

Give Texas Back Its Money

by
William B. Conerly, Ph.D.

Although employment in Texas remains relatively steady, it's time for the state to do what it can to improve the labor market. One step to take is to demand that the federal government quit taxing Texas employment just to balloon the federal surplus. Texas sends about \$496.8 million a year to Washington, DC in the federal unemployment insurance tax, but only gets \$165.9 million back.

WHAT IS FUTA?

The federal unemployment insurance tax (called FUTA, after the Federal Unemployment Tax Act) is collected from employers in every state. Funds are sent by Texas employers to Washington, DC, and then returned to the state for administrative expenses of the Texas Workforce Commission. The money also provides trust funds for loans to states and for the "federal share" of extended benefits, a program that kicks in when unemployment is unusually high.

However, only 33 percent of the dollars collected from Texas find their way back home. The balance stays in federal trust funds to build up the total budget surplus. (All of this is separate from the state unemployment insurance tax, which goes into state unemployment insurance trust funds, which in turn provide the actual benefit payments.)

The federal government calculates FUTA tax revenue as part of its total income, while appropriations from the trust fund are counted as expenditures. In other words, returning these funds to the states reduces the federal surplus. Back in the days of deficit spending, members of Congress got in the habit of using FUTA revenues to cover deficits in other programs. They never lost their taste for taking money that they failed to spend for its designated purpose.

The FUTA tax is 0.6 percent of each employee's wages (up to \$7,000 of wages a year). Even worse, Congress added a 0.2 percent surtax to replenish the trust fund after the recession of 1973-75. The replenishment has been accomplished, but Congress still maintains the surtax, for a total tax rate of 0.8 percent. Why? To keep any federal surplus looking as large as possible.

WHAT'S WRONG WITH THE FEDERAL TRUST FUND?

The federal trust fund is created by a tax on jobs. The strategy that we have used to reduce cigarette and alcohol consumption – taxing them heavily – is also reducing employment. The only problem is that in a recession, we want more jobs, not fewer.

There is some logic in taxing employment to administer the unemployment insurance system. Where is the logic in collecting the taxes but not spending the money? It's a case of pure loss to Texas, with no offsetting benefits.

State efforts to help the unemployed are stifled by the FUTA system. The formula for distributing administrative funding from the federal trust fund to the states is based on workloads, such as processing claims, hearing appeals, and distributing checks. If a state were to do a better job of getting people back to work, it would lose funding. The system actually provides perverse incentives against better services to the unemployed.

HOW TO RETURN THE MONEY TO THE STATES

The first step in returning the money to the states is for the federal government to stop collecting it. After the 0.8 percent federal tax is eliminated, Texas could levy a tax of only 0.3 percent of wages and cover its own administrative expenses. The tax cut would come at a time when job creation is sorely needed.

Texas, like every other state, already collects unemployment insurance taxes from employers. It would be a simple matter to add on the state administrative tax. No extra forms or paperwork would be required of employers. The only change is that they would no longer have to file duplicative federal forms in addition to their state forms.

Returning the existing trust funds to the states is the second step. Texas' share of the federal trust funds is now about \$1.6 billion, almost

ten times the annual administrative expenses paid by the federal government. Texas could use its distribution from the federal trust fund to bolster the state unemployment trust fund, which pays the actual benefits to the unemployed. With that addition to the state trust fund, Texas could afford to delay

implementation of the new administrative tax until the recession is over.

In addition to paying for administrative expenses, some of the FUTA tax goes into a trust fund that provides loans to

states that run out of money in their state unemployment insurance fund. The last such loans were made in 1993. As a source of funds to the states, though, the federal trust fund is expensive. Interest is charged at a rate equal to federal borrowing costs.

States, however, can borrow at lower rates, because of the tax-exempt status of state debt. For example, on November 21, 2001, states were paying, on average, 2.49 percent on bonds of two-year maturity, while the federal government was paying 3.11 percent. So it is no deal to the states to be able to borrow from the federal government.

If a safety net is needed, states can agree to borrow and lend among themselves. Even during the worst recessions the positive trust fund balances of healthier states have exceeded the deficits of weaker states. Further, the federal government could just lend from the U.S. general fund to the states as an ultimate safety net.

The final function of FUTA is to provide the "federal share" of extended benefits. The extended benefits program increases the maximum duration of benefits up from the normal 26 weeks to 39 weeks. It goes into

State efforts to help the unemployed are stifled by the FUTA system... If a state were to do a better job of getting people back to work, it would lose funding. The system actually provides perverse incentives against better services to the unemployed.

effect when a state's unemployment rate increases to an abnormally high level. Officially, half the benefits come from the state, and half from the federal government. However, the federal half comes from money collected from the tax on jobs in every state. As such, there is no separate pot of funds for the federal expenditures: the money really comes from the states.

Most states got through the severe recession of the early 1980s with enough in their state reserves to cover their own share of extended benefits, as well as the federal share. Had the state trust funds been bolstered by money that actually went to FUTA, then even more states would have avoided the need to borrow from the federal government.

But what of those states that did need additional funds to get through the recession? Just as with the state benefits, extended benefits could be protected in three different ways:

- ★ interstate loan agreements
- ★ general borrowing, to be repaid by the state unemployment insurance trust fund when employment rebounds
- ★ loans directly from the federal government. It is not necessary for the federal government to sit on money to protect the states' ability to pay benefits.

THE BENEFITS OF RETURNING TRUST FUNDS TO THE STATES

Texas, and every other state, is likely to enjoy greater employment, at least to a small extent, from elimination of the FUTA tax. In addition, some states are likely to experiment with better ways to serve the unemployed, now that they will not be penalized in reduced administrative funding. Some of those

experiments will certainly work, and then be copied by other states. It's also possible that by spending more on helping the unemployed find jobs faster, we can save an even greater amount in benefits. Right now states cannot make tradeoffs between administration and benefits funds. In the end, states will be able to save money by doing their job better, in marked contrast to the present system.

Finally, eliminating the FUTA will substantially reduce the administrative burden on business, which hits small business especially hard. Employers today have to file two employment tax returns, one to the federal government and one to the states. The forms are different, and the filing deadlines may even be different. The administrative burden is one factor making small businesses hesitant to hire staff. Total employment is quite likely to improve with this burden removed.

TIME TO CHANGE

The federal unemployment insurance tax has been a bad idea for some years, but it was a bad idea that we could afford. Now, in recessionary times, we cannot afford to continue to tax jobs just to maintain the federal surplus. It's time to return the money to Texas, stimulate better ways to help the unemployed, and ease the administrative burden on small business.

★ ★ ★

William Conerly is chairman of the board of the Cascade Policy Institute in Portland, Oregon and an economic consultant, whose clients include the American Institute for Full Employment. He can be reached at Bill@ConerlyConsulting.com