Unemployment Insurance

Proposals to Change Benefits Must Consider COVID-Hit Business

Through federal and state cooperation, unemployment insurance (UI) benefits act as a stabilizer during economic downturns by providing a source of temporary, partial wage replacement for workers who have become unemployed through no fault of their own and are looking for employment. To induce states to enact UI laws, the Social Security Act of 1935 provided a tax offset incentive to employers if a state UI program complies with federal requirements, including fully funding benefits for state claimants.

Aside from federal standards, each state has primary responsibility for the content and development of its UI laws, and administration of the program. California administers its UI program through the Employment Development Department (EDD) within the guidelines established under federal law.

FUNDED BY FEDERAL/STATE TAXES ON EMPLOYERS

California's UI program is funded exclusively by employers, via state and federal taxes on wages. The only exceptions to this rule are temporary federal grants for administration and certain emergency and extended benefits that have been paid from federal general revenue—some of which were utilized during 2020 in response to COVID-19 and are discussed below. Employees do not pay any UI taxes.

These employer contributions are deposited in the Unemployment Trust Fund (UI Fund) of the U.S. Treasury Department. States withdraw money from their account in the trust fund exclusively to pay UI benefits. If a state trust fund does not have adequate funds to pay benefits, a loan is made from the federal fund so that all claims are paid.

Generally, the federal UI tax is fixed at 6% of wages up to $7,000 per year for all employers in the state (Federal Unemployment Tax Act (FUTA) taxes), offset by a 5.4% credit in states that comply with federal UI laws (FUTA tax credit), resulting in a payable rate of 0.6%. Assuming the state is in compliance and the state's UI Fund is solvent, this comes out to $42 per employee per year. FUTA taxes are due January 31 following the year in which the taxes are applied (for example, 2018 taxes are due January 31, 2019). Employers receive the 5.4% credit when the state program is in compliance with the federal UI program rules.

If a fund remains insolvent for two consecutive years, then FUTA tax credits are reduced annually by 0.3% until the fund returns to solvency, creating essentially a steadily growing tax increase on the state's employers.

COVID-19 AND UNEMPLOYMENT INSURANCE

COVID-19 and the related economic shutdown have brought unemployment insurance policy to the forefront, both in California and nationally. As the tidal wave of COVID-19 has crashed across the nation and businesses have complied with state-mandated safety precautions and shutdowns, unemployment has risen to levels not seen since the Great Depression. Into this economic crater, unemployment insurance has emerged as the critical stopgap to help keep food on the table for many Californians and provided critical stimulus to the economy.

Unlike in prior recessions, however, entire sectors of the economy have been shut down or are operating at severely reduced capacity. Many businesses, particularly in the hospitality or food service industry, are closing and will never reopen. According to some estimates, about half of all small businesses are at risk of collapsing due to COVID-19. With unprecedented economic restrictions and collapse among the businesses that pay into California's UI Fund, California policy makers face a new question: where to find a social safety net when the business community cannot serve as one?

FEDERAL RESPONSE AND INCREASED BENEFITS

Multiple rounds of federal legislation struck a careful balance in 2020—providing additional benefits to employees without placing the cost on employers. First, the Families First Coronavirus Response Act (FFCRA - HR 6201) provided federal funding for extended benefits and waived charging interest for loans to states whose UI funds became insolvent. Then the Coronavirus Aid, CalChamber

Agenda for California Recovery

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Relief, and Economic Security (CARES) Act (HR 748) provided a host of significant changes, including hundreds of billions of dollars of aid to fund a $600 increase in weekly UI benefits through July 31, 2020 for all recipients, and to create a new category of benefits and extend existing categories of recipients. Thankfully, all these changes were federally funded, meaning they added no obligations to California's struggling businesses, but helped out-of-work Californians keep bread on the table.

A number of California legislators looked to increase state UI payments and place the cost on California employers during the 2020 session.

• Most prominent among them, AB 1107 (Chu; D-San Jose) was intended to add $600/week to California's UI program. AB 1107 would have funded the increase in benefits via the traditional mechanism—payroll taxes on California employers. Depending on the unemployment rate and applicants' UI awards, this could have placed a burden on California employers in the tens of billions of dollars annually.

• Similarly, AB 1731 (Boerner Horvath; D-Encinitas), before its final amendments, would have added billions of dollars of debt to California's UI fund by rewriting the equations related to UI benefits for reduced-time workers.

Due to legislative concerns about burdening the struggling business community with a tax increase during times of economic shutdown, none of these provisions came to pass during the 2020 session, but they may well return in 2021. The question again will be: when the business community is struggling to survive and cannot provide a social safety net, where will the state turn?

LESSONS FOR 2021

As states across the nation are exhausting their UI funds, what happens now? California's fund was depleted by May 2020, leading to federal loans similar to those utilized after the Great Recession of 2008. In that case, California's debt peaked at $10.3 billion in 2012 and California employers faced increasing taxes in subsequent years. This tax increase continued until 2018, when California's UI fund returned to solvency.

As an example of how those costs apply to California employers: by 2017, the employers' tax rate had risen to 2.7%, quadrupling per employee UI taxes from the traditional $42 per employee to $189 per employee.

Looking to 2021 and beyond, California's UI fund has already fallen deep into insolvency—the question is only how deep it will go. Although estimates vary, it is certain that California's UI fund will go far deeper into insolvency than it did during the Great Recession. As of March 2020, California's UI Fund held a surplus of more than $3.2 billion—but by November 9, 2020, it had fallen $15.7 billion into debt, according to the U.S. Treasury Department. The Employment Development Department's (EDD) October 2020 UI Fund Forecast estimated California's loan balance would be approximately $21.5 billion by the end of 2020, with ongoing extremely elevated levels of unemployment during 2021.

Based on this trajectory, EDD estimates that California's UI Fund appears very likely to fall $48 billion into debt by the end of 2021, bringing the total UI Fund debt to more than four times the debt in 2008. With these numbers in mind, and assuming no federal or state relief, that means California employers will be facing an increased tax burden on a per-employee basis—which will disincentivize hiring—for well beyond the next decade.

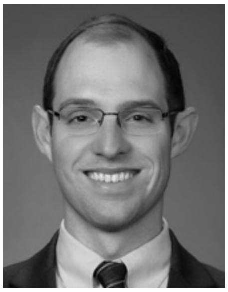
CAPABILITIES AND FRAUD CONCERNS

Another troubling result of the unprecedented surge of applicants caused by the state-mandated economic shutdowns was that some technological and logistical shortcomings in the EDD were laid bare. Outdated technology and organizational bottlenecks around claims processing caused many applications to be stuck in limbo, with some claimants waiting months for their claim to be processed. This backlog led to widespread criticism of EDD and, although some new systems were put into place after the legislative session in 2020, this will certainly be an ongoing focus for Californians heading into 2021.

EDD also faced criticism for failing to catch significant fraud due to its rush to distribute benefits. At least 100 arrests have been made across California as police attempt to catch these fraudsters, but it remains unclear as to how much fraud took place during 2020, and how significant an effect this fraud has had on California's UI fund.

CALCHAMBER POSITION

As we grapple with COVID-19 and the economic shockwaves it has sent through the California economy, California must weigh the ability of the battered business community to absorb a tax increase when considering changes to UI benefits. Before any such change can be considered, EDD must demonstrate that it has found new solutions to prevent theft and ensure that UI benefits are being distributed to those Californians who actually are in need.



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