State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December 2008

Prisoner Health Care Contract Update
By Lindsay Hollander, Fiscal Analyst

Pursuant to the United States Constitution and Federal court orders, the Michigan Department of Corrections (MDOC) provides health care to inmates incarcerated in State correctional facilities. Health care is provided at prison clinics by MDOC employees, as well as providers hired by Correctional Medical Services, Inc. (CMS). Additionally, the MDOC has had a contract with CMS since 1998 for all outside hospital and specialty care services. The current contract expires March 31, 2009. The primary difference between community-based and outpatient medical services arranged by the MDOC and those arranged by CMS is that the billing and contract negotiation are privatized. The actual outpatient medical services are still provided by outside service providers, as they were before 1997 when the MDOC first began contracting for these services. Correctional Medical Services, Inc. contracts with Blue Cross/Blue Shield and other medical service providers to provide care to inmates.

Correctional Medical Services, Inc. also hires Medical Service Providers (MSPs), who include physicians, physician assistants, and nurse practitioners, to staff the MDOC's prison clinics. The MDOC pays CMS Civil Service rates for the MSPs. Correctional Medical Services, Inc. does not have to pay these employees Civil Service rates and may pay more or less depending on regional market factors. The MDOC provides all pharmacy services, dental care, and vision care internally by Civil Service employees. Pharmaceuticals are supplied through a contract with PharmaCor, which is a subsidiary of CMS. The PharmaCor contract expires September 30, 2009.

Expenditures for prisoner health care rose by more than 50% over the past five years while the prison population grew by less than 4.0% during the same period. Table 1 outlines historical expenditures for prisoner health care.

Table 1

Prisoner Health Care[1] Expenditure History					
Fiscal Year	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**
Prison Clinics[2]	$39,794,421	$44,531,550	$51,894,984	$54,202,754	$56,284,760
Duane Waters Health Center & Infirmaries	5,603,134	7,771,617	8,284,781	9,386,268	10,179,661
Pharmacy	21,049,841	26,180,389	29,483,788	29,539,377	32,189,118
Administration	22,886,155	21,142,032	18,326,805	26,119,420	28,648,825
Telemedicine	38,760	45,874	44,737	53,293	68,465
Hospital & Specialty Care	53,278,112	57,641,934	71,133,440	95,244,861	93,236,172
Other	3,092,269	3,378,682	3,787,115	3,935,816	4,175,269
Total	**$145,742,693**	**$160,692,077**	**$182,955,650**	**$218,481,788**	**$224,782,270**

[1] Excludes dental care and mental health and psychological services.
[2] Includes MSPs, laboratory, and X-ray expenditures.

Source: Michigan Administrative Information Network

Both the primary expense and the driver of increased costs have been hospital and specialty care services provided by CMS. Not only has the cost of these services been increasing, but it has been increasing at a faster rate than other health care expenditures have risen. Additionally, hospital and specialty care expenditures take up a greater proportion of the total health care expenditure than they did five years ago. Table 2 and Table 3 show that hospital and specialty care was 41.5% of the total health care expenditure in FY 2007-08, in comparison to 36.6% in fiscal year (FY) 2003-04. This is because the hospital and specialty care services expenditure rose by 75.0%, while the total health care expenditure increased by 54.2%. The only other categories rising at a faster rate than the total expenditure were Telemedicine[1], and Duane Waters Health Center and Infirmaries, which together take up less than 5.0% of health care expenditures.

Table 2

Prisoner Health Care[1)] Expenditures - Percent of Total

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08	Difference Between '03-'04 & '07-'08
Prison Clinics[2)]	27.3%	27.7%	28.4%	24.8%	25.0%	(2.3)%
Duane Waters Health Center & Infirmaries	3.8	4.8	4.5	4.3	4.5	0.7
Pharmacy	14.4	16.3	16.1	13.5	14.3	(0.1)
Administration	15.7	13.2	10.0	12.0	12.7	(3.0)
Telemedicine	0.0	0.0	0.0	0.0	0.0	0.0
Hospital and Specialty Care	36.6	35.9	38.9	43.6	41.5	4.9
Other	2.1	2.1	2.1	1.8	1.9	(0.3)

1) Excludes dental care and mental health and psychological services.
2) Includes MSPs, laboratory, and X-ray expenditures.

Source: Michigan Administrative Information Network

Table 3

Percent Change in Prisoner Health Care[1)] Expenditures

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08	FY '03-'04 to FY '07-'08
Prison Clinics[2)]	5.6%	11.9%	16.5%	4.4%	3.8%	41.4%
Duane Waters Health Center & Infirmaries	(17.9)	38.7	6.6	13.3	8.5	81.7
Pharmacy	(6.1)	24.4	12.6	0.2	9.0	52.9
Administration	8.9	(7.6)	(13.3)	42.5	9.7	25.2
Telemedicine	(81.0)	18.4	(2.5)	19.1	28.5	76.6
Hospital & Specialty Care	(2.6)	8.2	23.4	33.9	(2.1)	75.0
Other	(17.6)	9.3	12.1	3.9	6.1	35.0
Total	**(0.6)%**	**10.3%**	**13.9%**	**19.4%**	**2.9%**	**54.2%**
Percent Change in Prison Population	(1.2)	0.0	2.6	2.2	(1.5)	3.3

1) Excludes dental care and mental health and psychological services
2) Includes MSPs, laboratory, and X-ray expenditures.

Source: Michigan Administrative Information Network

[1] Telemedicine is the use of electronic communications and video conferencing to provide medical care.

Amid rising costs, the Department of Management and Budget (DMB) issued a Request for Proposals (RFP) for hospital and specialty care services in 2007. The RFP included a design for a new contract cost structure. The process yielded only one bid that met the RFP's specifications, and this vendor pulled out of the process. The DMB then renewed the State's contract with CMS for an additional year, which will expire March 31, 2009. In May 2008, the DMB issued another RFP for hospital and specialty care services. The cost structure outlined in this RFP differs from the 2007 RFP and the current contract that the State has with CMS. The MDOC pays CMS for health care services rendered by hospitals and specialty care providers. As the MDOC's cost for services goes up, CMS' clinical management fees go down according to thresholds outlined in the contract. This fee structure was designed to give CMS an incentive to keep the MDOC's health care costs down. The payment amount is calculated by taking a per diem rate and multiplying it by the average number of prisoners incarcerated for the month. The per diem rate is adjusted quarterly based on actual expenditures for health care. During the past three years, the MDOC's cost for services has actually been at the top threshold, so CMS receives the minimum clinical management fee possible, which is currently 14.59% of costs.

The new contract design will include a target price for hospital and specialty care services and MSPs. Any health care costs above this amount will be shared between the State and the contractor, up to a cap. The contractor is responsible for any health care costs in excess of the cap. Any savings also will be shared in this shared-risk arrangement. This pricing model is similar to the CMS contract prior to April 1, 1999. According to the RFP, the new plan also will charge the contractor with maximizing the use of telemedicine. Table 3 reveals that telemedicine spending has steadily increased as telemedicine equipment has been installed in correctional facilities. Increasing use will further reduce costs associated with transporting inmates to the community for medical appointments.

The DMB has chosen Prison Health Services (PHS) as its preferred vendor for the new contract. Prison Health Services, like CMS, is a national correctional health care company that various states and counties contract with for health care services. Just as PHS will likely be awarded this contract in Michigan that is presently held by CMS, CMS has won contracts in other states that have been held by PHS. Prison Health Services currently has contracts with four states, as well as numerous counties throughout the country, including Michigan's Kent and Genesee Counties. Tennessee-based PHS is a subsidiary of America Service Group, Inc. which also owns Correctional Health Services, Inc., a company that provides correctional health services in several county jails and juvenile facilities in New Jersey. The State Administrative Board likely will make a decision on the contract award in January.

The FY 2008-09 MDOC appropriations act is predicated on reducing expenditures by $4.0 million through hospital and specialty care services contract changes. According to the award recommendation letter to Prison Health Services dated December 4, 2008, the three-year contract would total $325,594,397 for MSPs and hospital and specialty care services. If this is the amount that the MDOC pays to PHS over three years, the annual cost will be similar to that paid to CMS during FY 2007-08. Thus, $4.0 million in hospital and specialty care savings would not be realized during FY 2008-09, or in future contract years.

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Michigan's Unemployment Compensation Fund
By Elizabeth Pratt and Maria Tyszkiewicz, Fiscal Analysts

Michigan's Unemployment Insurance program has been stressed by the increasingly high level of unemployment in Michigan. Michigan unemployment benefits have exceeded unemployment tax revenue each year since 2001. Beginning in 2006, the balance in the State Unemployment Compensation Fund has been reduced to a level that has required the State to use loans available from the Federal government to pay benefits pending the receipt of State unemployment tax revenue. As of December 31, 2008, the State had $772.5 million in Federal loans outstanding and is continuing to borrow in order to pay unemployment benefits.

Due to the prolonged deficit in the benefits fund, in June the State met the statutory thresholds to trigger a State solvency tax, which will be assessed beginning January 1, 2009. The State also is expected to trigger an additional Federal unemployment tax, the Federal Unemployment Tax Act (FUTA) credit reduction, beginning January 1, 2010.

This article reviews the basic operation of the unemployment insurance system, the ongoing borrowing to pay benefits, Federally funded extended benefit programs, the expected additional tax costs to employers, and the State budget impact.

Employee Benefits under the Unemployment Insurance System

Unemployment insurance provides covered employees with the short-term replacement of wages when they become unemployed through no fault of their own. When an unemployed worker applies for benefits, the Unemployment Insurance Agency (UIA) is able to verify wages and employment through data routinely reported by employers. Based on the data, an approved claimant's amount and duration of benefits are determined through a statutory formula. Benefit payment amounts vary and are determined by a formula based on quarterly wage data and the number of dependents. An approved claimant can receive up to $362 per week for as many as 26 weeks of benefits (although some claimants are eligible for as few as 14 weeks of benefits). While receiving unemployment benefits, the recipient must certify to the UIA that he or she is seeking and available for full-time employment.

The Federal law provides for extended unemployment benefits through a combination of ongoing programs triggered by specific economic conditions and special purpose acts of Congress. Michigan workers currently may qualify for Emergency Unemployment Compensation through two temporary extended benefits programs enacted at the Federal level. These programs are 100% Federally funded. Under each program, Michigan workers who have exhausted their unemployment benefits may receive additional weeks of benefits. Workers who exhaust regular unemployment benefits no later than March 28, 2009, will receive up to 20 additional weeks of benefits; the number of weeks is 80.0% of the benefit weeks originally determined. If these additional weeks are exhausted on or before March 28, 2009, a worker may qualify for up to an additional 13 weeks (50.0% of the number of weeks for which he or she initially qualified).[1]

[1] "Emergency Unemployment Compensation (EUC) in Michigan", Fact Sheet #120, November 2008, Michigan Unemployment Insurance Agency, available at http://www.michigan.gov/documents/uia/EUC_Fact_Sheet_120_240939_7.pdf]

Applications to these programs may be made until March 28, 2009, and payments attributable to the programs will continue until August 29, 2009. The UIA has estimated that these extensions will benefit about 63,000 unemployed individuals in Michigan.

Also, states are required to include in their unemployment insurance law a section pertaining to extended benefits for those claimants who have exhausted their standard benefit eligibility during times of high unemployment. This program requires states to cover 50.0% of the costs of providing extended benefits. The Federal and state threshold for eligibility for this program is based on the insured unemployment rate (IUR) instead of the total unemployment rate (TUR). The IUR includes only those individuals who are collecting benefits, not the unemployed who are no longer receiving benefits. Under the law, the IUR rate must be 5.0% or higher for the previous 13 weeks and 20.0% higher than the IUR for the same period in each of the last two years. Although Michigan's seasonally adjusted employment rate was reported at 9.6% in November 2008, the IUR (4.9% as of 12-6-08) remained below the 5.0% trigger for most of 2008, meaning the State currently is not eligible for this program.

In 2003, Michigan enacted a temporary extended benefit measure to participate in an optional Federal program in which the trigger for extended benefits is based on the TUR, requiring the rate to be at least 6.5% for the last three months and 110.0% of the TUR for the same period in either or both of the preceding two calendar years. The act included a sunset on the change at the end of 2003.

Funding for Unemployment Insurance

Unemployment Insurance programs are funded by a combination of state and Federal taxes on employers. The Federal Unemployment Tax Act requires payment of a Federal payroll tax on the first $7,000 of employee income. The standard rate for this tax is 6.2%, which is offset by a 5.4% credit if the employer has paid its state unemployment taxes and the state unemployment law and administrative practices are in conformity with Federal law. The net FUTA tax rate for most contributing employers, after the credit, is 0.8%. This revenue is deposited in the Federal Unemployment Trust Fund where it is available for the payment of the costs of administration of the state UI programs, cash-flow lending to states, known as Title XII loans, and extended benefits programs. In Michigan, Public Act (P.A.) 251 of 2008, which is the fiscal year (FY) 2008-09 appropriation act for the Department of Energy, Labor, and Economic Growth (DELEG), includes $136.5 million in Federal revenue for State administrative costs for the Unemployment Insurance program.

The State Unemployment Compensation Fund is funded by employers through State unemployment taxes. Most employers that are for-profit companies are contributing employers, meaning they pay State unemployment taxes on the first $9,000 of employee payroll for each worker at a rate determined for each employer based on the cost of employment benefits charged to that employer. The second category of employers is reimbursing employers, which do not pay unemployment taxes into the Unemployment Compensation Fund, but instead reimburse it for the actual cost of chargeable unemployment benefits paid to former employees. Governmental employers are automatically reimbursing employers and nonprofit organizations and Indian tribes may request status as reimbursing employers.

For contributing employers with at least five years of contribution and benefit history, the State unemployment tax act (SUTA) rate is made up of the following three components:

- **Nonchargeable Benefits Component.** This portion of the rate is between 0.06% (for employers with no chargeable benefits within 108 months of the computation date) and a maximum of 1.0%. Revenue from this portion of the tax is used to pay benefits that cannot be charged to a specific employer, for example, payments to employees of a company that has gone out of business or has filed for bankruptcy.

- **Account Building Component.** This rate is based on the history of all taxes paid and benefits charged to an employer's reserve account. The rate ranges from 0.0% for employers with high reserves to 3.0% for those with low reserve balances.

- **Chargeable Benefit Component.** This rate is calculated by dividing five years of benefit charges by five years of taxable payroll. Employers' rates range from 0.0% for employers with no benefit charges to 6.3% for employers with high benefit charges.

Based on these components, an experience-rated, contributing employer has a SUTA rate from 0.06% to 10.3%, with the rate determined annually for each employer.

For new employers with less than five years of experience, a separate rate schedule is established in statute. This sets the rate for new employers with no benefit history at 2.7% for regular employers and at a separately determined rate, now 7.9%, for new construction employers. The rate components described above are phased in as the employers accumulate experience in the UI system.

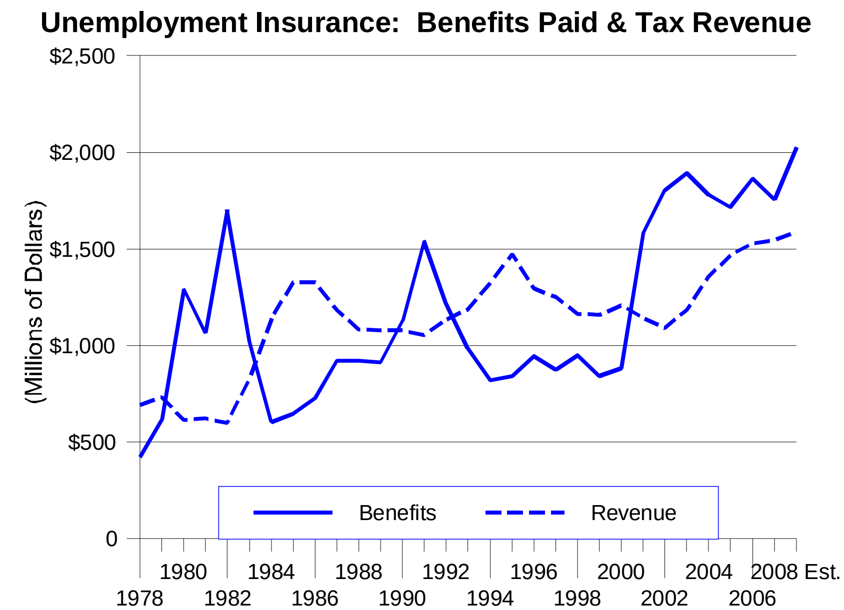
State Unemployment Compensation Fund Balance

As stated previously, the State began borrowing from the Federal government in 2006 to support benefit payments from the Unemployment Compensation Fund. Although most employers have continued to stay current in their required tax payments, an imbalance between revenue and expenditures has occurred. The Fund has a history of imbalance during poor economic times when the Unemployment Compensation Fund may be exhausted. Figure 1 shows the history of revenue and expenditures since 1978.

Currently, the State is in the eighth consecutive year during which benefit payments have been greater than revenue, the longest stretch of annual reductions in the Fund in the program's history. This prolonged economic downturn has drained the balance in the Unemployment Compensation Fund. As shown in Figure 2, the balance of the Fund was $3.0 billion in 2002. By the middle of 2008, that balance had been completely eliminated.

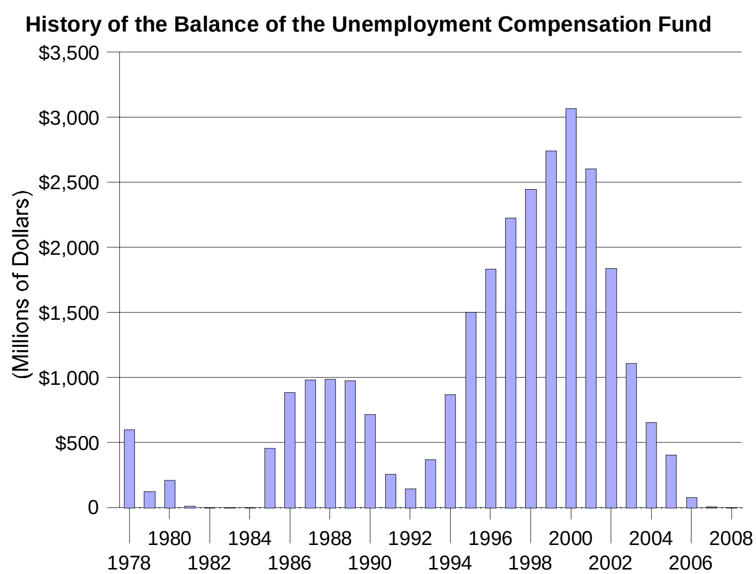
The decline in the Unemployment Compensation Fund balance is a result of a number of factors. First, Michigan's unemployment rate has continued to increase from its lowest level, 3.8% in 1999-2000, to the recent level of 9.6%. This increase in the unemployment rate over an extended period of eight years has led to an increase in the expenditures. Although revenue also has grown during this period, it has not kept pace with the increased benefit amounts. Average employer tax rates have risen as experience ratings are updated annually to reflect increased benefits paid. Due to the five-year look-back period for experience ratings, there is a lag between increased claims and the tax rate adjustment. As covered employment has declined by over 500,000 jobs since the peak in 2000, the higher average tax rates are applied to a diminished total amount of taxable wages, further constraining revenue growth.

Figure 1



Source: Department of Energy, Labor, and Economic Growth, Unemployment Insurance Agency

Figure 2



Source: Department of Energy, Labor, and Economic Growth, Unemployment Insurance Agency

Other factors contributing to the current imbalance are the policy changes made to the Michigan Employment Security Act by P.A. 192 of 2002. These changes affected both the taxes paid by employers and the benefits paid to recipients. The first of the two tax changes affected the taxable wage amount. The 2002 Act reduced the tax base from the first $9,500 of an employee's wages to the first $9,000 of an employee's wages. The second tax change lowered the minimum rate charged to an employer for the Nonchargeable Benefits Component. Before this Act was passed, the minimum rate was 0.1% for an employer with 108 months without charges to its account. The current law sets the minimum at .06%. The final major change included in this Act, that affected the balance in the Fund, was the increase in the maximum benefit payment to eligible recipients from $300 per week to $362 per week.

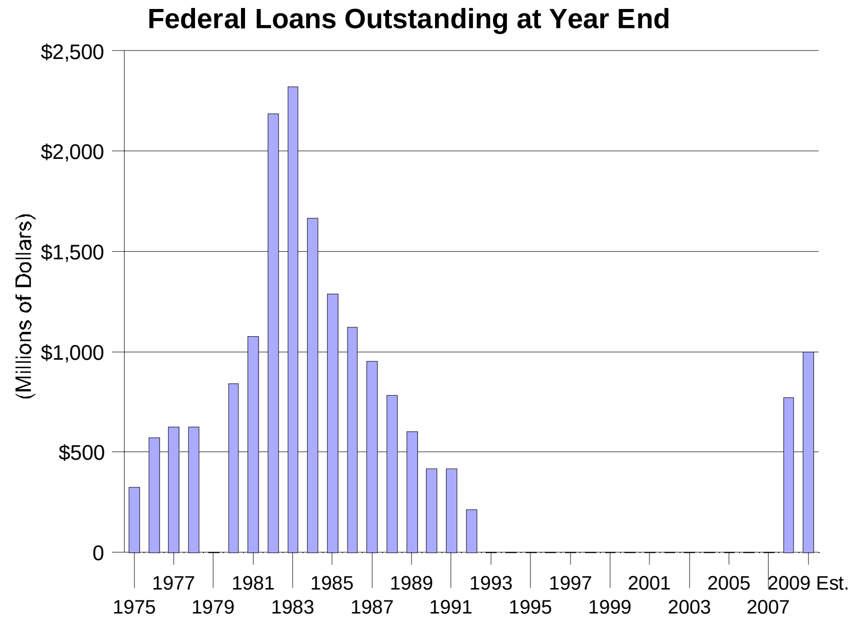
The UIA has estimated that combined changes from the 2002 legislation and the tax rate reduction from 1996 to 2003 (which reduced tax rates when the Trust Fund balance was greater than or equal to 1.2% of the aggregate amount of all contributing employers' payroll for each year) resulted in a cumulative loss to the Unemployment Compensation Fund of approximately $1.0 billion. The revenue declines, benefit increases, and continuing poor economic conditions have resulted in the State's using all of the $3.0 billion balance that was available at the end of 2000 and created a deficit situation in which the State, beginning in 2006, has had to borrow to meet expenditure obligations.

Borrowing to Pay Benefits

Federal law permits borrowing from the Federal government when the State Unemployment Compensation Fund otherwise would be unable to pay benefits. Those loans can be repaid over a period of years, if necessary, with faster repayment possible in a period of economic expansion. The amount and timing of the State's SUTA revenue and benefit payments have required the State to take advantage of these Federal loans many times. The State has borrowed from this program during recessionary periods, borrowing each year from 1975 to 1977, 1980 to 1985, and 1992 to 1993. These loans were repaid over time, sometimes over an extended period. As Figure 3 illustrates, except in 1979, the State had loan balances outstanding from 1975 to 1992.

The timing of tax receipts influences the schedule of borrowing and repayment. Contributing employers pay unemployment taxes quarterly in April, July, October, and January, with the largest collections in April. The large cash influx in April has allowed repayment of a portion of the loans, which has reduced the State's cost of borrowing. Cash flow loans obtained in 2006 and 2007 were repaid within the same year. In 2008, however, the State ended the year with a debt to the Federal government for the first time since 1992. As of December 31, 2008, the outstanding loan balance was $772.5 million, with borrowing continuing. During the first week of January 2009, the State borrowed an additional $88.3 million, increasing the loan balance to $860.8 million as of January 8, 2009. Borrowing to pay unemployment benefits is expected to decline temporarily after April 25, 2009, the next major tax collection date. The cash from those tax receipts will reduce temporarily the need for loans, but based on current and projected economic conditions, the State expects to borrow more from the Federal government in 2009 than in 2008.

Figure 3



Source: Department of Energy, Labor, and Economic Growth, Unemployment Insurance Agency

The Federal government charges interest on these loans (except for cash-flow loans issued and repaid from January to September within a calendar year). There are substantial penalties for states that fail to pay interest on time, including the elimination of all FUTA credits for employers and all Federal funds for UI administration.

These interest payments have already had an impact on the State budget. In FY 2007-08, interest payments totaling $10.8 million were made from the Contingent Fund Penalty and Interest Account. This sum consisted of $3.6 million paid in December 2007 funded through an increase in the appropriation line item for Unemployment Programs added in the conference committee for the FY 2007-08 budget, and $7.2 million paid in September 2008 funded by a legislative transfer approved on May 21, 2008, which increased the expenditure authority in the line to cover that payment. In the budget for FY 2008-09, the conference committee included the Governor's revised recommendation to add $9.4 million in General Fund/General Purpose (GF/GP) revenue to the UIA administrative lines in a fund shift that paid certain DELEG administrative costs with General Fund revenue while making Contingent Fund Penalty and Interest Account revenue available for the interest payment. The UIA is estimating that the interest costs in 2009 will total approximately $41.0 million.

The Contingent Fund Penalty and Interest Account was created in P.A. 1 of 1936. Revenue to the Fund comes from penalties and interest paid by employers that are in arrears or negligent in their unemployment taxes, and can be used for the administration of the UI Agency, including the payment of interest on Federal loans. The Contingent Fund Penalty and Interest Account also will receive revenue from the State solvency tax, which will be levied beginning January 1, 2009, and is discussed below. This solvency tax revenue will be segregated within the Fund and can be used only for interest on Federal loans. The balance in the Contingent Fund, Regular Penalty and Interest Account has been reduced in recent years and the Fund is expected to go into deficit by the close of FY 2008-09. Statutory transfers have been made out of the Contingent Fund and deposited into the General Fund to help balance the State budget. The Fund transferred $79.5 million to the General Fund in FY 2001-02. Also, P.A. 192 of 2002 restricted the balance in the Fund to $15.0 million, requiring any overage to be deposited into the Unemployment Compensation Fund beginning in FY 2001-02. Another transfer of $10.0 million from the Contingent Fund Penalty and Interest Account to the General Fund was made pursuant to P.A. 84 of 2003 in FY 2003-04.

Money in the Contingent Fund Penalty and Interest Account also has been spent for administrative costs within the Bureau of Workers' Compensation due to some previous fund shifts enacted to save General Fund dollars. In FY 2001-02, Corporation and Securities fees were used to replace GF/GP funding in the Workers' Compensation line items. Then, in FY 2006-07, Contingent Fund Penalty and Interest Account revenue was used to replace a portion of the Corporation and Securities fees in the same line items. The appropriation of $9.4 million GF/GP in FY 2008-09 eliminated all of the Contingent Fund Penalty and Interest Account revenue previously used to fund the Bureau of Workers' Compensation, which is now funded by a combination of GF/GP support, corporation fees, and securities fees.

In summary, the Contingent Fund Penalty and Interest Account has been depleted by transfers to the General Fund, use of the Fund for administrative purposes formerly supported by the General Fund, and recent interest payments. The balance in the Contingent Fund Penalty and Interest Account at the close of FY 2006-07 was $12.8 million. The balance at the close of FY 2007-08, following the interest payments, was $2.9 million. Estimates for FY 2008-09 project the Fund will have a deficit of $2.7 million at the close of the fiscal year. This reduces the options the State has for paying future interest costs.

State Solvency Tax and FUTA Credit Reduction

Due to the outstanding loan balance the State has with the Federal government, current State and Federal law requires the imposition of two additional taxes. Under State law, the State solvency tax will become effective for calendar year 2009 to raise funds to pay interest on the debt. In addition, under Federal law, the FUTA tax credit will be reduced beginning in 2010, thereby increasing the tax rate for all of Michigan's contributing employers. Revenue from this Federal tax will be used to pay the principal on the outstanding loans.

Pursuant to current law (MCL 421.19a), the Unemployment Insurance Agency will begin levying the State solvency tax on certain employers in calendar year 2009. This tax will raise additional funds to help pay the cost of borrowing from the Federal government. The tax will apply only to those contributing employers that have a negative balance in their experience accounts as of June 30, 2009; that is, employers for which benefits paid to covered employees exceeded unemployment contributions by those employers. In lieu of paying the tax, employers with a negative balance can pay the amount of that balance and avoid the solvency tax.

The UIA estimates that the solvency tax will apply to approximately 20.0% of employers. The solvency tax rate is based on the Account Building Component of each employer's unemployment tax rate. The maximum solvency tax rate is 0.75%, and the tax is applied to wages up to the $9,000 wage base per employee. The maximum amount of the tax is $67.50

per employee in 2009. The UIA has estimated that revenue from the tax will be approximately $35.0 million in 2009. By statute, the revenue is deposited into the Unemployment Insurance Contingent Fund to be used to pay the interest on Federal loans. Even with this tax revenue, there will still be an imbalance between the funds available and the projected interest liability.

The UIA projects that pursuant to Federal law, the FUTA tax rate credit currently received by Michigan employers will be reduced starting with calendar year 2010. This tax rate increase will apply to all contributing employers, with a cost of approximately $21 per covered employee. According to the UIA, revenue from the FUTA tax credit reduction is estimated at $68.0 million in 2010. The trigger for this increase is an outstanding loan balance on January 1 for two consecutive calendar years. In order to avoid this tax, Michigan would have to pay all outstanding balances by November 2009. Revenue from this tax goes directly to the Federal government and is applied to any outstanding loan balance. Depending on the level of loans outstanding, the FUTA tax credit could be reduced further in future years.

Conclusion

The insolvency in the Unemployment Compensation Fund not only will affect employers through higher tax rates, but also will affect all taxpayers, if the solvency tax revenue is insufficient to meet the interest obligations on the outstanding Federal loans. This problem has already affected the FY 2008-09 appropriation bill for the Unemployment Insurance Agency with the addition of $9.4 million GF/GP revenue to facilitate a fund shift required to make a portion of the 2009 interest payment. This is not the first time that Michigan has had to borrow to meet unemployment benefit obligations; however, this is the longest period in which net withdrawals from the Fund have persisted, causing the deficit to worsen as the economy continues to deteriorate. The economic troubles that have been plaguing Michigan have begun to affect other states as well, and Indiana and South Carolina also ended 2008 with UI loans outstanding.

Michigan may need to review the current policies that govern the unemployment benefit program. This could include consideration of statutory changes to address the imbalance between revenue and expenditures. Changes could be made to the tax base and rates charged to employers and/or the level of benefits. Other policy decisions could include determining whether changes should be permanent or temporary, and how to fund supplemental appropriations if necessary to pay interest costs on outstanding loans.

In the absence of changes to the structure of the Unemployment Insurance system, the deficit will continue until economic conditions improve. The costs of borrowing will continue to be borne primarily by employers, which will be paying the State solvency tax and a higher FUTA tax rate as the Federal tax credit is reduced.

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November/December 2008

Drivers of Caseload Change in the Family Independence Program
By David Fosdick, Fiscal Analyst

Introduction

In December 2008, the Michigan Legislature approved Executive Order (EO) 2008-21. The EO reduced State GF/GP expenditures in fiscal year (FY) 2008-09 by $145.8 million, and $23.3 million of the savings realized in the EO came from base adjustments in the Family Independence Program (FIP). These adjustments in the EO recognize of a trend of caseload decline in FIP that has been evident since April 2007. This caseload decline is difficult to understand as most measures of economic health in the State of Michigan have significantly worsened. This article will examine changes in the FIP caseload since 2000, with a discussion of issues that have been driving FIP caseload declines in recent years.

FIP Summary and Recent Caseload History

The Family Independence Program is the primary cash assistance program administered through the State of Michigan. Individuals meeting financial criteria (low income and asset levels) and nonfinancial factors (e.g., family size and composition, employment status, and child support status) are eligible for cash grants. The program is primarily funded through Federal Temporary Assistance for Needy Families (TANF) and State General Fund/General Purpose (GF/GP) funds.

Table 1 provides a summary of the average quarterly caseload in FIP since FY 2000-01. The table shows slow but steady growth in program caseload between FY 2000-01 and FY 2005-06, a sudden spike in caseload at the end of FY 2005-06 and the beginning of FY 2006-07, and then a dramatic decrease in cases from the midpoint of FY 2006-07 through FY 2007-08.

Table 1

Average Quarterly FIP Caseload - FY 2000-01 through FY 2007-08

Quarter	Caseload	% Change	Quarter	Caseload	% Change
Oct to Dec 2000	67,376	---	Oct to Dec 2004	78,514	1.2%
Jan to Mar 2001	69,279	2.8%	Jan to Mar 2005	78,784	0.3
Apr to Jun 2001	70,056	1.1	Apr to Jun 2005	78,050	(0.9)
Jul to Sep 2001	71,459	2.0	Jul to Sep 2005	77,836	(0.3)
Oct to Dec 2001	74,349	4.0	Oct to Dec 2005	78,740	1.2
Jan to Mar 2002	76,935	3.5	Jan to Mar 2006	78,735	0.0
Apr to Jun 2002	73,525	(4.4)	Apr to Jun 2006	79,204	0.6
Jul to Sep 2002	68,825	(6.4)	Jul to Sep 2006	84,760	7.0
Oct to Dec 2002	70,379	2.3	Oct to Dec 2006	88,042	3.9
Jan to Mar 2003	73,936	5.1	Jan to Mar 2007	88,854	0.9
Apr to Jun 2003	75,072	1.5	Apr to Jun 2007	85,520	(3.8)
Jul to Sep 2003	76,955	2.5	Jul to Sep 2007	79,140	(7.5)
Oct to Dec 2003	77,822	1.1	Oct to Dec 2007	75,803	(4.2)
Jan to Mar 2004	78,226	0.5	Jan to Mar 2008	73,739	(2.7)
Apr to Jun 2004	78,214	0.0	Apr to Jun 2008	71,854	(2.6)
Jul to Sep 2004	77,612	(0.8)	Jul to Sep 2008	68,876	(4.1)

Source: Department of Human Services

Factors Affecting FIP Caseload Change

Social Welfare Act Changes in FY 2005-06 and FY 2006-07

The first factor in recent FIP caseload activity that has to be understood is the dramatic increase in the FIP caseload observed between the fourth quarter of FY 2005-06 and the third quarter of FY 2006-07. The caseload, fairly steady for some time at 77,000 to 79,000 cases, ended up growing to nearly 90,000 cases within a six-month period.

This increase was directly tied to changes in FIP policy accomplished through a statutory change. In December 2005 the Legislature approved Public Act 323 of 2005; the legislation modified a requirement in the Social Welfare Acct that an individual attend an orientation session conducted by the Department of Human Services (DHS) and the Department of Labor and Economic Growth before receiving FIP payments, by permitting recipients to attend the orientation session after eligibility was determined. When the legislation was enacted in December 2005, the FIP caseload was 79,138; by March 2007, the caseload had reached 89,333.

Partially in response to this increase in cases, the Legislature passed Public Act 9 of 2007 in May 2007. The legislation modified the Social Welfare Act to require individuals to participate in work-related activities after an initial determination that an applicant may be eligible for FIP benefits. As a result of this statutory change, the FIP caseload was back to 78,719 cases by August 2007.

Continued Caseload Decline in FY 2007-08

It is appropriate to assume that caseload declines observed in FY 2006-07 are directly tied to the statutory changes discussed above; the caseload continued to decline at a significant rate throughout FY 2007-08.

The reasons for the continued reduction in the FIP caseload over the past fiscal year are more difficult to determine. The economy in Michigan has continued to grow weaker; this was evidenced by growth in measures of unemployment and declines in wages in Michigan. The economic weakness in Michigan likely accounts for observed caseload growth in Medicaid and the Food Assistance Program (FAP), programs targeted to similar populations of Michigan residents.

Table 2 provides a comparison of changes in seasonably adjusted unemployment, Medicaid caseload, Food Assistance caseload, and FIP caseload. The table further demonstrates that changes in FIP are seemingly not tied to economic conditions in the State at this time or the need for State-administered assistance programs.

In FY 2007-08, the FIP caseload declined 9.6%, an average monthly decline of over 1.0%, while Medicaid caseload increased by 3.2% FAP caseload increased by 7.8%, and unemployment grew from 387,000 individuals to nearly 430,000 individuals. This strongly suggests that noneconomic factors account for the decline in the FIP caseload in FY 2007-08.

Several factors appear to be related to this caseload change. The factors include modification of Department policy related to referrals of FIP applicants to Work First, more aggressive use of sanctions within FIP, demographic changes in the State, and passage of an increased minimum wage.

Table 2

Family Independence Program (FIP) and Food Assistance Program (FAP) Caseloads FY 2007-08							
Month	FIP Cases	FIP % Change	Medicaid Cases	Medicaid % Change	FAP	FAP % Change	Unemployed
Oct. 07	77,391	---	1,511,221	---	570,276	---	387,000
Nov. 07	75,351	(2.6%)	1,520,217	0.6%	572,769	0.4%	370,000
Dec. 07	74,666	(0.9)	1,516,627	(0.2)	575,711	0.5	372,000
Jan. 08	73,985	(0.9)	1,523,071	0.4	580,679	0.9	353,000
Feb. 08	73,851	(0.2)	1,529,518	0.4	586,024	0.9	358,000
Mar. 08	73,381	(0.6)	1,536,049	0.4	590,615	0.8	360,000
Apr. 08	72,257	(1.5)	1,534,049	(0.2)	594,381	0.6	346,000
May 08	72,147	(0.2)	1,549,983	1.0	599,089	0.8	428,000
Jun. 08	71,157	(1.4)	1,548,931	(0.1)	602,323	0.5	423,000
Jul. 08	69,587	(2.2)	1,554,446	0.4	604,863	0.4	419,000
Aug. 08	69,097	(0.7)	1,558,466	0.3	609,614	0.8	439,000
Sep. 08	69,943	(1.7)	1,559,063	0.0	614,955	0.9	429,000
Average	**72,568**	**(1.2%)**	**1,536,803**	**0.3**	**591,778**	**0.7%**	**390,333**

Source: Department of Human Services, Department of Community Health, Bureau of Labor Statistics, U.S. Department of Labor.

Work First Referral

The statutory adjustments affecting the timing of referrals to Work First, discussed above, appear to have influenced caseload change in FY 2007-08. Table 3 provides data describing the number of applications for FIP, the number of FIP cases opened and the percentage of successful applications for each fiscal year of this decade.

Table 3

Family Independence Program (FIP) Application Information FY 2000-01 to FY 2007-08			
Fiscal Year	Total Applications	Total FIP Openings	Percentage Apps/Opened
FY 2000-01	184,148	74,890	40.7%
FY 2001-02	187,820	73,444	39.1%
FY 2002-03	189,724	74,446	39.2%
FY 2003-04	191,463	74,623	39.0%
FY 2004-05	188,024	72,286	38.4%
FY 2005-06	188,064	80,597	42.9%
FY 2006-07	185,538	79,560	42.9%
FY 2007-08	184,427	63,993	34.7%

Source: Department of Human Services

Compared with prior years, there was a decline in the number of applications received for FIP in FY 2007-08. This decline may be viewed as significant when one considers that the economy in Michigan continued to weaken during this time period.

Perhaps the more interesting element in Table 3 is the number of applications opened in FIP in FY 2007-08. Before the statutory changes that made opening a FIP case easier, as discussed above, about 40.0% of FIP applications were successfully opened. In FY 2005-06 and FY 2006-07, with the passage of more permissive language related to Work First referral, the percentage of opened cases grew to about 43.0%. In FY 2007-08, less than 35.0% of applications were successfully opened.

This decline in opened cases appears to be related to the enactment of new requirements mandating participation in Work First before enrollment in FIP. The relationship between passage of Public Act 9 of 2007, which mandated this change, and caseload changes is pretty clear. The legislation was enacted in May 2007; between October 2006 and May 2007, 48.2% of FIP applications were opened, but during the four months after passage of the amendment (June through September 2007) the percentage of opened FIP applications dropped to 33.8%.

Changes in Sanction Policy

Major changes in the Social Welfare Act signed into law by Governor Granholm in December 2006 included a modification in sanctions applied to FIP recipients who are not complying with program rules. Recipients could be sanctioned for losing their job through misconduct or absenteeism, quitting a job, or not complying with Work First or their self sufficiency plan. The new sanction policy mandates that recipients be removed from FIP for 90 days for their first instance of noncompliance, 90 days for their second instance, and 12 months for a third violation.

More aggressive use of sanctions has led to a reduction in program caseload. The DHS has noted that about half of sanctioned individuals do not return to the program. Data on the number and percentage of FIP recipients removed because of sanctions show a steady increase since the policy was implemented in April 2007.

Table 4 compares the number of FIP case closures between FY 2005-06 and the first half of FY 2006-07 before implementation of the new sanction policy, with case closures due to sanctions under the new policy observed during the second half of FY 2006-07 and in FY 2007-08. Measures of the percentage of total closures that now come from sanctions and the percentage of current program caseload that is closed through sanctions are also provided.

Table 4

Sanction Closure FY 2005-06 to FY 2007-08

			Sanction Closures as a:	
Fiscal Year	**Average Monthly Closures**	**Average Monthly Sanction Closures**	**Percent of Closures**	**Percent of Caseload**
FY 2005-06	5,973	706	11.8%	0.9%
FY 2006-07	6,887	1,588	23.0%	1.9%
Oct 06- Mar 07	*7,044*	*1,265*	*18.0%*	*1.4%*
Apr 07- Sep 07	*6,826*	*1,910*	*28.4%*	*2.3%*
FY 2007-08	6,374	1,720	27.0%	2.5%

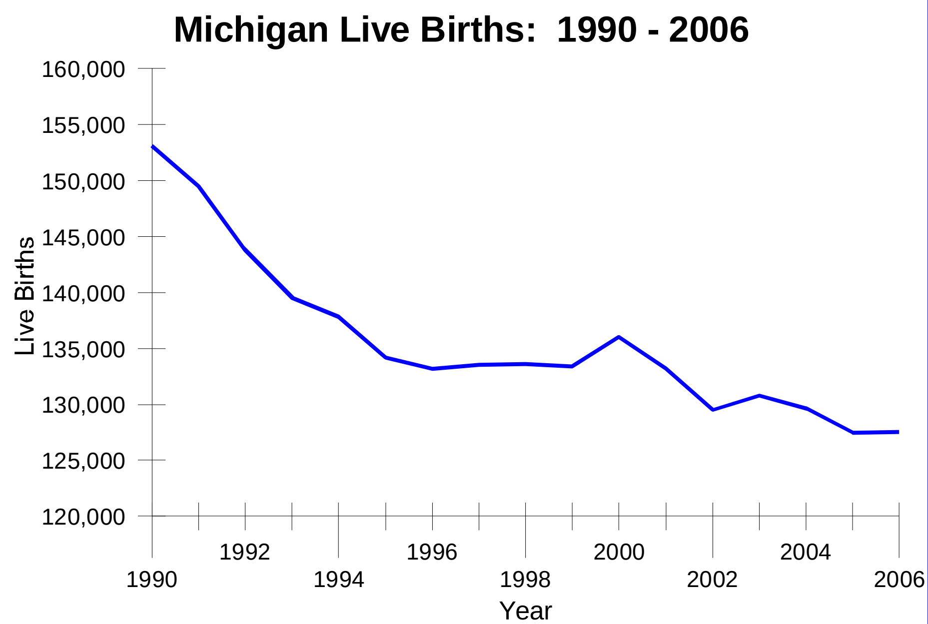
Source: Department of Human Services

Removals from FIP because of sanctions jumped up from between 600 and 750 per month during FY 2005-06 to between 1,600 and over 2,000 per month in FY 2007-08. This sanction rate is especially interesting because it held fairly steady on a month-to-month basis even as caseload declined from about 77,000 cases at the beginning of FY 2007-08 to below 70,000 cases by the end of the fiscal year.

Demographic Change

The DHS has noted that there is a relationship between the births in the State of Michigan and caseloads in programs like FIP. Births have been declining in Michigan at a fairly consistent rate since 1990 (as demonstrated in Figure 1).

Figure 1



Source: Department of Community Health

This decline in births (down nearly 20% since 1990) affects the FIP caseload in two ways. First, the cohort of families with older children eligible for the program declines each year as children age out of the program. There may very well be fewer eligible families with children under the age of 18 this year than in prior years because of changes in births. The declining number of Michigan births also reduces the number of FIP-eligible families with young children.

Additionally, population loss in the State may lead to a small impact on the number of overall families eligible for FIP benefits. This could have a small effect on the program as well.

The Passage of Minimum Wage Legislation

The passage of new minimum wage legislation may have had a marginal impact upon FIP caseloads. While the program disregards a portion of earned income (the first $200 and then 20.0% of earned income for each month), a significant number of FIP recipients earn income. In 2006, nearly 20.0% of FIP recipients had some level of earned income.

Increases in the minimum wage passed in 2006 would have led to increased income for some low-wage families and may have made them ineligible for FIP benefits. A minimum wage worker working 30 hours a week brought home about $618 per month (pre-tax) before the increase in 2006 and now would make $888 (pre-tax) per month under the current minimum wage. This may have led to a marginal reduction in the number of working individuals who are financially eligible for FIP benefits.

Conclusion

While it is difficult to identify precisely the reasons for change in program caseload, it is clear that several factors have affected the number of Michigan residents collecting FIP benefits. Recently enacted legislation tightening program sanctions, modifying the process for referral to Work First, and increasing the State's minimum wage appear to have influenced the size and cost of the program at this time. It is not clear whether the declines in the FIP caseload that have been observed over the past few years will continue or whether the economic difficulty Michigan currently faces will lead to an increase in the number of individuals who successfully access cash assistance.