust Fund
(Millions of Dollars)

	FY 00-01	FY 01-02	FY 02-03 (estimate)
Total Revenues	$200.8	$196.1	$237.1
Expenses (UI Benefits)	183.2	486.8	390.2
Reed Act Transfer	0	142.7	0
Accounting Adjustments	12.9	(19.1)	4.8
Fund Balance	$794.1	$626.9	$478.6

Solvency tax surcharge. Colorado law provides for a solvency tax surcharge, an additional state tax paid by employers when the state UI Trust Fund balance is equal to or less than nine-tenths of one percent of the total wages reported by employers in a given year. Legislative Council Staff forecasts that the UI Trust Fund balance will fall below this threshold ($603.2 million) at the end of FY 2002-03, triggering the solvency tax for employers in CY 2004 through CY 2006. The $142.7 million distribution that Colorado received allowed the state to avoid the solvency tax in CY 2003, saving Colorado employers about $56 million in taxes for the year.

Use of the 2002 Special Reed Act Distribution

Use for unemployment benefits. Federal law limits how states may use their 2002 Reed Act distributions. States can use their money to fund regular UI cash benefits out of their UI trust funds for qualified individuals who were unemployed for a period after March 9, 2002. States may change their UI laws to allow this money to support certain unemployed individuals who are not otherwise eligible for unemployment benefits, including individuals who are seeking or are available only for part-time work or who would qualify for benefits under a different formula than a state normally uses to calculate benefits.

Additional compensation can also be paid to individuals using this Reed Act money in cases where there are conditions of high unemployment or other special factors. Additional compensation can only be paid to individuals after they have exhausted their entitlement to regular state UI benefits and any benefits they were eligible for under TEUCA. Federal funding for the UI benefits provided by TEUCA expires on August 30, 2003.

Use for UI administration and employment services. States can use Reed Act money to administer their UI programs and employment services programs that help individuals return to work. Acquiring property, or purchasing or constructing a building for use and occupancy by a state UI agency, is considered an administrative use.

The General Assembly must appropriate any Reed Act money that is used for administrative expenses and specify the purpose and the amounts of the state appropriation. State law requires that any Reed Act money appropriated for administrative costs be obligated within two years of the appropriation date.

Reporting requirements. States are required to record all Reed Act expenditures and appropriations and report all transactions involving Reed Act money, including deposits and withdrawals from the state UI Trust Fund, to the federal government.