State Notes

TOPICS OF LEGISLATIVE INTEREST

Summer 2010

State Employee Concessions – An Update

By Joe Carrasco, Jr.

As a result of the ongoing Michigan budget crisis, the State continues to explore a number of cost-saving measures. Cutbacks in the amount of funding to pay for Michigan's State employee payroll and benefits often have been included in efforts to achieve State savings. The following provides an update on the concessions State Civil Service employees have made over the current and previous fiscal years to reduce State expenditures. These concessions have included furlough days, banked leave time, and changes to health care benefits.

Background

Article XI, Section 5 of the Michigan Constitution of 1963 establishes the classified State Civil Service and the State Civil Service Commission (CSC), and provides for a process to increase the rates of compensation for State employees. Ultimately, the CSC has authority over rates of compensation and conditions of employment, including the authority to make modifications to previously agreed-upon collective bargaining agreements.

Over 70.0% of the total State classified work force is represented by unions eligible to bargain collectively on behalf of State employees. Employees not eligible for exclusive union representation include those in supervisory, managerial, and confidential positions as well as employees in business/administration services. These nonexclusively represented employees (NEREs) have their terms and conditions of employment determined through a process administered by the Civil Service Employee Relations Board. The Employee Relations Board serves as a Coordinated Compensation Panel that recommends a Coordinated Compensation Plan for NEREs to the Civil Service Commission. The Coordinated Compensation Plan and the collective bargaining agreements are subject to review, modification, and approval by the Civil Service Commission.

On December 17, 2007, the Civil Service Commission approved collective bargaining agreements for the next three fiscal years (2008-09, 2009-10, and 2010-11) for employees exclusively represented by the American Federation of State, County, and Municipal Employees (AFSCME), the Michigan State Employees Association (MSEA), the Michigan Corrections Organization (MCO), the United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW), and the Service Employees International Union (SEIU) Local 517M. The agreements include hourly rate increases as follows:

October 1, 2008 - 0%
October 1, 2009 – 1.0%
October 1, 2010 – 3.0%

Article XI, Section 5 of the Michigan Constitution also states that increases in the rates of compensation authorized by the CSC require prior notice to the Governor, who then transmits the increases to the Legislature as part of the budget. Within 60 calendar days following the transmission, the Legislature, by a two-thirds vote of the members elected to and serving in each house, may reject or reduce increases in rates of compensation authorized by the CSC. Reductions made by the Legislature must apply uniformly to all classes of employees and cannot adjust pay differentials already established by the Commission. Rates of compensation also cannot be reduced below those in effect at the time the increases were transmitted to the Legislature.

To date, the Legislature has never rejected the wage increases approved by the Civil Service Commission for represented State employees; however, on February 10, 2010, the Civil Service Employee Relations Board did not agree to the 3.0% wage increase for NEREs for FY 2010-11 resulting in an estimated savings of $43.7 million gross ($17.7 million General Fund). The remaining represented civil service employees will receive the scheduled 3.0% base wage increase beginning October 1, 2010.

FY 2008-09 and Furlough Days

Concessions agreed to by State employees and the State Employer during FY 2008-09 included a furlough program. The furlough program required full-time State employees to take 48 hours of unpaid leave in FY 2008-09. The unpaid leave time equated to a 2.3% pay reduction for State employees. All employees, except essential employees, were furloughed without pay on June 19, July 6, July 24, August 7, August 21, and September 4, 2009. The furlough program did not have any effect on an employee's retirement service credit, longevity payments, step increases, holiday pay, sick and annual leave time accruals, benefit levels, or insurance premiums. The amount saved from this program in FY 2008-09 was an estimated $53.7 million gross; $21.7 million General Fund/General Purpose (GF/GP).

Table 1 illustrates the amount of savings achieved by State departments or agencies through the furlough program in FY 2008-09.

Table 1
FY 2008-09
Furlough Day Savings by Department

Department/Agency	Gross	GF/GP
Agriculture	$769,900	$395,200
Attorney General	960,400	449,500
Casino Gaming Board	154,900	0
Civil Rights	188,300	158,000
Civil Service Commission	776,900	216,700
Community Health	5,283,200	2,252,700
Corrections	9,487,300	9,316,500
Education	605,000	59,900
Environmental Quality	2,109,700	284,800
Executive Office	82,000	82,000
History, Arts, and Libraries	262,800	227,600
Human Services	12,560,700	4,773,700
Information Technology	2,734,600	978,700
Labor and Economic Growth	4,172,400	160,700
Lottery	297,800	0
Management and Budget	1,121,000	255,500
Michigan Strategic Fund Agency	249,500	249,500
Military Affairs	637,300	200,100
Natural Resources	2,069,600	144,900
State	1,801,600	196,400
State Police	1,569,300	1,013,800
Transportation	3,984,100	0
Treasury	1,790,600	263,200
Total	**$53,668,900**	**$21,679,400**

Source: State Budget Office

FY 2009-10 and Banked Leave

Concessions agreed to by State employees represented by the five bargaining units described above, NEREs, the Michigan State Police Troopers Association (MSPTA), and the State Employer for FY 2009-10 primarily include a banked leave time provision. It is important to note that the MSPTA has not ratified this agreement to take banked leave time although it is anticipated. In addition, the employees represented by the MSEA have already taken five furlough days on January 29, February 12, February 26, March 12, and March 26, 2010. In addition to banked leave time savings, two bargaining units achieved additional savings totaling $9.5 million through specific modifications to their contracts: The MCO will save $7.6 million from elimination of pre-shift meetings and the UAW will save $1.9 million for withdrawal from the Joint Employee Education, Training and Development Fund.

In FY 2009-10, employees have continued to work 40 hours per week, but their base pay has been reduced by two or three hours per pay period depending on the bargaining unit. The number of pay periods affected also depends on the bargaining unit. Table 2 provides the detail by bargaining unit.

The two or three hours per pay period for which State employees are not being paid instead will be placed into a separate banked leave time account and will not count toward an employee's regular annual leave cap. The accumulated banked leave time hours may be used as regular annual leave or remain in the employee's banked leave time account until separation from State employment, at which time the State will make a contribution to the employee's 401k or 457 retirement plan for the banked leave time hours. The amount of the State's contribution for the banked leave time will be based on the employee's rate of pay at the time of separation.

The banked leave time provision equates, on average, to an estimated 1.6% pay reduction for State employees while the furlough day provision equates to a 1.9% pay reduction for those employees. State employees, however, did receive their previously negotiated 1.0% base wage adjustment on October 1, 2009. The savings from these concessions in FY 2009-10 is estimated at $46.6 million gross ($33.6 million from banked leave time, $9.5 million from specific bargaining unit savings, and $3.5 million from furlough days). The GF/GP savings is estimated to be about 53.0% of the gross savings amount, on average.

Table 2 provides detail, by bargaining unit, on the number of banked leave time hours taken, furlough days, and the corresponding amount of savings achieved in FY 2009-10.

Table 2

FY 2009-10 Estimated Employee Concession Savings by Bargaining Unit						
Bargaining Unit	**Banked Leave Time Hours Taken**	**Furlough Days Taken**	**Number of Pay Periods Affected**	**Specific Bargaining Unit Savings**	**Furlough Day or Banked Leave Time Savings**	**Gross Estimated Savings**
MSEA	None	5	5	N/A	$3,446,000	$3,446,000
MCO	3 total; 3 per PP	None	1	$7,600,000	600,000	8,200,000
SEIU	34 total; 2 per PP	None	17	N/A	4,200,000	4,200,000
MSPTA[1)]	30 total; 2 per PP	None	15	N/A	1,400,000	1,400,000
AFSCME	45 total; 3 per PP	None	15	N/A	1,950,000	1,950,000
UAW	26 total; 2 per PP	None	13	1,932,100	10,760,000	12,692,100
NEREs	28 total; 2 per PP	None	14	N/A	14,700,000	14,700,000
Total				**$9,532,100**	**$37,056,000**	**$46,588,100**

1) The MSPTA has not ratified these changes, though it is anticipated by the State Employer that these concessions will be agreed to by the end of the fiscal year, and the savings realized.

Source: State Budget Office

FY 2009-10 and FY 2010-11 Health Care Benefit Changes

Along with rates of compensation and conditions of employment, health care benefits also are negotiated in the collective bargaining process. The approved collective bargaining agreements for FY 2008-09, FY 2009-10, and FY 2010-11 made some significant changes to the premium and co-pay amounts paid by State employees. Employees choosing to enroll in the State Health Plan PPO (preferred provider organization) now are required to pay 10.0% of the annual premium, compared with 5.0% in previous contracts. Those enrolling in a health maintenance organization (HMO) plan previously did not pay any portion of the premium, 100% of which was paid by the State. Under the new contracts, employees choosing an HMO plan now pay 5.0% of the annual premium.

The new collective bargaining agreements for FY 2008-09, FY 2009-10, and FY 2010-11 also made significant changes to the deductible and prescription and office visit co-pay amounts that State employees pay. The deductible for members under the State Health Plan PPO increased from $200 per member ($400 per family) to $300 per member ($600 per family) for in-network services, while the deductible for out-of-network services increased from $500 per member ($1,000 per family) to $600 per member ($1,200 per family). The out-of-pocket maximums remained the same: $1,000 for individuals and $2,000 per family for in-network services; $2,000 for individuals and $4,000 per family for out-of-network services.

The prescription drug co-pay amounts increased under the new collective bargaining agreements. The co-pay for generic drugs was set at $10 while the co-pay for brand name drugs was set at $20. Also, the co-pay for nonpreferred brand name drugs increased from $30 to $40. The co-pay for mail order prescriptions of 90-day supplies now is $20 for generic, $40 for brand name, and $80 for nonpreferred brand name drugs. Finally, the co-pays for office visits and emergency services were increased for in-network services. The office visit co-pay increased to $15 per visit, while emergency visits are still covered at 100%. If an individual is *not* admitted to the hospital, however, a $50 co-pay per emergency room visit is required.

Concession agreements made between the State Employer and represented employee unions and NEREs include further changes to the amount of health premiums newly hired State employees must pay along with increased co-pay amounts. The State Employer has ratified memorandums of understanding with employee unions (except MSPTA) and NEREs for changes that took effect on April 1, 2010, for employees hired on or after that date. These agreed-upon concessions affect employees choosing the State Health Plan PPO and those choosing an HMO. The agreed-upon changes are detailed in Table 3 and include changes to the amount of premium paid by the employee, prescription drug and office visit co-pays, emergency room visit co-pays, and deductible amounts.

Table 3
Comparison of Health Care Plans for Current Employees vs. New Hires as of 4/1/2010

Item	Current Employee PPO	New Employee PPO	Current Employee HMO	New Employee HMO
Employer Premium Share	90%	80%	95%	85%
Prescription Drug Co-pays	Retail - $10/$20/$40	Retail - $10/$30/$60	Retail - $5/$10	Retail - $10/$30/$60
	Mail order - $20/$40/$80	Mail order - $20/$60/$120	Mail order - $10/$20	Mail order - $20/$60/$120
In-Network:				
Deductible	$300 - member $600 - family	$400 - member $800 - family	N/A	N/A
Office Visit Co-pay	$15	$20	$10	$20
Emergency Room Co-pay (if not admitted)	$50	$200	$50	$200
Co-insurance after deductible	0%	10%	N/A	N/A
Out-of-Pocket Maximum	$1,000 member $2,000 family	$1,500 - member $3,000 - family	N/A	N/A
Out-of-Network:			**No out-of-network for HMOs**	**No out-of-network for HMOs**
Deductible	$600 - member $1,200 - family	$800 - member $1,600 - family		
Office Visit Co-pay	10% after deductible	20% after deductible		
Emergency Room Co-pay (if not admitted)	$50	$200		
Co-insurance after deductible	10%	20%		
Out-of-Pocket Maximum	$2,000 - member $4,000 - family	$3,000 - member $6,000 - family		

Source: State Budget Office

The actual savings for the health care benefit changes agreed-upon by these concessions are yet to be determined. The Office of State Employer estimates that these concessions will save approximately 21.3% from current plan costs. The average number of new employees hired annually by the State between 2005 and 2009 was 2,100. The annual premium for health care for the family plan in the State Health Plan PPO for employees hired before April 1, 2010, averages $17,600 per year while the premium for HMO coverage averages $16,000 annually. Due to changes in co-pays and deductibles, the annual premium for employees hired on or after April 1, 2010, drops to an average of $15,600 for the State Plan PPO (for the family plan) and $14,500 for HMO coverage.

Using these averages, the current State portion (90.0%) of premium paid for the State Plan PPO family plan is an estimated $15,840 annually compared with $15,200 (95.0%) paid for the family plan HMO. The decreased portion of the premiums required to be paid by the State for newly hired employees equates to an estimated $12,480 (80.0%) for the State Plan PPO and $12,325 (85.0%) for the HMO. Depending on the plan chosen, the estimated savings to the State of the changes to health care premiums alone for the 2,100 new employees hired annually could exceed $7.1 million per year, a 21.3% reduction compared with current costs for the same 2,100 new employees.

Conclusion

Negotiations on the State budget for all departments and agencies for FY 2010-11 continue as of this printing. How the budget will be resolved likely will require some concessions between the employee unions and the State Employer. These concessions could include furlough days, banked leave time, or further changes to employee health plans. The savings realized from previous concessions serve as a model for potential future savings. If history provides a hint to the future, it is likely that employee concessions will continue to provide a partial solution to the State's budget woes.

State Notes

TOPICS OF LEGISLATIVE INTEREST
Summer 2010

Retirement Incentive and Pension Reform of the Michigan Public School Employees' Retirement System
By Kathryn Summers, Chief Analyst

Introduction

On May 19, 2010, Governor Granholm signed into law Senate Bill 1227, Public Act 75 of 2010, which amended the Michigan Public School Employees Retirement Act. This legislation provided a window for a retirement incentive, and also implemented long-term reforms to the system, including mandatory contributions for retiree health care and a hybrid defined benefit/defined contribution pension for new employees. This article examines the changes enacted, and discusses current legal action surrounding the reforms.

The Michigan Public School Employees' Retirement System (MPSERS) provides pensions and health care to its retirees, who were eligible employees of school districts, intermediate school districts, participating charter schools, and community colleges, as well as the employees of seven universities hired before those institutions left the system. Pensions and health care are funded by a combination of employer (school) contributions and employee contributions. Employers are told yearly what percentage of their payroll to remit to the State for funding these costs; that percentage is made up of three components: a pension normal cost, a retiree health care cost, and a cost to pay for the unfunded accrued liability.

Without the recent legislation, the employer contribution rate for fiscal year (FY) 2010-11 was estimated at 19.41% of payroll. The reforms enacted in this legislation were designed to partially control the growth in employer contribution costs by shifting a portion of retiree health care costs onto employees, and by enacting the hybrid pension plan. With the enactment of this legislation, the 19.41% MPSERS rate in FY 2010-11 may decrease somewhat (reflecting a blend of the cost of paying for the retirement incentive and the savings from the new 3.0% employee contributions for retiree health), but the effects of a lawsuit (discussed below) have frozen the rate at 19.41% for the time being.

Retirement Incentive for MPSERS Employees

Currently, public school employees who are members of MPSERS have to be age 55 with 30 years of service or age 60 with 10 years of service to be eligible to retire, or may retire at any age with 30 years of service if they are in the Member Investment Plan. Under current law, the pension multiplier is 1.5%.

A member's pension is calculated by multiplying years of service by the pension multiplier by the final average compensation (FAC). For example, a person with 30 years of service, and a FAC of $60,000 would receive a yearly pension equal to 30 X $60,000 X 1.5%, or $27,000 under the normal pension formula, without an increased multiplier.

Public Act 75 of 2010 (PA 75 below) provided an increase in the pension multiplier for members choosing to retire during the window (if they submitted an application before June 11, and retire between July 1 and September 1, 2010). Specifically, a 1.6% multiplier was offered to employees currently eligible to retire, and a 1.55% multiplier was offered for employees who have a combined age and years of service totaling 80 by August 31, 2010. However, the final average compensation is capped at $90,000 under the enhanced multipliers; any higher FAC is part of the pension calculation, but at the 1.5% multiplier.

One extension (for a retirement date no later than September 1, 2011) per reporting unit was allowed, if requested by the employer and employee, and another 2,500 of retiring employees could be granted an extension, with the Office of Retirement Services distributing the additional 2,500 extensions on a pro-rata basis. Pension costs will be amortized over a five-year period.

Roughly 30.0%, or 17,000, of the 56,000 eligible public school employees took advantage of the retirement incentive. In the previous year, without an incentive, approximately 5,000 workers retired. Approximately 1,300 extensions were used. The cost to the pension system to pay for this incentive is estimated at $792.0 million amortized over five years, plus $562.0 million to pay for the health care of the additional retirees, for a total of $1.35 billion.

Increased Employee Contributions

Before the enactment of PA 75, employees in the Basic Plan (those hired before January 1, 1990) paid nothing for retirement; employees hired before January 1, 1990, who switched to the Member Investment Plan (MIP) paid 3.9% of salary toward their retirement; employees hired after July 1, 1990, and before July 1, 2008, paid $510 annually plus 4.3% of salary above $15,000; and employees hired after July 1, 2008, paid $510 annually plus 6.4% of salary above $15,000.

Public Act 75 requires all employees in MPSERS to contribute 3.0% of salary (in addition to the pre-existing pension contributions described above) into a funding account, defined as an appropriate irrevocable trust established under PA 77 of 2010 (House Bill 4073), on wages earned after July 1, 2010. However, employees who worked and made less than $18,000 in the 2009-2010 school year or new employees who are expected to make less than $18,000 in the 2010-2011 school year will contribute 1.5%, rather than 3.0% during that school year, increasing to 3.0% yearly thereafter.

It is anticipated that the 3.0% employee contributions will save employers more than $300.0 million per year, or $3.5 billion over a 10-year period. These savings will be realized by a lower employer contribution rate than otherwise would have occurred in the absence of the employee contributions. However, at the present time, the judge presiding over a lawsuit in Ingham County Circuit Court has ordered that the employee contributions being remitted as of July 1, 2010, be placed in escrow until the lawsuit is resolved. Therefore, the Office of Retirement Services will continue to charge MPSERS employers 19.41% of their payroll to be remitted for support of the pension system, until the lawsuit is resolved, at which time the actuary will again re-examine the system and determine if the rate should be adjusted, and in which direction.

In general terms, the lawsuit (*McMillan, et al.* vs. *MPSERS, et al.*) alleges that the new 3.0% employee contributions for retiree health care are a violation of the State's contract with the members of the Retirement System. Since there was no corresponding increase in benefits, the lawsuit alleges that the increased employee contributions impair or violate the State's contractual obligation to provide health care benefits as prescribed in the Retirement Act. If the lawsuit is decided in favor of the plaintiffs and the 3.0% employee contributions are disallowed, then there will be a net increase to schools to pay for the retirement incentive, since there will no longer be offsetting savings from employer contributions to pay for the incentive. If the lawsuit is decided in favor of the State, and the 3.0% employee contributions are allowed to be counted in FY 2010-11, the MPSERS employer contribution rate may fall somewhat below the 19.41% currently being charged.

Hybrid Plan for New Employees

Employees first hired on or after July 1, 2010, will be placed in a new "hybrid" pension plan, with a blending of defined benefit (DB) and defined contribution (Tier 2) components. A person under this plan will not be able to receive pension payments until age 60, and will be required to have worked at least 10 years as a public school employee. The purchase of service credit by these employees is prohibited, and cost-of-living adjustments to the pension are not provided. An employee will have to contribute $510 annually plus 6.4% of salary above $15,000, in addition to the Tier 2 contributions described below.

An employee under this plan will have to contribute 2.0% of salary to his or her Tier 2 account, unless affirmatively electing not to contribute or to contribute a lesser amount. The employer will have to match 50% of the employee's first 2.0% of salary contribution, for a maximum total employer payment of 1.0% of salary deposited into the Tier 2 account. This is in addition to the employer cost for the DB pension of this employee. The employee will be allowed to contribute more than 2.0% of salary, but the employer will not match more than 1.0%, unless choosing to do so under a locally negotiated agreement. An employee described here is immediately vested in his or her own contributions, and will vest in employer contributions as follows: 25% after two years of service, 75% after three years of service, and 100% after four years of service.

The DB side of this hybrid plan will use a five-year period on which to calculate the final average compensation, likely generating a lower FAC than is in current law. (For Basic Plan members, the time frame is five years; for MIP members, the time frame is three years.) Also, under this plan, the actuary will be required to assume a 7.0% rate of return on the investments in the portfolio (rather than the 8.0% rate under current law). The actuary may determine a different employer contribution rate for these members.

Any entity receiving full or partial, direct or indirect funding from the School Aid Fund, and not participating in MPSERS, may opt into the hybrid retirement plan for its employees, upon approval by the Internal Revenue Service. In addition, existing MPSERS employees hired before July 1, 2010 (i.e., not part of the hybrid plan) may opt into the Tier 2 component of the hybrid plan without an employer match. Hybrid plan employees may contribute more than 2.0%, and employers may locally negotiate higher matches than the required 1.0%, not to exceed a total match of 3.0% (for an employee contribution of 6.0%). However, any additional employer match beyond 1.0% is at the discretion of the employer, and must be decided annually. An employer may negotiate matches for nonhybrid employee contributions.

Third-Party Contracted Employees

Currently, members who retired before July 1, 2010, may return to work and avoid the earnings limitations in statute (roughly one-third of final average compensation) if they return to work as contractual employees, using a third-party employer. The employer also does not have to pay contributions to MPSERS for these employees.

Public Act 75 closed this avoidance of the earnings limitation cap. Members retiring on or after July 1, 2010, who draw a pension and return to work directly for a MPSERS reporting unit will remain subject to the current earnings limitation cap, meaning they may draw a pension and retiree health care and still earn a working salary equal to roughly one-third of their FAC. However, if a retiree working directly for a reporting unit exceeds that earnings cap, then the retiree will forfeit pension and retiree health care, until he or she ceases employment. Also, new retirees who return to work indirectly (either via a third party or as an independent contractor) will have their pension and retiree health care suspended (i.e., not provided) for the period of time they are performing core services.

Detailed Fiscal Analysis

Public Act 75 includes an increase in the pension multiplier from 1.5% to 1.6% for people already eligible to retire, and allows an "early out" for people with a combined age and years of service equal to 80, with a pension multiplier of 1.55%. With the known participation rate of 30%, the estimated cost of these provisions is $1.35 billion, distributed over the next six years, but will be partially offset by estimated wage and replacement savings of $1.04 billion, leaving a net cost of the incentive estimated at $317.0 million over 10 years. This analysis assumes the 30% participation rate for those retiring with the enhanced multipliers, that 90% of employees will be replaced (compared with the current 95% average replacement), and that wage savings will accrue during the years these people otherwise would have worked. Clearly, the assumptions on replacement and wage savings are merely that, since each local school will determine its own replacement and salary schedules for its retirees.

If found to be legal, requiring all employees to pay 3.0% of salary toward retirement health care will create savings for employers, because these employee contributions will be used to help pay for current-year retiree health care costs, and will reduce the employer contribution rate from what it otherwise would have been. The estimated employee contributions total $300.0 million in the first year, and $3.5 billion over 10 years (as shown in the attached table).

The revised hybrid plan is estimated to save $1.2 million in the first year, and $129.4 million over 10 years.

The combined effects of the three components described above (assuming 3.0% employee contributions to support current retiree health care costs are allowable, the pension incentive, and the hybrid plan for new employees) are estimated to save schools and other MPSERS reporting units $553.0 million in the aggregate for FY 2010-11, totaling an estimated $3.33 billion over 10 years. These savings will vary from employer to employer, and will depend upon the number of additional people who retire because of the incentive, and the wage and replacement decisions made by schools. At the extreme ends of the scale, a school with no retirees could see additional costs during the first six years (to pay for the enhanced incentives provided to other schools' retirees), while a school with large numbers of retirees who are not replaced could see substantial savings, even after netting out the extra cost of the incentives.

Local savings in the initial years will not be affected via a lower MPSERS contribution rate, because the pension system will have to pay for the enhanced multiplier and the early out. In fact, the contribution rate may increase in the short term, above what it otherwise would have been, and certainly will increase if resolution of the lawsuit determines that employee contributions may not be collected. Any local savings in the initial years will be driven entirely by local decisions: employees retiring (or not) and the wage and replacement decisions made by the employer. Once the costs of the enhanced multiplier and early out have been paid for (by FY 2016-17), the MPSERS contribution rate should be around three percentage points lower than what otherwise would have occurred (without these changes in law), but only if the employee contributions are allowed. This is because of the increased employee contributions to the system, and the introduction of the hybrid plan for new employees, both of which lower the cost to employers, via the MPSERS contribution rate.

School Employee Pension Reforms: 10-Year Estimated Savings Analysis of Public Act 75 of 2010
(Dollars in Millions)

	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	Cumulative Savings Total
3.0% Employee Contributions[1)]	$300.0	$310.6	$321.4	$332.6	$344.2	$356.4	$368.7	$381.6	$395.1	$409.1	$3,519.7
Revised Hybrid Plan for New Employees	1.2	4.0	6.5	8.9	11.3	13.8	16.5	19.4	22.4	25.4	129.4
Retirement Incentive – Pension Cost	0.0	(158.3)	(158.3)	(158.3)	(158.3)	(158.3)	0.0	0.0	0.0	0.0	(791.3)
Increased Retiree Health Care Costs	(176.4)	(176.4)	(176.4)	(32.9)	0.0	0.0	0.0	0.0	0.0	0.0	(562.1)
Wage Savings	427.7	334.4	224.0	50.7	0.0	0.0	0.0	0.0	0.0	0.0	1,036.8
Estimated Gross Savings	**$552.5**	**$314.3**	**$217.3**	**$201.1**	**$197.2**	**$211.9**	**$385.2**	**$401.0**	**$417.5**	**$434.5**	**$3,332.5**

[1)] Currently held in escrow pending resolution of lawsuit.

Note: See assumptions detailed above.

Source: Senate Fiscal Agency

State Notes

TOPICS OF LEGISLATIVE INTEREST

Summer 2010

Update Brief: State Crime Lab Needs Being Addressed
By Bruce R. Baker, Fiscal Analyst

As first reported in the Senate Fiscal Agency's January/February 2009 issue of *State Notes*, the Michigan State Police Forensic Science Division has faced a considerable challenge in providing timely crime lab services to local law enforcement agencies. The efforts by the Division to achieve this mission was affected greatly when, in 2008, the State assumed responsibility for the forensic laboratory needs of the City of Detroit, as the City closed its locally funded and operated facility, which had been functional since 1927. This closure placed a significant strain on the entire Michigan State Police Laboratory system consisting of locations in Lansing, Northville, Grayling, Grand Rapids, Sterling Heights, Bridgeport, and Marquette, by adding 20.0% in additional cases to an already stressed State caseload with a considerable existing backlog. In addition to the unknown impact facing the State in taking over the Detroit casework, the uncertainty of whether it would be able to continue to maintain an Upper Peninsula crime lab during difficult economic times has added to the challenge.

To address the challenge from the Detroit lab closure, several resources within the Department needed to be increased, including laboratory scientists, equipment (with associated maintenance costs), and laboratory space. As a practical matter, the Department had to assign casework from Detroit to existing regional State labs, primarily those in Northville and Sterling Heights, although all State labs were affected.

To provide the additional resources needed, the Legislature has appropriated considerable additional funding for the State labs since the closure of Detroit's lab. Initial enacted funding for the Michigan State Police Forensic Science Division for FY 2007-08 was $26.0 million Gross, with $21.5 million coming from State resources. This amount has risen to $40.2 million Gross, with $34.5 million coming from State resources for FY 2009-10, a Gross increase of $14.2 million or 53.0% and an increase in funding from State resources of $13.0 million or 60.0%. This has enabled the Department to create and fill 52 new positions (a 23.0% increase in staff) to deal with the additional caseloads. Table 1 shows the distribution of laboratory-related positions in 2007 and 2010, indicating that the Northville laboratory (with 33 new hires) and the Sterling Heights laboratory (with 13 new hires) have borne the major burden in assuming the new cases.

Table 1
Forensic Science Division
Laboratory Positions

	2007	**2010**
Michigan State Police Central Administration......	8	9
Lansing Laboratory	73	76
Northville Laboratory..	34	67
Grayling Laboratory	19	19
Grand Rapids Laboratory	4	4
Sterling Heights Laboratory	25	38
Bridgeport Laboratory	24	25
Marquette Laboratory	8	9
Total Positions	**229**	**281**
Positions added specifically to address Detroit caseload: 52		

Source: Michigan State Police

This bolstering of laboratory resources has resulted in a significant increase in productivity. In FY 2007-08, the number of cases completed by State labs was 80,300. For FY 2009-10, that number is expected to reach 93,992, an increase of 17.1% in cases completed. The disciplines that had the biggest increase in completed cases included the bomb squad (114.9%), firearms (111.6%), polygraph (35.9%), biology/DNA (24.4%), and questioned documents (20.5%).

Despite all the efforts to address increased caseloads, the enormity of the problem posed by the Detroit lab closure is demonstrated by the fact that the overall caseload backlog actually has increased from 5,147 in 2007 to the current level of 12,300. Plus this figure does not include 10,500 rape evidence kits never analyzed by the Detroit Lab and the subject of a sample analysis and subsequent study by Michigan State University. The Department has done what it can to address the problem with its current strategies, including parceling out some work to private labs and sending Detroit cases to regional labs that are now filled to capacity with existing personnel and equipment. The other resource, mentioned previously as one needing to be increased in order to address the caseload problem, is laboratory space. The Department has run out of space at its current stable of regional labs to house the necessary number of scientists and equipment to ensure adequate, timely, and accredited completion of its caseload.

The general consensus among those in the field of law enforcement is that to solve the problem, a new State-run lab, large enough and with enough personnel and equipment to handle area caseloads, should be created within the City of Detroit. Current fiscal constraints on State and local finances make this a difficult goal to achieve. There have been many options explored to house such a proposed facility, but perhaps the most likely option is the recent action by the Detroit City Council approving the purchase and renovation of the 400,000 square-foot former MGM Grand Detroit casino building for use as the new headquarters for the Detroit Police and Fire Departments. The proposal calls for the building also to be used to house a State crime lab run by the Michigan State Police. Negotiations are ongoing between the City and the State as to which would bare what costs and what the relationship would be between the two political entities. If this project became a reality and the necessary equipment and personnel to use this space were provided, the State might be able to eliminate the problematic laboratory backlog for both the Detroit area and other jurisdictions throughout the State.

The other problem facing the State lab system is the uncertainty of whether a regional Upper Peninsula lab at Marquette could be continued. For many years the lab was housed in a historical building leased by the State from a local historical society. When the society chose to end the arrangement two years ago, the State Police found a temporary solution by leasing a facility that had been previously used as a U.S. Fish and Wildlife Service facility. The building has been adequate for some evidence analysis, but since it was not designed for many lab procedures, a number of portable laboratory "pods", or trailers, have been used, on loan from the Federal government. With the Federal government looking to reacquire its portable labs and the State having difficulty in locating another facility in the area, the future has looked problematic for the State's northern-most regional lab.

Recent action by the Legislature has addressed this problem, however, with the enactment of Public Act 111 of 2010, which provides $2.5 million in General Fund/General Purpose funds for the State purchase and renovation of the currently leased 28,600 square-foot facility in Marquette. Of the $2.5 million, $900,000 is appropriated for the purchase price of the building and $1.6 million is for required building conversion costs. The acquisition and conversion of this property would allow the Department to return the portable laboratory "pods" to the Federal government, prevent the potential shifting of Upper Peninsula crime lab needs to the Michigan State Police Grayling Lab, take some pressure off other regional Michigan State Police labs currently dealing with additional cases due to the closure of the Detroit Police Crime Lab, and permit the following functions/disciplines to be housed at the Marquette property: firearms, polygraph, controlled substances, fingerprint analysis, bomb squad, trace evidence, crime scene response, and DNA analysis (potential). The local radio unit associated with the Michigan Public Safety Communications System and the State Police 8th District Headquarters, both currently housed at other Marquette locations, also are likely to be housed at the newly purchased facility.

State Notes

TOPICS OF LEGISLATIVE INTEREST

Summer 2010

Local Government Consolidation: Assessing the Evidence for Cost Savings and Economic Improvement
By Eric Scorsone, Senior Economist

"Encouraging, and if need be requiring, local units of government and school districts to share or consolidate administrative services and deliver them more cost effectively. Michigan has more than 1,800 local units of government and 553 school districts, another 230 charters, and 57 intermediate school districts." Governor's Emergency Financial Advisory Panel 2007 Report

"Facilitate and provide incentives for sharing of services (vertical and horizontal integration) and/or consolidation across local units of government" Legislative Commission on Governmental Efficiency 2009 Report

These statements and many others continue to bring to the fore the issue of government efficiency, cost savings, and the number of units of local government in Michigan. Since the release of the report of the Legislative Commission on Governmental Efficiency and certainly far before that as well, there has been much talk of the policy idea of the merger or consolidation of local governments in the State. This policy idea is most often discussed today in the context of addressing the severe fiscal stress on local governments brought on by falling revenue sharing, loss of population, and declining property tax revenue. This paper explores the possible costs and benefits of such a policy option by reviewing the existing evidence on local government consolidation from other states and countries.

As a reform idea, one of the central goals of intergovernmental cooperation and consolidation is the restructuring of government services in order to reduce costs or slow the growth rate of costs while still maintaining a reasonable level of service capacity and quality. Generally, in the case of a situation of fiscal stress, governments are faced with the uncomfortable choice of cutting services (and costs) or raising taxes and fees. Intergovernmental cooperation and consolidation, among other reforms, attempt to cut this knot by restructuring services and operations to maintain capacity while reducing costs.

In short, one policy question is whether a more fragmented state with a greater number and complexity of local government units will be more expensive and costly compared with a state with fewer units of local government. The issue of cost and efficiency can be subdivided into two questions: 1) the impact of political consolidation or a reduction in the number of units of local government on cost, and 2) the impact of specific service cooperation and consolidation on cost.

However, cost may not be the only issue. Another prominent rationale behind local government consolidation is that the economy will be better in a less fragmented region or state compared with a more fragmented one. This third policy question relies on the assumption that a less fragmented region or state will be more efficient, resulting in a better business climate and improved economic performance. This article attempts to assess the evidence regarding these three policy questions.

Michigan's Local Government System

Before assessing the evidence, it is useful to map the local government system in Michigan. Michigan has what is known as a two-tier system of local governance. One tier is county government which is generally responsible for courts, prosecutor and public defender offices, public health, sheriff and jail operations, drain commission, property equalization, county roads, and a variety of other tasks. In the second tier lie the cities, villages, and townships. Cities and townships are mutually exclusive units while villages overlap with townships. Cities, townships, and villages are generally responsible for water and sewer services, police and fire protection, property tax collection and assessment, urban roads and streets, parks, and other items. Michigan residents live in a county and either reside in a city, township, or village (township) combination. Counties, cities, villages, and townships are known as general purpose governments because they provide a wide range of services.

There is a third hybrid form of local governance which is known as the special district government. Excluding schools, which are special district governments also; these entities are established by general purpose governments to provide a specific service such as a water or sewer authority, fire authority, library district, or recreation authority, among other options. Technically, they are part of the second tier of governmental units but function only for that specific purpose. In Michigan, almost all special districts are governed by a board appointed by one or more general purpose governments. In many cases, special district governments are the key mechanism through which intergovernmental cooperation is achieved for a specific service.

In raw numbers looking across these tiers, Michigan does contain a large number of local government units.[1] Based on those raw numbers, Michigan ranks 14th among all states with 2,314 local government units (see Table 1.) The number of Michigan special districts has grown over the past few decades, albeit at a slower rate than many other states.

Table 1

Local Units of Government in Michigan	
Type of Government	**Number**
County Government	83
City/Village Governments	533
Township Governments	1,242
Special District Governments	456
Total	**2,314**

Source: 2007 Census of Governments

Local Governments and Spending Across the States

The first policy question to address is whether reducing the number of local governments will slow the growth rate of spending in this sector. In terms of spending per person, the best approach is a state-by-state comparison across all types of local units of government. Using this approach, Michigan ranks 14th among all states based on the 2007 Census of

[1] For purposes of the analysis presented here, school districts are excluded due to their special nature and funding sources.

Governments (see Table 2). This ranking translates into $4,609 per person. Of course, this is an average and would vary widely depending on where a person lived and worked. New York State is the highest spender with an average per capita local government spending rate of $7,996 and the lowest is Hawaii with a per capita spending rate of $1,896. The average for all states is $4,253 per person.

As shown in Table 2, there is no clear relationship between spending per person and total number of local governments or number of persons per local government. New York has the highest spending per person of any state. Of course, this information is skewed potentially by the inclusion of New York City, which is unique in the scope of its services. Meanwhile, Illinois spends only half as much as New York on local government and has more than twice the number of local units of government, including the City of Chicago. The basic problem with these national comparisons is the difference in the scope of service responsibilities and taxing authority given to local governments. A better approach may be to compare similar states, such as those from the Midwest or Great Lakes region, which is what we turn to next.

Table 2

Local Governments and Spending Across States

State	# of Local Units	Persons Per Local Government	Population	Local Spending Per Person
New York	2,918	6,697	19,541,453	$7,996.30
Wyoming	1,153	472	544,270	$6,895.89
California	6,574	5,622	36,961,664	$6,688.23
Nebraska	2,876	625	1,796,619	$6,003.40
Alaska	1,189	587	698,473	$5,506.45
Florida	2,197	8,438	18,537,969	$5,153.53
Washington	2,754	2,420	6,664,195	$5,119.87
Colorado	3,988	1,260	5,024,748	$5,034.85
Minnesota	3,185	1,653	5,266,214	$4,966.83
Nevada	309	8,554	2,643,085	$4,952.47
Illinois	6,082	2,123	12,910,409	$4,914.37
New Jersey	1,043	8,349	8,707,739	$4,830.44
Tennessee	964	6,531	6,296,254	$4,802.50
Michigan	2,314	4,308	9,969,727	$4,609.26

Source: 2007 Census of Governments

Table 3 shows that Michigan has the fewest number of local government units in the Great Lakes region[2]. In contrast, Illinois has the highest number with 6,082 local government units. Illinois has a large number due to its extensive use of special district governments. In fact, Illinois is ranked first among all states for the number of local units of government. These raw numbers, however, may be deceptive. More importantly, related to the question posed at the beginning of this article, is there a relationship between number of units of local government and per-person spending?

In fact, as Table 3 reveals, there is no clear relationship between those two variables. Illinois, with many local units of government, spends nearly the same as Michigan, with the fewest local units. The number of local governments does not appear to make a significant difference on spending per person. For example, the state of Illinois has almost 7,000 governments compared with fewer than 3,000 in the State of Michigan. Illinois has such a high number due to the extensive use of special districts compared to Michigan. Again, the evidence does not seem to suggest that there is a strong relationship between number of local units of government and spending per person.

Table 3

Total Local Units of Government for select Midwestern States

State	# of Local Governments	Local Government Spending Per Person
Illinois	6,082	$4,914
Michigan	2,314	$4,609
Ohio	3,034	$4,521
Wisconsin	2,679	$4,508
Pennsylvania	4,356	$4,417
Indiana	2,939	$4,074
Minnesota	3,185	$4,976

Source: 2007 Census of Governments

Looking across these Midwestern states, all of which have a similar governmental structure and system, per-person spending is nearly identical considering the wide variation in the number of local government units. This evidence at least throws into question the assumption

[2] According to a widely used measure of state-local centralization, Michigan ranks as a more decentralized state, which is termed a "local services" state. The general categories range from centralized to decentralized. A state like Hawaii is classified as highly centralized and this matches its ranking as the lowest spending state per person on local government. On the other side, New York is the highest spending state on local government and is also classified as the most decentralized state. Michigan looks more like New York than Hawaii. Other Midwest states are ranked as more balanced such as Illinois, Ohio, Indiana, Minnesota, and Wisconsin. Given that the Midwest states all cluster around being balanced or more decentralized, it would appear that a comparison of local government spending per person is a relatively fair comparison. A different approach to assessing government fragmentation was developed by David Miller of the University of Pittsburgh called the Metropolitan Power Diffusion Index (MPDI). According to this index, the Detroit Metropolitan Area did rank highly, eighth among all metropolitan areas, in terms of fragmentation. However, for the State as whole, Michigan did not even rank in the top 15 for degree of local government fragmentation.

that local government consolidation is likely to result in lower spending or cost savings. Other evidence and more detailed analysis is required to test the assertion that consolidation will result in the outcomes posited.

Intergovernmental Cooperation and Consolidation in Michigan: A Policy Analysis

Having reviewed the overall structure of local government in Michigan and across a variety of other states, a more detailed investigation of individual government services may be constructive. A second policy question is whether, via consolidation or intergovernmental cooperation of specific governmental services, Michigan could reduce the growth rate or actually reduce this per-person spending number. From an economic benefit cost analysis perspective, the second and related question is whether there are policies that are more cost effective in achieving this same outcome. In other words, would alternative policies achieve cost savings in a more efficient or effective manner? The next best alternative would be the internal restructuring of government agencies by a unit of government to reduce costs and improve efficiency. Such activities might include streamlining, adopting lean management strategies, and other changes.

To this point, the evidence seems to point to the fact that a policy of local government consolidation may not be effective in reducing or slowing the growth rate of governmental costs. However, local governments are not monolithic; in fact, they provide a wide variety of services that vary across the types of governmental units. Each of these services presents a different profile and some services may present input opportunities for consolidation and cost reduction. Table 4 provides a brief summary of the types of services delivered by local governments based on spending patterns.

Table 4

Local Government Spending by Category 2007
(Dollars in Millions)

Service Categories	Local Govt. Spending
General Government	$2,187
Social Welfare	4,635
Education and Libraries	529
Transportation	2,761
Public Safety	3,768
Environment and Housing (including sewer)	3,788
Utility and Transit	3,402
Total	**$25,601**

Source: 2007 Census of Governments

It should be noted that the criteria upon which one judges the potential benefits of government consolidation must be clarified. Efficiency is generally defined as an improvement in the productivity of government operations as producing more outputs or outcomes from the same amount of input. Efficiency refers to doing an existing task better. Effectiveness is defined as whether the right set of governmental services or tasks are being performed.

Further, in thinking about governmental consolidation, it is useful to divide up government operations into categories. Labor-intensive services are those that require more human input as opposed to the use of capital and technology. For example, while technology has enhanced the ability of police personnel to combat crime, it remains necessary under many best practice strategies to employ police officers. In the case of the fire department, a greater use of capital and technology has complemented the protection of property and people. Thus, some services may be characterized as capital intensive. Finally, some services may require a skill or human capital intensive element to them. This for example could include information technology operations, financial operations, property assessment, some police and fire investigation services, and the prosecutor's office. These services require a high degree of training and education.

For labor-intensive services, the evidence suggests that it is difficult to merge and improve efficiency of these operations. In fact, 2009 Nobel Laureate in Economics Elinor Ostrom found in her work that smaller police operations were more efficient than larger police operations (Ostrom, 2009). The reason behind these findings is that an expansion of population is not likely to result in the ability to reduce numbers of employees without directly reducing service quantity or quality by its very nature. These types of services might include police patrol, some general government or city hall functions, code compliance, and similar activities. One caveat to this finding is that any specific local government may be operating inefficiently and a consolidation may result in improvements. However, this change also could be achieved by internal restructuring in some cases.

For capital-intensive services, it is often presumed that a local government consolidation or cooperative effort will result in cost savings. Cost savings may occur due to enhanced purchasing power through bulk purchasing. Of course, in this case, the issue is whether the units of local government purchase the same types of equipment or materials to achieve bulk purchasing power. Another source of cost savings in the case of capital intensive services may be the better use of existing equipment or technology. Two units of local government may both have fire apparatus that are underused and better utilized in a larger jurisdiction. These services include fire suppression, information technology and geographic information system (GIS), water and sewer services, road maintenance, and others.

For skill-intensive services, it may be useful to consolidate across governmental units due to underutilization based on workload in any governmental unit. For example, a court administrator or information technology expert in one jurisdiction may be underutilized based on caseload analysis and it makes sense to combine court personnel. These types of skill-based sharing arrangements are already beginning to occur across local jurisdictions both in terms of personnel and equipment and capital. These services might include high level property assessors, information technology and GIS personnel, librarians, court officials and judges, financial officials, and others.

Thus, in the arena of intergovernmental consolidation of specific services, local and state government policy makers may find it advantageous to address these issues and reduce costs and improve effectiveness. Michigan has certain policies that continue to raise the transaction costs of intergovernmental cooperation activities. At a minimum, it is likely to be a better strategy for local governments to pursue service specific arrangements before considering political consolidation.

Local Government Consolidation and Economic Development

A third policy question is whether a consolidated form of government, whether a metro-type government or simply the consolidation or a more intensive degree of regional cooperation, may result in a higher level of economic performance. Feiock and Carr (1997) found that the Jacksonville/Duval County merger did not result in improved economic outcomes. Savitch and Vogel (2010) found that, after several years, the Louisville/Jefferson County merger has not resulted in an economic improvement. Based on the available evidence, local government consolidation does not appear to boost a local economy. Contrary to these studies, there is evidence that the economy of Indianapolis performed better following consolidation. The evidence for or against improvement in a local economy is unclear at this time.

A Successful Consolidation: Iron River, Michigan

The case of Iron River, Michigan is an example where local government consolidation has apparently worked, at least five years after the fact. The feasibility analysis indicated that Iron River, post consolidation, should be able to save significant dollars. In fact, research has shown, five years later, that this consolidation did in fact result in lower costs on a per-person basis (Scorsone and Martin, 2010). The economic development outcomes are unclear in this case. Therefore, as stated above, while the burden of evidence may suggest that local government consolidation will perhaps not produce improvements in cost or efficiency, there are certainly cases where it may work.

Despite the success of Iron River, Michigan, the question remains as to the most cost-effective policy needed in order to reduce governmental expenses over time. A policy of intergovernmental government or consolidation should be compared with other alternatives such as internal restructuring or the shifting of services between tiers of government. At this time, very little evidence exists as to the relative effectiveness of these policies. This remains an arena for expanded investigation and research.

Summary and Conclusion

Local governments in Michigan face a severe fiscal crisis following the Great Recession of 2008-2009. Property tax revenue is depressed and likely to continue falling for several years into the future. State revenue sharing has been cut significantly and local option taxes remain highly restricted. Personnel expenditures, particularly those related to health care, continue to rise, creating structural budget deficits. In this fiscal environment, major reforms and restructuring are likely to be ongoing topics of policy discussions. One option is to simply raise taxes; another is to cut spending and reduce services. Beyond those two options, local governments and State policymakers face the challenge of identifying reforms that may be able to reduce costs while still maintaining public services provided. Intergovernmental cooperation and consolidation is one of those reforms.

The evidence presented here suggests that there are significant challenges in using the policy reform of intergovernmental cooperation and consolidation in attaining cost efficiency. In her 2009 Nobel speech, Elinor Ostrom stated, "Complexity is not the same as chaos" in reference to her own work regarding the relationship between local government structure and the efficiency and effectiveness of services. It would be wrong to argue that evidence presented here states that there is never a case for local government consolidation or cooperation. In fact, given the diversity across places and local governments, one should always proceed with a careful analysis of the costs and benefits of local government consolidation or cooperation in that particular case. Some cases will find significant benefits from consolidation; others will find the case for consolidation wanting.

A word of caution is in order in assessing the feasibility of local government consolidation or cooperation. It is relatively straightforward to generally demonstrate that two local government entities -- for example, a contiguous township and city -- can be shown to have duplicative positions and equipment. A proposed merger could eliminate these duplicative activities and positions and lead to lower costs and perhaps lower millage rates. The problem lies in the notion of "feasible". The evidence collected here does at least reveal that the implementation of a local government consolidation or intergovernmental cooperative effort is often very different than the proposed changes. Feasibility studies must be challenged to assess the likeliness that their actual proposals and plans will be carried out and maintained by administrators and elected officials over time.

References

Carr, Jered and Richard Feiock. "A Reassessment of City/county Consolidation and Economic Development Impacts" State and Local Government Review, Fall 1997.

Ostrom, Elinor. "Beyond Markets and States: Polycentric Governance of Complex Economic Systems" Nobel Lecture Dec 12th, 2009.

Savitch, H.V. and Richard Vogel. "Beyond the Rhetoric" American Review of Public Administration Vol. 40, No. 1 (2010).

Scorsone, Eric and Joseph Martin. "Cost Ramification of Municipal Consolidation: A Comparative Analysis" Journal of Public Budgeting, Accounting and Financial Management (Forthcoming, 2010)

State Notes

TOPICS OF LEGISLATIVE INTEREST

Summer 2010

A Preliminary Look at the Impact of the 2010 Census on Revenue Sharing
By David Zin, Economist

In April 2010, the Federal government began the decennial census required by Article I, Section 2 of the Constitution of the United States. The population figures from the 2010 Census will be used to determine a number of high-profile matters, ranging from the number of seats each state will have in the U.S. House of Representatives, to how much Federal funding will be distributed, to the boundaries of state legislative districts. On a lower level, numerous Michigan statutes refer to population and, unless otherwise provided, MCL 8.3v indicates that those references will apply the population totals from the most recent preceding decennial census. This article discusses the impact of the 2010 Census on money the State distributes to local units of government through revenue sharing payments.

Background

Population forms the basis for many revenue sharing payment distributions. Article IX, Section 10 of the Michigan Constitution states, "Fifteen percent of all taxes imposed on retailers on taxable sales at retail of tangible personal property at a rate of not more than 4% shall be used exclusively for assistance to townships, cities and villages, on a population basis as provided by law." Before, and after, the adoption of this constitutional provision, the State has elected also to provide assistance to local units of governments through statutory provisions. While some statutory provisions have not been affected by population figures, many have been -- particularly when the statutory distribution formulas were changed in 1998.

State revenue dropped substantially during the 2001 recession as a result of both the slower economy and a variety of tax reductions. While sales tax collections generally continued to increase each year, the loss of revenue ultimately affected revenue sharing payments. Initially, revenue declines were offset by minor spending reductions and the use of one-time money, such as transfers from the Budget Stabilization Fund. However, as the Michigan economy remained in recession, more substantial budgetary changes were necessary. Revised revenue estimates in November 2002 forecast a General Fund deficit, prompting a mid-year Executive Order (E.O.) reduction that also reduced FY 2002-03 revenue sharing payments. However, E.O. 2002-22 (and accompanying statutory amendments) did more than reduce statutory revenue sharing payments, it also altered the distribution of payments by effectively suspending a portion of the distribution formula adopted in 1998.

Before E.O. 2002-22 was issued, statutory payments to local units were distributed on the basis of a variety of factors that could change from year to year, even though many of those factors were affected by population (which, at the time, was fixed at the totals from the 2000 Census). Reductions in the appropriation for revenue sharing payments slowed the rate at which the 1998 formula was phased in and affected different local units differently. For example, as long as sales tax revenue increased during the year, the distribution formula froze the combined constitutional and statutory payment to the City of Detroit at $333.9 million, regardless of the appropriation. Under the original FY 2001-02 appropriation, some local units were slated to receive increases as large as 9.1%, compared with their FY 2000-01 payment, while other local units were forecast to experience declines as large as 7.7%.

The impact of an Executive Order for that fiscal year did not alter the City of Detroit's payments, while payments to Lee Township in Allegan County dropped from a 5.6% increase over FY 2000-01 to a 0.4% decline (a 6.0 percentage point change) and payments to Elk Rapids Township in Antrim County fell from a 1.5% increase to a 0.9% increase (a drop of only 0.6 percentage point).

Executive Order 2002-02 shifted the focus from phasing in the 1998 distribution formula to comparing the change in total (constitutional and statutory) revenue sharing payments from the prior year. The language in E.O. 2002-02 (and accompanying legislation) endeavored to ensure that each local unit, including the City of Detroit, experienced the same percentage reduction in total payments from the reduced appropriation. In every fiscal year since E.O. 2002-02 was issued, revenue sharing distributions have been specified to require that each local unit receive the same percentage change, compared with the prior year, in total payments.

Repeated application of this "uniformity" requirement, in conjunction with basing the changes on the combined total of constitutional and statutory payments, eventually resulted in the elimination of statutory payments to many local units. The uniformity changes particularly affected units where the statutory payment to a local unit was small relative to the constitutional payment. The dynamic is relatively easy to illustrate: Assume a unit received a $5,000 statutory payment and a $95,000 constitutional payment in year one, and that sales taxes grow 2.0% in year two, so that the constitutional payment increases to $96,900. Now assume that the appropriation and distribution formula for year two specifies that each local unit will receive only 96.0% of the year one payment. In this case, the "4% reduction" eliminates the statutory payment. If the unit is to receive 96.0% of the prior year's combined payment, the unit will receive $96,000 -- $900 less than its constitutional payment. In such circumstances, the local unit will receive the constitutionally required payment, but no statutory payment. After eight years of these "uniform" reductions and given the current appropriation for FY 2009-10, approximately 1,207 local units (out of approximately 1,774) are not expected to receive a statutory payment.

2008 Inter-Census Estimates and the 2010 Census

Based on the current estimates of Michigan's population since the 2000 Census, Michigan gained population through 2005 but has been steadily losing population since then. The current estimate for Michigan's 2009 population at 9,969,727 is only 0.3% above the 2000 Census figure of 9,938,444. In comparison, the U.S. population is estimated to have grown 9.1% over the 2000-2009 period. Virtually all of the decline in Michigan's population has occurred during the current U.S. recession -- which has witnessed a dramatic collapse in manufacturing employment, record-setting declines in housing, employment and retail sales, and the bankruptcy of General Motors and Chrysler.

As of the writing of this article, inter-census estimates of local unit populations by the U.S. Bureau of the Census are available through 2008. While Michigan's total population for 2008 is only 0.7% more than it was in 2000, the population change for some local units is quite substantial and extreme variation exists between local units. Approximately 13 local units exhibited population increases estimated at 50.0% or more between 2000 and 2008, while approximately 79 local units exhibited population declines exceeding 10.0%.

In order to estimate 2010 revenue sharing populations for individual local units, the 2008 estimate for each local unit was adjusted by the unit's average annual growth rate between 2006 and 2008. On a statewide basis, as the national economy slid into recession during late 2007, Michigan's population exhibited a substantially different trend than it had shown earlier in the decade. Michigan's population is estimated to have grown in every year between 2000 and 2005. During 2006, Michigan's population essentially remained flat -- declining a negligible 0.09%. However, statewide population figures fell 0.34% in 2007 and an additional 0.46% in 2008. As a result, given the Michigan economy during 2009 and early 2010, the 2008 estimates are assumed to change by the average rate of change over the 2006-2008 period, compounded for two years, in producing estimates of 2010 revenue sharing populations.

Under the Senate Fiscal Agency projections for 2010 local unit populations, some local units exhibit very drastic swings relative to the 2000 populations: 17 local units exhibit population increases of more than 50.0%, and 70 units exhibit increases of more than 25.0%, while 138 local units exhibit population declines of more than 10.0%. Michigan, as a whole, is estimated to have lost 0.1% of population over the decade, with the population in cities declining 5.0%, township populations increasing 5.6%, and village populations falling 0.9%.

The Effect of the 2010 Census on Revenue Sharing Payments

Because the total population of the State is approximately the same as it was a decade ago, the implementation of the 2010 Census population figures is not likely to result in a meaningful change in the per-person revenue sharing payment under the constitutional provisions. As a result, local units with a population increase of 50.0% or more will likely experience a 50.0%-plus increase in their constitutional revenue sharing payments, while units with declines of 10.0% or more will experience declines of 10.0% or more in their constitutional payments.

In aggregate, based on the May 2010 consensus revenue estimates, these changes mean that constitutional revenue sharing payments to cities will decline by approximately $15.6 million relative to current estimates, with the City of Detroit accounting for $2.9 million of that loss. Constitutional revenue sharing payments to villages are expected to decline by $0.3 million, while constitutional payments to townships should rise by $15.9 million. Counties do not receive constitutional revenue sharing payments.

The impact of the 2010 Census on statutory revenue sharing payments (and thus total revenue sharing to local units of government) largely depends on the distribution formula that is enacted for FY 2010-11. For cities, villages and townships (CVTs), the Governor's budget recommendation would freeze the combined total of statutory and constitutional payments to each local unit at a level equal to that unit's combined total during FY 2009-10. The House-passed appropriation would grant each city, village, and township a 1.0% increase in total payments, while the Senate-passed version would cut each by 5.0%. The effect of the 2010 Census on each of these proposals is discussed separately below.

The Governor's FY 2010-11 Recommendation

As indicated earlier, under current estimates, approximately 1,207 CVTs are not expected to receive any statutory payment during FY 2009-10. Under the Governor's FY 2010-11 recommendation, these CVTs (mostly townships) would experience an increase in their payments of 1.3% given current populations and revenue estimates, but under the 2010 population estimates, the average increase would be 8.5%. However, not all of these units would experience an increase in their constitutional payment. While one of these units, Fife Lake Township in Grand Traverse County, would realize a 123.7% increase, Webber Township in Gratiot County would see a 25.8% decrease in its constitutional revenue sharing payment. If all local units are examined (not just those expected to receive no statutory payment during FY 2009-10), the spread between the largest and smallest growth in constitutional payments remains unchanged, mirroring the population changes described above.

The Governor's budget recommendation specifies that each local unit should receive the same combined constitutional and statutory revenue sharing payment during FY 2010-11 as the unit received during FY 2009-10. For CVTs still receiving a statutory payment and experiencing a population increase, this means that their statutory payment would be reduced for every dollar that their constitutional payment increases as a result of the new census counts (assuming statutory payments would be sufficient to offset the constitutional increases). For units losing population, whether they currently receive a statutory payment or not, the recommendation would hold them harmless for any reductions reflecting the new census figures.

Because some local units do not receive statutory payments currently, the Governor's budget recommendation would create an asymmetry in the budget. A portion of CVTs will, pursuant to the State Constitution, receive larger constitutional revenue sharing payments but there would be no statutory payments to offset the increase. However, the language regarding statutory revenue sharing payments would attempt to hold any local unit that loses population harmless for the decline. As a result, if the Governor's recommendation were enacted and the current revenue estimates are accurate, the appropriation would be approximately $20.6 million less than needed to make the specified payments. Holding CVTs harmless for population declines would result in statutory payments to an additional 417 local units that do not currently receive statutory payments.

While the Governor's recommendation would ensure that no local unit would receive less in revenue sharing funds during FY 2010-11 than in FY 2009-10, assuming the additional $20.6 million was appropriated, considerable variation would exist between local units in their year-to-year changes. Approximately 1,087 local units would experience no change in their total revenue sharing payments between FY 2009-10 and FY 2010-11, while 71 local units would experience increases of 25.0% or more (and one would see an increase of 123.7%). A summary of the impact of the 2010 Census on the Governor's recommendation is presented in Table 1.

Table 1

Effect of 2010 Census on FY 2010-11 Revenue Sharing Payments
Appropriation as Recommended by the Governor
(Dollars in Millions)

		FY 2010-11 Governor's Recommendation						
			Change from FY 2009-10			Change from FY 2009-10		
	Current FY 2009-10 Estimate	Current Estimate	Dollar	Percent	Projected Revision	Dollar	Percent	Difference Due to Census
Sales Tax Constitutional:								
Counties	$0.0	$0.0	$0.0	---	$0.0	$0.0	---	$0.0
Cities, Villages, & Townships								
Cities	325.2	329.4	4.2	1.3%	313.1	(12.2)	(3.7)%	(16.3)
Detroit	59.9	60.7	0.8	1.3	57.8	(2.1)	(3.5)	(2.9)
Townships	282.9	286.5	3.6	1.3	303.0	20.1	7.1	16.5
Villages	17.4	17.6	0.2	1.3	17.5	0.1	0.5	(0.1)
Subtotal CVTs	625.5	633.5	8.0	1.3	633.5	8.0	1.3	(0.0)
Subtotal Constitutional	**$625.5**	**$633.5**	**$8.0**	**1.3%**	**$633.5**	**$8.0**	**1.3%**	**($0.0)**
Sales Tax Statutory:								
Counties	$55.3	$114.7	$59.4	107.5%	$114.7	$59.4	107.5%	$0.0
Cities, Villages, & Townships								
Cities	300.2	296.0	(4.1)	(1.4)	313.4	13.3	4.4	17.4
Detroit	179.3	178.5	(0.8)	(0.4)	181.4	2.1	1.2	2.9
Townships	7.1	6.4	(0.7)	(9.4)	9.1	2.0	28.7	2.7
Villages	4.8	4.6	(0.2)	(4.2)	5.1	0.3	6.1	0.5
Subtotal CVTs	312.1	307.1	(5.0)	(1.6)	327.6	15.6	5.0	20.6
Subtotal Statutory	**$367.3**	**$421.8**	**$54.5**	**14.8%**	**$442.4**	**$75.0**	**20.4%**	**$20.6**
Total Restricted Revenue Sharing	**$992.8**	**$1,055.3**	**$62.5**	**6.3%**	**$1,075.9**	**$83.1**	**8.4%**	**$20.6**
Counties	55.3	114.7	59.4	107.5	114.7	59.4	107.5	0.0
Cities, Villages, & Townships								
Cities	625.4	625.4	0.0	0.0	626.5	1.1	0.2	1.1
Detroit	239.2	239.2	(0.0)	(0.0)	239.2	(0.0)	(0.0)	(0.0)
Townships	289.9	292.9	3.0	1.0	312.0	22.1	7.6	19.1
Villages	22.2	22.2	0.0	0.1	22.6	0.4	1.7	0.4
Subtotal CVTs	937.5	940.5	3.0	0.3	961.1	23.6	2.5	20.6
Special Census Payments (Gen'l Fund)	**$0.0**	**$0.0**	**$0.0**	**---**	**$0.0**	**0.0**	**---**	**$0.0**
Total Revenue Sharing	**$992.8**	**$1,055.3**	**$62.5**	**6.3%**	**$1,075.9**	**$83.1**	**8.4%**	**$20.6**

Notes: Estimates for FY 2009-10 and FY 2010-11 are based on consensus sales tax estimates adopted at the May 2010 Consensus Revenue Estimating Conference.
County payments reflect payments made to hold counties harmless for the depletion of revenue sharing reserve funds created as part of the FY 2004-05 budget.

House-Passed FY 2010-11 Appropriation

Because the distribution of constitutional revenue sharing payments is controlled by the State Constitution, constitutional payments under the House-passed appropriation are identical to those under the Governor's recommendation. The same is true for the distribution of those payments after the 2010 Census counts are implemented.

The House-passed appropriation specifies that each local unit should receive, in combined constitutional and statutory revenue sharing payments, a 1.0% increase above combined constitutional and statutory revenue sharing payments received during FY 2009-10. As with the Governor's recommendation, for CVTs still receiving a statutory payment and experiencing a population increase, this means that their statutory payment would be reduced for every dollar that their constitutional payment increases as a result of the new census counts (assuming statutory payments would be sufficient to offset the constitutional increases). For units losing population, whether they currently receive a statutory payment or not, the recommendation would hold them harmless for any reductions reflecting the new census figures.

As a result, the same sort of asymmetry in payments as described under the Governor's recommendation would occur, and if the House-passed appropriation were enacted and the current revenue estimates are accurate, the appropriation would be approximately $21.2 million less than needed to make the specified payments. Holding CVTs harmless for population declines would result in statutory payments to an additional 526 local units that do not currently receive statutory payments.

While the House-passed appropriation would ensure that all local units would receive at least a 1.0% increase in revenue sharing funds between FY 2010-11 and FY 2009-10, assuming the additional $21.1 million was appropriated, considerable variation would exist between local units in their year-to-year changes. Approximately 1,161 local units would experience no change in their total revenue sharing payments between FY 2009-10 and FY 2010-11, while 71 local units would experience increases of 25% or more (and one would see an increase of 123.7%). A summary of the impact of the 2010 Census on the House-passed appropriation is presented in Table 2.

Table 2

Effect of 2010 Census on FY 2010-11 Revenue Sharing Payments
Appropriation as Passed by the House
(Dollars in Millions)

		FY 2010-11 House-Passed Recommendation						
			Change from FY 2009-10			Change from FY 2009-10		
	Current FY 2009-10 Estimate	Current Estimate	Dollar	Percent	Projected Revision	Dollar	Percent	Difference Due to Census
Sales Tax Constitutional:								
Counties	$0.0	$0.0	$0.0	---	$0.0	$0.0	---	$0.0
Cities, Villages, & Townships								
Cities	325.2	329.4	4.2	1.3%	313.1	(12.2)	(3.7)%	(16.3)
Detroit	59.9	60.7	0.8	1.3	57.8	(2.1)	(3.5)	(2.9)
Townships	282.9	286.5	3.6	1.3	303.0	20.1	7.1	16.5
Villages	17.4	17.6	0.2	1.3	17.5	0.1	0.5	(0.1)
Subtotal CVTs	625.5	633.5	8.0	1.3	633.5	8.0	1.3	(0.0)
Subtotal Constitutional	**$625.5**	**$633.5**	**$8.0**	**1.3%**	**$633.5**	**$8.0**	**1.3%**	**($0.0)**
Sales Tax Statutory:								
Counties	$55.3	$114.7	$59.4	107.5%	$114.7	$59.4	107.5%	$0.0
Cities, Villages, & Townships								
Cities	300.2	$302.3	$2.1	0.7	$319.6	$19.4	6.5	17.3
Detroit	179.3	180.9	1.6	0.9	183.8	4.5	2.5	2.9
Townships	7.1	7.0	(0.1)	(1.2)	10.2	3.2	45.2	3.3
Villages	4.8	4.8	0.0	0.1	5.3	0.5	10.3	0.5
Subtotal CVTs	312.1	314.1	2.0	0.6	335.1	23.1	7.4	21.1
Subtotal Statutory	**$367.3**	**$428.8**	**$61.5**	**16.7%**	**$449.9**	**$82.5**	**22.5%**	**$21.1**
Total Restricted Revenue Sharing	**$992.8**	**$1,062.3**	**$69.5**	**7.0%**	**$1,083.4**	**$90.6**	**9.1%**	**$21.1**
Counties	55.3	114.7	59.4	107.5	114.7	59.4	107.5	0.0
Cities, Villages, & Townships								
Cities	625.4	631.6	6.3	1.0	632.6	7.2	1.2	1.0
Detroit	239.2	241.6	2.4	1.0	241.6	2.4	1.0	0.0
Townships	289.9	293.5	3.5	1.2	313.2	23.3	8.0	19.7
Villages	22.2	22.4	0.2	1.0	22.8	0.6	2.6	0.4
Subtotal CVTs	937.5	947.5	10.0	1.1	968.6	31.1	3.3	21.1
Special Census Payments (Gen'l Fund)	**$0.0**	**$0.0**	**$0.0**	**---**	**$0.0**	**$0.0**	**---**	**$0.0**
Total Revenue Sharing	**$992.8**	**$1,062.3**	**$69.5**	**7.0%**	**$1,083.4**	**$90.6**	**9.1%**	**$21.1**

Notes: Estimates for FY 2009-10 and FY 2010-11 are based on consensus sales tax estimates adopted at the May 2010 Consensus Revenue Estimating Conference.
County payments reflect payments made to hold counties harmless for the depletion of revenue sharing reserve funds created as part of the FY 2004-05 budget.

Senate-Passed FY 2010-11 Appropriation

As indicated earlier, the nature of constitutional revenue sharing payments means that constitutional payments will be the same under the Senate-passed appropriation as under the House-passed appropriation and the Governor's recommendation. Implementation of the 2010 Census counts will change the payments from what is currently estimated with the 2000 Census counts, but not from what they would be under a different appropriation.

The Senate-passed appropriation specifies that each local unit should receive, in combined constitutional and statutory revenue sharing payments, a 5.0% decrease from combined constitutional and statutory revenue sharing payments received during FY 2009-10. As with the Governor's recommendation and the House-passed appropriation, for CVTs still receiving a statutory payment and experiencing a population increase, this means that their statutory payment would be reduced for every dollar that their constitutional payment increases as a result of the new census counts (assuming statutory payments would be sufficient to offset the constitutional increases). For units losing population, whether they currently receive a statutory payment or not, the recommendation would hold them harmless for any reductions reflecting the new census figures.

As a result, the same sort of asymmetry in payments as described under the other two appropriation options would occur, and if the Senate-passed appropriation were enacted and the current revenue estimates are accurate, the appropriation would be approximately $19.2 million less than needed to make the specified payments. Holding CVTs harmless for population declines would result in statutory payments to an additional 109 local units that do not currently receive statutory payments.

While the Senate-passed appropriation would ensure that all local units' total revenue sharing payments would change by no more than -5.0% between FY 2010-11 and FY 2009-10, assuming the additional $19.2 million was appropriated, considerable variation would exist between local units in their year-to-year changes. Approximately 633 local units would experience no change in their total revenue sharing payments between FY 2009-10 and FY 2010-11, while 71 local units would experience increases of 25.0% or more (and the same unit mentioned above still would increase 123.7%). A summary of the impact of the 2010 Census on the Senate-passed appropriation is presented in Table 3.

Table 3

Effect of 2010 Census on FY 2010-11 Revenue Sharing Payments
Appropriation as Passed by the Senate
(Dollars in Millions)

		FY 2010-11 Senate-Passed Recommendation						
			Change from FY 2009-10			Change from FY 2009-10		
	Current FY 2009-10 Estimate	Current Estimate	Dollar	Percent	Projected Revision	Dollar	Percent	Difference Due to Census
Sales Tax Constitutional:								
Counties	$0.0	$0.0	$0.0	---	$0.0	$0.0	---	$0.0
Cities, Villages, & Townships								
Cities	325.2	329.4	4.2	1.3%	313.1	(12.2)	(3.7)%	(16.3)
Detroit	59.9	60.7	0.8	1.3	57.8	(2.1)	(3.5)	(2.9)
Townships	282.9	286.5	3.6	1.3	303.0	20.1	7.1	16.5
Villages	17.4	17.6	0.2	1.3	17.5	0.1	0.5	(0.1)
Subtotal CVTs	625.5	633.5	8.0	1.3	633.5	8.0	1.3	(0.0)
Subtotal Constitutional	**$625.5**	**$633.5**	**$8.0**	**1.3%**	**$633.5**	**$8.0**	**1.3%**	**($0.0)**
Sales Tax Statutory:								
Counties	$55.3	$109.0	$53.7	97.1%	$109.0	$53.7	97.1%	$0.0
Cities, Villages, & Townships								
Cities	300.2	265.3	(34.8)	(11.6)	283.1	(17.1)	(5.7)	17.7
Detroit	179.3	166.5	(12.7)	(7.1)	169.4	(9.9)	(5.5)	2.9
Townships	7.1	4.3	(2.8)	(39.2)	5.3	(1.8)	(25.5)	1.0
Villages	4.8	3.6	(1.2)	(24.7)	4.1	(0.7)	(14.3)	0.5
Subtotal CVTs	312.1	273.3	(38.8)	(12.4)	292.5	(19.6)	(6.3)	19.2
Subtotal Statutory	**$367.3**	**$382.3**	**$14.9**	**4.1%**	**$401.5**	**$34.1**	**9.3%**	**$19.2**
Total Restricted Revenue Sharing	**$992.8**	**$1,015.8**	**$23.0**	**2.3%**	**$1,034.9**	**$42.1**	**4.2%**	**$19.2**
Counties	55.3	109.0	53.7	97.1	109.0	53.7	97.1	0.0
Cities, Villages, & Townships								
Cities	625.4	594.7	(30.6)	(4.9)	596.1	(29.3)	(4.7)	1.4
Detroit	239.2	227.2	(12.0)	(5.0)	227.2	(12.0)	(5.0)	(0.0)
Townships	289.9	290.8	0.9	0.3	308.2	18.3	6.3	17.4
Villages	22.2	21.2	(1.0)	(4.4)	21.6	(0.6)	(2.7)	0.4
Subtotal CVTs	937.5	906.8	(30.8)	(3.3)	925.9	(11.6)	(1.2)	19.2
Special Census Payments (Gen'l Fund)	**$0.0**	**$0.0**	**$0.0**	**---**	**$0.0**	**$0.0**	**----**	**$0.0**
Total Revenue Sharing	**$992.8**	**$1,015.8**	**$23.0**	**2.3%**	**$1,034.9**	**$42.1**	**4.2%**	**$19.2**

Notes: Estimates for FY 2009-10 and FY 2010-11 are based on consensus sales tax estimates adopted at the May 2010 Consensus Revenue Estimating Conference.
County payments reflects payments made to hold counties harmless for the depletion of revenue sharing reserve funds created as part of the FY 2004-05 budget.

Equity Issues and Conclusion

For much of the last decade, the distribution of revenue sharing payments has been based on the total of constitutional and statutory revenue sharing payments received by each local unit during the prior year. The rationale behind this approach was that, because generally revenue sharing payments were being limited to address budget problems, all local units would be treated the same and thus share the burden of any reductions in equal proportion. This approach ran counter to the approach used in making annual revenue sharing distributions in previous decades, when variations in taxing authority, property values, retail sales, and appropriations could cause significant year-to-year changes (both positive and negative) in a unit's payments, despite constitutional payments' being based on a fixed population count for 10 years at a time.

However, as this "uniform" approach to handling reductions continued, it became impossible to treat all units the same. As long as the distribution formula limited growth in total payments to a rate less than the increase in sales tax revenue, which occurred in every year the uniform approach was used, the distribution formula would reduce or even eliminate statutory revenue sharing payments. As indicated above, more than 1,200 local units no longer receive statutory revenue sharing. Under current estimates for FY 2009-10, statutory payments to the 30 largest local units (those with the 30 largest statutory payments, not the largest populations) account for approximately 82.1% of total statutory revenue sharing. Units that no longer receive statutory payments generally have experienced increases in revenue sharing payments, as growth in retail sales has increased constitutional payments, while other local units have remained flat or experienced reduced payments.

All of the proposed distribution formulas for FY 2010-11 would attempt to retain this "uniform" approach to distributing revenue sharing payments although in reality very little uniformity will result when the 2010 Census counts are implemented. As discussed earlier, population changes from the 2010 Census will result in much larger swings in payments than experienced previously. Sales tax collections are expected to increase roughly 1.3%, but nearly six dozen local units will experience more than 25.0% growth in revenue sharing payments.

The uniformity provisions also will result in a number of inconsistencies in the payments received by local units. Some local units that experience population growth will see commensurate increases in their revenue sharing payments, while others will experience no change at all -- losing statutory payments on a dollar-for-dollar basis as constitutional payments increase. Other local units with population increases will fare between these two extremes. Similarly, for units losing population, some will be held harmless for those declines while others will experience declines commensurate with their population changes.

In summary, the 2010 Census will drastically change the distribution of revenue sharing payments across local units regardless of which of the current proposals is adopted. Furthermore, once the new counts are adopted, all of the current proposals will have an insufficient appropriation to fund payments as specified in law, as shown in Table 4. If supplemental appropriations are not made to sufficiently fund required payments, none of the proposals offer language to address any shortfall. Policy-makers will need to address not only these budget issues, but distributional issues as well, including the extent that payments should change to reflect population changes that have occurred over the last decade.

Table 4

2010 Census Impact on FY 2010-11 Revenue Sharing
Effect on Appropriation Proposals Compared
(Dollars in Millions)

	Governor's Recommendation	House-Passed	Senate-Passed
Current Estimates			
Constitutional	$633.5	$633.5	$633.5
Statutory	421.8	428.8	382.3
Total	**$1,055.3**	**$1,062.3**	**$1,015.8**
Projected Revision			
Constitutional	$633.5	$633.5	$633.5
Statutory	442.4	449.9	401.5
Total	**$1,075.9**	**$1,083.4**	**$1,034.9**
Change			
Constitutional	($0.0)	($0.0)	($0.0)
Statutory	20.6	21.1	19.2
Total	**$20.6**	**$21.1**	**$19.2**
Statutory Shortfall	**$20.6**	**$21.1**	**$19.2**

State Notes

TOPICS OF LEGISLATIVE INTEREST

Summer 2010

Solvency of Unemployment Compensation Fund – An Update
By Elizabeth Pratt and Maria Tyszkiewicz, Fiscal Analysts

The unprecedented 10-year economic downturn in Michigan and resulting job losses greatly increased the cost of the State's Unemployment Insurance program, which is financed by taxes on Michigan employers. Between June 2001 and June 2008, employment of people covered by unemployment insurance in Michigan declined by about 391,000. Over the next 13 months, to July 2009, covered employment fell by another approximately 450,000 jobs, more than doubling the job losses of the previous seven-year period. In 2009, benefit payments cost as much as $94.0 million per week.

These extraordinary costs exceeded the funds available in Michigan's Unemployment Compensation Fund to pay benefits, resulting in the need to borrow from the Federal government. This borrowing started in 2006, initially for cash flow loans to bridge the gap between tax collections and payments. By 2008, however, benefit payments far exceeded tax collections and Michigan began borrowing from the Federal government in order to cover the cost of unemployment benefits. In the span of two and a half years, the State has accumulated outstanding loans totaling over $3.8 billion as of August 12, 2010. While Michigan has borrowed for this purpose during past economic downturns, the current outstanding balance is greater than at any time in history, with the largest previous outstanding loan balance being $2.3 billion in 1983.

Loans from the Federal Unemployment Trust Fund are available to states for payment of benefits. They do, however, accrue interest. The American Recovery and Reinvestment Act (ARRA) of 2009 provided states a two-year forbearance on repayment and accrual of interest on these loans. This interest-free period ends December 31, 2010. In the absence of another reprieve from the Federal government or qualifying for a temporary waiver, the first interest payment of approximately $140.0 million will be due September 30, 2011. Identifying funds available to make this payment is a major budgetary challenge. The terms of the Federal loan prevent using the Unemployment Compensation Fund (the benefit account) for interest payments. Other funds, such as solvency tax revenue and contingent fund, penalty and interest account (discussed below) are insufficient to pay the obligation, resulting in a possible budget gap estimated at $91.2 million in FY 2010-11.

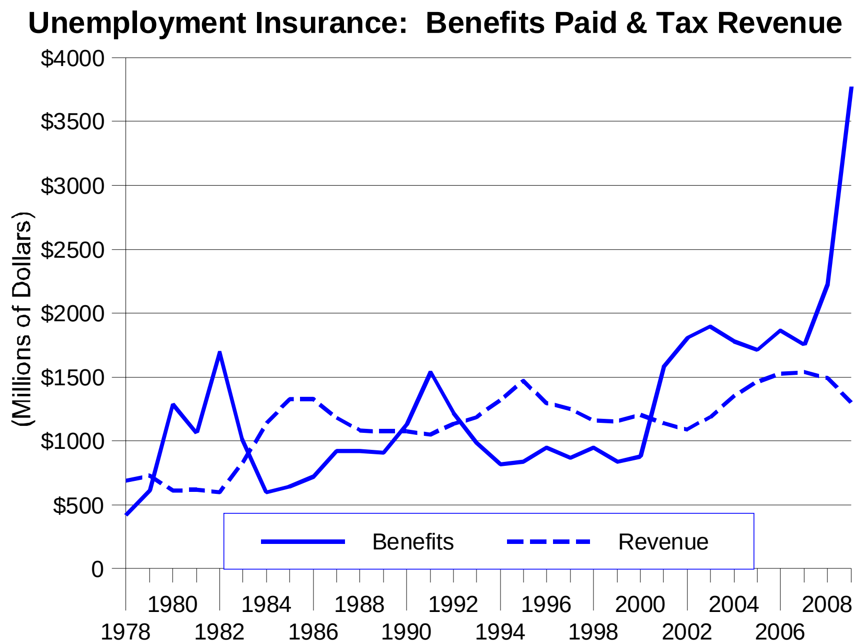
This article updates a previous paper on the solvency of the Unemployment Compensation Fund (Senate Fiscal Agency, State Notes, November/December 2008) including the history of borrowing to pay benefits, the expected additional tax costs to employers, and possible options for meeting the large interest payments that the State will incur until the Federal loans are repaid. Background on benefits including Federally funded extended benefit programs, is in Appendix 1 and a description of the State unemployment tax structure can be found in Appendix 2.

State Unemployment Compensation Fund Balance

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.

Figure 1

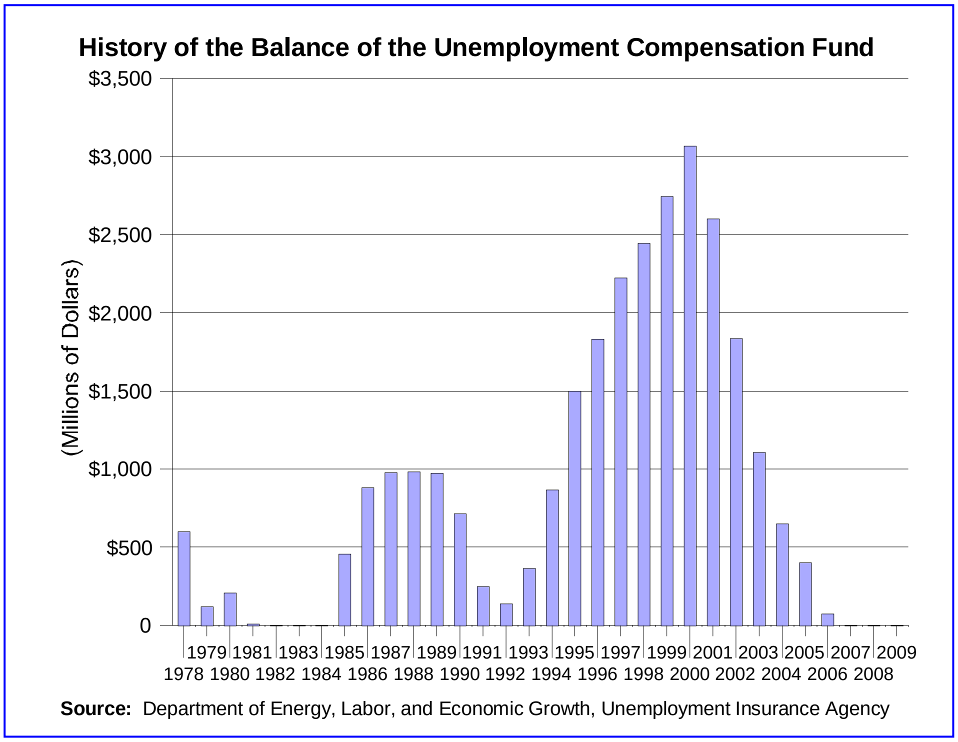


Source: Department of Energy, Labor, and Economic Growth, Unemployment Insurance Agency

Currently, Michigan is in the 10th consecutive year of benefit payments exceeding revenue, the longest such period 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 2000. By the middle of 2008, that balance had been completely eliminated.

A number of factors have contributed to the decline in the Unemployment Compensation Fund balance. First, Michigan's unemployment rate increased from its lowest level, 3.8% in 1999-2000, to a peak of 14.5% (as adjusted by the U.S. Bureau of Labor Statistics) in December 2009, and to the recent level of 13.2% in June 2010. This increase in the unemployment rate over an extended period of 10 years has led to an increase in unemployment compensation expenditures. Although revenue grew during most of the recent decade, tax collections declined in 2008 and 2009, increasing the gap between tax revenue and benefit payments. 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 declined, the higher average tax rates were applied to a diminished total amount of taxable wages, further constraining revenue growth. The UIA notes that for the most recent three quarters, tax collections were higher than the same quarter in the prior year and Federal loans have not increased since April 2010.

Figure 2



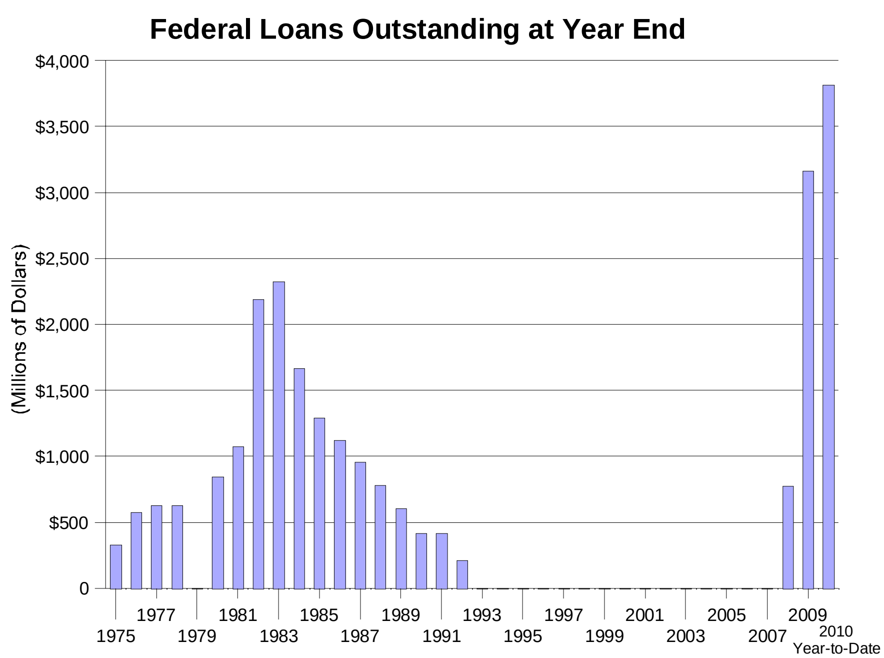
Other factors contributing to the current imbalance are the policy changes made to the Michigan Employment Security Act by Public Act (PA) 192 of 2002. These changes affected both the taxes paid by employers and the benefits paid to recipients. The first of the two tax changes affected the taxable wage amount. The 2002 Act reduced the tax base from the first $9,500 of an employee's wages to the first $9,000. The second tax change lowered the minimum rate charged to an employer for the Nonchargeable Benefits Component. Before this Act was passed, the minimum Nonchargeable Benefits Component 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 PA 192 that affected the balance in the Fund, was the increase in the maximum benefit payment to eligible recipients from $300 to $362 per week. (Appendix 1 contains background on unemployment benefits and Appendix 2 describes the State and Federal unemployment tax and credit system.)

The Unemployment Insurance Agency (UIA) has estimated that, through 2008, the 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 in excess of $1.0 billion. The revenue decline, increased benefit, 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 when tax receipts are higher and benefits are lower. The amount and timing of the State's unemployment tax revenue and benefit payments have required the State to take advantage of these Federal loans many times. The State has borrowed previously 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.

Figure 3



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

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. 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. By December 31, 2008, the outstanding loan balance was $772.5 million, with borrowing continuing through 2010. The cash from tax receipts reduces temporarily the need for loans, but due to the poor economic conditions and the auto industry decline in 2009, the State tripled its borrowing from the Federal government in 2009 compared with 2008.

In 2010, the State borrowed to pay benefits until the first quarterly tax collections were received. Based on forecasted economic conditions, the UIA estimates that no additional borrowing will be necessary this year. As of August 12, 2010, the outstanding loan balance was $3,814,145,991.

Loan Repayment

Due to the outstanding loan balance the State has with the Federal government, current Federal and State law requires the imposition of two additional taxes. These are an increase in the Federal Unemployment Tax Act (FUTA) rate in order to raise additional funds to retire the principal of the debt, and the imposition of the State Solvency Tax, pursuant to State law, to raise revenue to assist in paying the interest costs on that debt.

Pursuant to Federal law, the FUTA tax rate credit of 5.4% (described in Appendix 2) previously received by Michigan employers was reduced by 0.3%, effective for the 2009 tax year and payable beginning in 2010. This effective tax rate increase applied to all contributing employers, with a cost of approximately $21 per covered employee. The tax increase is offset, however, by a State tax reduction for positive balance employers of one-half of the extra FUTA tax paid in the prior calendar year. This credit is capped at the nonchargeable benefits component of the tax rate, which varies between 0.06% and 1.0% of taxable wages. 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 had 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. Each year the credit will be reduced by 0.3% until the entire 5.4% credit is eliminated or the loan balance is repaid. The UIA has estimated that employers will be paying the increased FUTA tax for the next 10 years, reducing the tax credit by 3.3%.

There also is the potential that additional credit reductions, on top of the 0.3% credit reduction, could be applied by the Federal government. These could be applied in year three and four and beyond if an outstanding loan still exists. These FUTA credit reductions can be limited to 0.6% of wages or the reduction from a previous year (0.3% per year) whichever is higher for states that meet certain criteria including no changes in the tax effort or solvency of the fund and a requirement that the state tax rate is at least equal to the average benefit/cost ratio computed over a five-year period. This ratio is the quotient of all unemployment benefits paid by contributing employers (including extended benefits) divided by the total wages paid by contributing employers. The loan balance also must be equal to or less than the amount prior to the third year of repayment.

In addition to repaying the principal, the Federal government requires states to pay interest on Federal Unemployment Account 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 unemployment insurance administration.

An interest payment estimated at $140.0 million will be due September 30, 2011, unless the State qualifies for a waiver or interest forebearance is extended by the Federal government.

State solvency tax revenue and the balance in the Contingent Fund, Penalty and Interest Account are expected to cover only a portion of this payment.

Under previous State law, the State solvency tax would have become effective for calendar year 2009 to raise funds to pay interest on the debt. Due to the Federal forbearance on the outstanding loans, the statute was amended in March 2009, to delay levying this tax. Pursuant to current law (MCL 421.19a), and without additional forbearance from the Federal government, the UIA will begin levying the State solvency tax on certain employers in calendar year 2011. This tax will raise additional funds to help pay for the cost of borrowing. The tax will apply only to those contributing employers that have a negative balance in their experience accounts as of June 30, 2010; that is, employers for which benefits paid to covered employees exceeded unemployment contributions by those employers will pay the solvency tax. 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 28.0% of active 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 equates to $67.50 per employee for employers with a negative balance. The UIA has estimated that the solvency tax assessments will total approximately $39.0 million in FY 2010-11. By statute, the revenue is deposited into the Unemployment Insurance Contingent Fund to be used only to pay the interest on Federal loans. Even with this tax revenue, there still will be an imbalance of approximately $101.0 million between the funds available and the projected interest liability due at the end of FY 2010-11.

Another possible source of funds to pay a portion of the interest due is the Contingent Fund Penalty and Interest Account which was created in PA 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 UIA, including the payment of interest on Federal loans. The balance in the Contingent Fund Penalty and Interest Account has been reduced in recent years. 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, beginning in FY 2001-02 PA 192 of 2002 restricted the balance of the Fund to $15.0 million, requiring any overage to be deposited into the Unemployment Compensation Fund where it was available for the payment of current benefits. Another transfer of $10.0 million from the Contingent Fund Penalty and Interest Account to the General Fund was made pursuant to PA 84 of 2003 in FY 2003-04. The $15.0 million restriction forced a transfer of $10.8 million to the Trust Fund at the close of FY 2007-08. Transfers to the Compensation Fund reduced borrowing, but if those funds had remained in the Contingent Fund, they could have been available for the impending interest payments on the outstanding loans.

Money from the Contingent Fund Penalty and Interest Account also has been spent for administrative costs within the Bureau of Workers' Compensation due to 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 used to fund the same line items. This use of the Contingent Fund Penalty and Interest Account to save GF/GP was limited when monies from this Fund became necessary to pay interest on Federal loans. 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 and $7.2 million paid in September 2008. In FY 2008-09, a fund shift added $9.4 million in General Fund/General Purpose (GF/GP) revenue to pay certain Department of Energy, Labor, and Economic Growth (DELEG) administrative costs with General Fund revenue and reduce use of the Contingent Fund Penalty and Interest Account, making that account available for possible interest payments. Because of the Federal forbearance on these payments in 2009, as discussed earlier, no interest payment has been made since 2008. 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 the 2008 interest payment. The balance in the Contingent Fund Penalty and Interest Account at the close of FY 2008-09 was $10.8 million. Estimates for FY 2009-10 include a projection that the Fund will be required to deposit $2.6 million at the close of the fiscal year to the Unemployment Trust Fund to comply with the $15.0 million cap set on the Fund. This reduces the amount the State has available to pay the future interest costs.

It is possible that the current Federal forbearance on the accrual of interest on these loans could be extended. According to the U.S. Department of Labor, there are 32 states that will be required to make interest payments in 2011. Because of the large number of states that would be affected there may be interest at the Federal level to delay or forgive these costs.

Another option available under Federal law is a nine-month grace period that would delay the first interest payment due. To qualify, Michigan must obtain approval from the US Department of Labor by demonstrating an average total unemployment rate of 13.5% or higher over the previous 12 months for which data are available. No interest would accrue on the postponed interest payment. Obtaining this waiver would push the due date for the first interest payment to June 30, 2012. Depending on economic conditions, Michigan might qualify for this waiver.

Currently the only revenue expected to be available to pay the interest cost in FY 2010-11 are the $39.0 million of solvency tax revenue and an estimated $9,804,400 available from the Contingent Fund. This leaves an unfunded gap of approximately $91.2 million that must be resolved before September 30, 2011, when the interest will first come due, absent another Federal extension or forbearance. This also could have a significant impact on subsequent State budgets. MCL 421.19a(3) states that if the solvency tax revenue is insufficient to pay the Federal interest due in any year, the UIA shall recommend that the Legislature appropriate the funds needed. The statute also states that if any such appropriations are made, these amounts are required to be repaid with interest to the State as soon as possible from solvency tax revenue. The Legislature likely will have to decide whether to attempt to appropriate GF/GP revenue to pay future interest costs, or to pursue other policy changes such as an increase in the solvency tax to fund the required interest payment or the removal of the $15.0 million cap on the balance in the Contingent Fund Penalty and Interest Account. The UIA projects that interest and principal payments will continue for 10 years. Thus, taking even a portion of the interest expenses onto the General Fund budget could have long-term consequences for the State budget.

Conclusion

The insolvency in the Unemployment Compensation Fund not only will affect employers through higher tax rates, but also will affect other taxpayers, as the solvency tax revenue will be insufficient to meet the estimated $140.0 million in interest due on the outstanding Federal loans for FY 2010-11, plus future obligations. It is estimated that funds available for the FY 2010-11 interest payments consist of approximately $39.0 million from the solvency tax and about $9.8 million from the Contingent Fund, Penalty and Interest Account, leaving an unfunded interest obligation of approximately $91.2 million in FY 2010-11.

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. This could include increasing the taxable wage base from the current level of $9,000, which is lower than the base level in 26 states. Michigan could join the 17 other states that index the taxable wage base to the average level of wages, a policy that reduces the likelihood of insolvency. 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.

This is not the first time that Michigan has had to borrow to meet unemployment benefit obligations, but it is the longest period in which net withdrawals from the Fund have persisted, causing the deficit to worsen as the economy has deteriorated. 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.

Appendix 1

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 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 (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 is available for full-time employment. For the week of July 12, 2010, Michigan had 165,000 people collecting regular benefits.

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. During this recession, Michigan workers have qualified for Emergency Unemployment Compensation (EUC), temporary extended benefits programs enacted at the Federal level. These programs were 100% Federally funded. Under each program, Michigan workers who had exhausted their unemployment benefits were eligible to receive an additional 53 weeks of benefits. These extended benefits expire November 30, 2010. The UIA has estimated that in Michigan as of the week of June 12, 2010, Emergency Unemployment Compensation was paid to 210,000 people.

States also 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. Public Act 19 of 2009 changed the state threshold for eligibility for this program from the insured unemployment rate (IUR) to the total unemployment rate (TUR) for the period for which extended benefits were funded under ARRA. The IUR includes only those individuals who are collecting benefits, not the unemployed who are no longer receiving benefits. Under the law, if the TUR rate for the quarter is 6.5% or higher and 10.0% higher than the average rate for the same period in either of the last two years, then claimants are eligible for up to 13 weeks of benefits. However, if the TUR exceeds 8.0%, claimants are eligible for 20 weeks of benefits (80.0% of the 26 week regular benefit term). Michigan triggered on for these benefits in January 2009, first under the IUR trigger, and later through ARRA and Federal extensions, so the cost of these benefits has been borne solely by the Federal government. The final date for benefits under this program currently is November 30, 2010. When the Federal program expires, the statute requires that Michigan again go back to using the IUR as the rate for triggering these benefits. Under the statute, for these extended benefits to trigger on the IUR must be at least 5% and 120% of the average rate for the same 13-week period in each of the previous two years. The IUR as of June 26, 2010 is 4.26%, a rate that in the absence of the Federal program would be too low to trigger these benefits.

In addition to these extensions, ARRA provided an additional $25.00 to the weekly benefit. This program has expired, meaning that any new claimant filing for benefits after May 29, 2010, will not be eligible for these funds, although those individuals that are currently receiving State or Federal benefits will continue to receive this additional compensation through December 11, 2010, or until their benefits are exhausted, whichever comes first.

Appendix 2

Funding for Unemployment Insurance

Regular 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, the state's unemployment law and administrative practices are in conformity with Federal law, and the state does not have outstanding debt for payment of benefits. 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 unemployment insurance programs, cash-flow lending to states, known as Title XII loans, and extended benefits programs. In Michigan, PA 130 of 2009, which is the FY 2009-10 appropriation act for the DELEG, includes $124.3 million in Federal revenue for State administrative costs for the unemployment insurance program. In addition, ARRA provided an additional $84.4 million in 2009, which is available for expenditure through FY 2009-10.

The State Unemployment Compensation Fund is funded by employers through State unemployment taxes. 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, Indian tribes, and tribal units are reimbursing employers, however, Indian tribes and tribal units may request status as contributing employers. Nonprofit organizations 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 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 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 starting rate for new employers with no benefit history at 2.7% for regular employers and at a separately determined rate for new construction employers based on the average construction contractor rate as determined annually by the UIA. The rate components described above are phased in as the employers accumulate experience in the unemployment insurance system.