Michigan League for Human Services

March 2003

Michigan's Reed Act Fund Diversions:
Implications for Workforce Development Services

Summary

In March 2002, the federal government disbursed $8 billion to states to build up their unemployment insurance (UI) trust funds, for the purpose of helping workers affected by the September 2001 terrorist attack and the resulting economic fallout. Michigan's UI trust fund received nearly $291.5 million in Reed Act funds through this disbursement. In addition to building up the trust funds, states were permitted to use the money for other services and benefits for the unemployed, including related administrative costs. Michigan chose to use its Reed Act money, with its narrow range of allowable uses, to replace some of the much more flexible Workforce Investment Act (WIA) and Temporary Assistance for Needy Families (TANF) funds that constitute the majority of funding for the Michigan Works! one-stop centers. As Reed Act funds are prohibited from covering the costs of such Work First services as job training, child care-related programs, and vehicle purchase and repair, some local Workforce Development Boards faced difficulties as they continued to provide such services. Moreover, Reed Act funds were provided under a one-time disbursement; if Michigan cannot find a replacement for those funds beyond Fiscal Year 2004, the affected agencies may find themselves shortfunded by as much as $66.1 million per year in subsequent fiscal years.

Background of the Reed Act Distribution

Enacted in 1954 as a result of tension between states and the federal government over unemployment insurance (UI) funding, the Reed Act provides for the transfer of excess dollars from federal unemployment trust funds to state trust funds in the event that the reserves in the federal UI administration, loan, and extended benefits accounts exceed a certain threshold level. The distribution in 2002 was the fifth such transfer, and was part of the Economic Stimulus Package (HR 3090) passed by Congress several months before. Totaling $8 billion nationally, it was by far the largest distribution under the Reed Act, and the largest single infusion in history of flexible funds into the broader employment and training system.

The Reed Act allows states to use the money to finance either regular UI benefits or administrative costs of UI and public employment offices. The U.S. Department of Labor has set flexible guidelines governing the use of these funds. It allows states to use funds to extend unemployment benefits to workers who do not otherwise qualify for such benefits under existing federal UI laws (for example, those who want to work part-time or those who qualify for UI benefits through an alternative base period calculation). A state may use its distribution for administration of programs serving unemployed

1115 South Pennsylvania Avenue, Suite 202, Lansing, MI 48912-1658 • (517) 487-5436
Fax: (517) 371-4546 • Web site: http://www.MiLHS.org

workers, provided the state legislature has appropriated money for that use. States are permitted to use a portion of their distribution to build up or improve their one-stop workforce investment systems, and may use the funds to pay the costs of job search and placement services. States are not permitted to use the funds to cover costs of job training, outside of training for UI or employment services staff.

Michigan's Use of the Funds

The federal Reed Act distribution of 2002 allocated approximately $291.5 million to Michigan for the purpose of strengthening the state's unemployment reserves. After receiving the funds, however, there was contention within the legislature and the administration over the use of the funds. Citing high unemployment statistics, some lawmakers called for using the money to increase the benefits for unemployed workers and to eliminate the provision that required unemployed workers to wait one week from the date of approval before receiving benefits. Other lawmakers insisted that the benefit increase should be lower, thus allowing more money to be kept in the UI trust fund to maintain its solvency.

During the June budget process, it became clear that neither increasing unemployment benefits nor guaranteeing UI trust fund solvency was at the heart of the appropriation decisions. Instead, Michigan needed to maximize all available federal funds in order to achieve savings in the General Fund. The Reed Act money was removed from the UI trust fund and dispersed among three Michigan agencies—the Department of Career Development (DCD), the Department of Consumer and Industry Services (CIS), and the Department of History, Arts and Libraries—to go toward such projects as supporting Work First job search and job readiness activities through the one-stop centers, providing the Detroit and Grand Rapids public library systems with computers by which claimants may access unemployment agency websites, and updating current computer software systems to improve customer service for claimants (see Appendix).

$66 million in Reed Act money was allocated to the DCD for use in its Work First program, while an equal amount of TANF funding being used for that program then reverted back to the FIA. The hope was that TANF funds could be used in a way that would "free up" General Fund monies.

The Impact of the Diversion on Human Services Delivery

The replacement of TANF funds with Reed Act funds in the DCD budget has created difficulties for some of Michigan's regional workforce development agencies in delivering their services. Reed Act funds have a much narrower range of allowable uses than TANF or WIA funds (the funding sources that provide the majority of financing of the operations of one-stop center services), and there are services currently provided by one-stop centers that cannot be covered by Reed Act funds. This in itself is not problematic; other one-stop center funding sources such as Wagner-Peyser Act and Welfare-to-Work have a narrower range of allowable uses as well, and the various Workforce Development Boards budget with such restrictions in mind. The difficulties arose from the timing and manner in which the funds were shifted.

The effective date for the Reed Act funds was March 13, 2002, while the beginning of the State of Michigan's Fiscal Year is October 1. Because the shift in funding for the DCD Welfare to Work programs occurred in June 2002, after the effective date of the Reed Act funds, those funds were applied retroactively to the Welfare to Work budgets. This produced accounting difficulties for Work First programs that had budgeted a generous amount of TANF funds for programs that were not allowable under Reed Act funds, and then found themselves having to shift the sources of funding for those programs.

Further problems were created by a shift in the effective date of the Reed Act funds. There had been an understanding among the Engler Administration and the one-stop center directors that the Reed Act funds would be retroactive to October 1, 2001, and local workforce boards had budgeted their funds accordingly. The U.S. Department of Labor unexpectedly moved the effective date to March 2002, however, creating additional accounting difficulties for the local agencies and costing them many hours of manpower. (In August, the Governor sent a letter to the Department of Labor requesting more flexibility, saying that the state acted in good faith in its Reed Act planning and that moving the effective date up would create additional hardships for Michigan.)

For some workforce development agencies the resulting problems were limited to accounting. However, at least one agency experienced a two-month disruption in vehicle purchase services (which are not covered by the Reed Act) because there were not enough TANF or WIA funds left to cover all the services they had been covering prior to the effective date shift. Another agency has said that the shift to a March 2002 effective date might force them to request more funds from the state later during this fiscal year to continue operating their vehicle purchase program.

The Reed Act Diversions and the State Budget

As a result of enacted tax cuts, the use of numerous one-time measures to balance the budget, and a decrease in available federal funds, the State of Michigan is facing its worst budget crisis in forty years. The newly elected administration and legislature are currently facing a structural deficit of nearly $2 billion, including an additional current year shortfall of nearly $300 million.
The state constitution mandates that Michigan maintain a balanced budget, but spending pressures and declining revenues will make this very difficult. Moreover, the Budget Stabilization Fund, which had a balance of nearly $1.3 billion in Fiscal Year 1999-2000, will be exhausted by the end of this fiscal year, eliminating a significant source of budget relief. Due to prior budget cuts, it will also be difficult to trim funding of various education and human service programs to find such relief without severely jeopardizing the effectiveness of those programs.

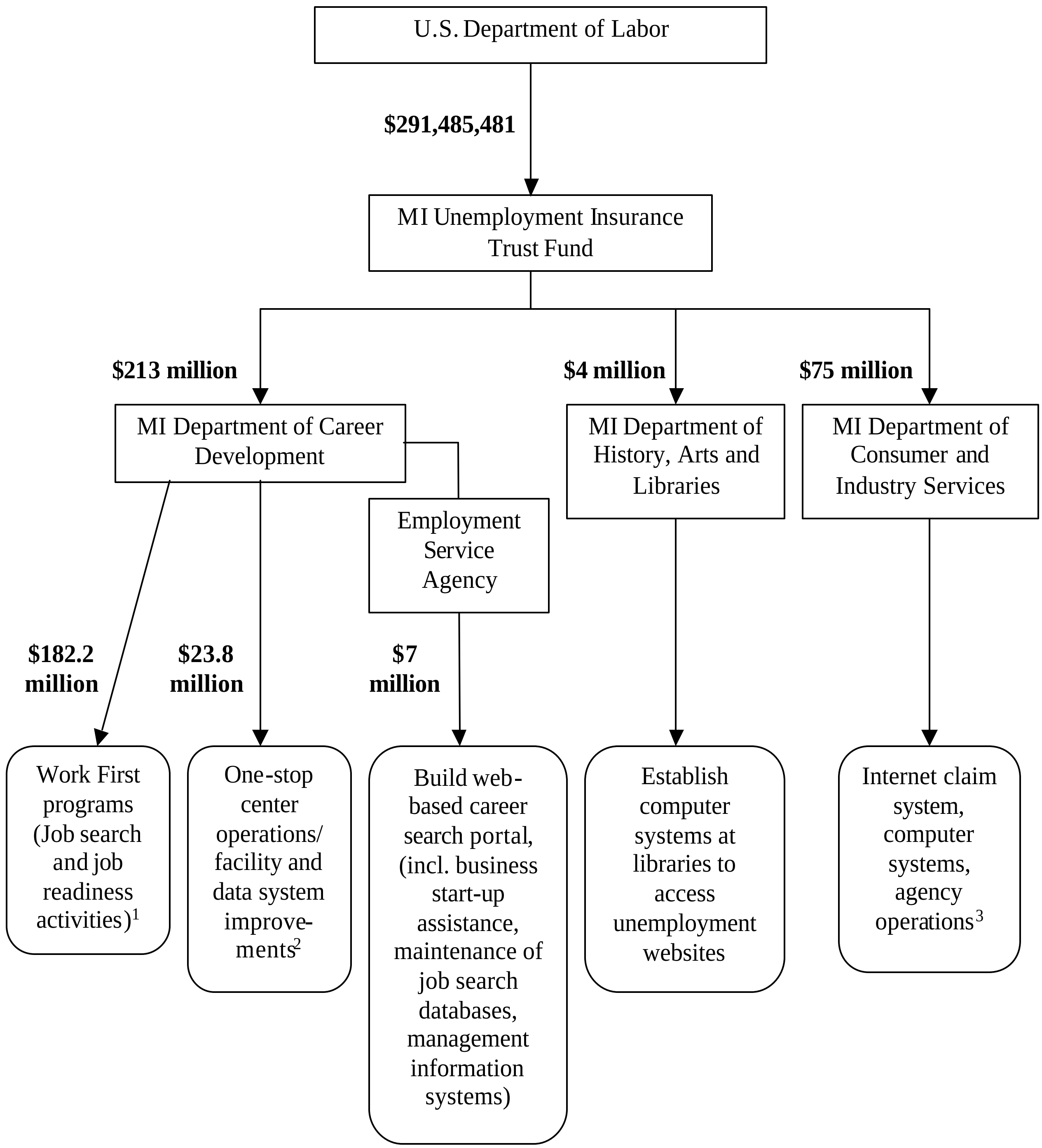
The supplantation of Reed Act funds for TANF funds is particularly problematic since this is only a one-time source of funding. The Reed Act distribution will fund programs only through Fiscal Year 2004, after which an alternative source of funding will have to be found. At this time of writing the federal TANF block grant has not been reauthorized, so the amount of federal TANF funding that Michigan will receive in subsequent years cannot be determined. In the event that Michigan's funding is reduced due to a reduction in overall federal funding for TANF, the state may have difficulty replacing the funds that it has removed from the Welfare to Work budget.

Conclusion

The shifting of funds in the 2003 budget is clearly a form of supplantation that has had some detrimental effects on human service delivery in Michigan, through the creation of accounting difficulties and uncertainty and, in at least one case, a temporary disruption of services. It may also have a negative effect on the unemployment trust fund, whose solvency it was intended to ensure. At a time when the state budget is experiencing a shortfall, the diversion of Reed Act funds in Michigan may seem fiscally responsible to the degree that it saves General Fund dollars. However, because it has created difficulty in the administration of workforce services, does not provide a permanent source of funding for such services, and shifts federal money from its intended uses, the diversion of Reed Act funds and the reason for it need to be reexamined.

Appendix

Funding Stream of Michigan's Reed Act Distribution



[1] These funds replace TANF funds currently in the DCD budget. Those TANF funds will revert back to the FIA budget in the following amounts: FY 2002 $46 million; FY 2003 $66.1 million; FY 2004 $66.1 million. This could result in a baseline funding problem in FY 2005 and subsequent fiscal years.

[2] These funds replace $200,000 in DCD funds that will be shifted back to the general fund.

[3] These funds replace $10 million in CIS funds that will be shifted back to state UI penalty and interest contingency funds.