Unemployment Insurance Fund

UI Debt Means Ongoing Tax Increases for California Employers

Through federal and state cooperation, unemployment insurance (UI) benefits act as a stabilizer and safety net during economic downturns by providing 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.

In addition to maintaining 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).

HOW EMPLOYERS FUND THE PROGRAM

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. Employees do not pay any UI taxes.

Employer contributions are deposited in the Unemployment Trust Fund (UI Fund) of the U.S. Treasury Department. States withdraw money from their accounts 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 per employee for all employers in the state (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 to $42 per employee per year. FUTA taxes are due January 31 following the year in which the taxes are applied (for example, 2024 taxes are due January 31, 2025).

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

COVID-19 AND UNEMPLOYMENT INSURANCE

COVID-19 and the related economic shutdown brought unemployment insurance policy to the forefront in California and nationally. As COVID-19 crashed across the nation, and businesses complied with state-mandated safety precautions and shutdowns, unemployment rapidly rose to levels not seen since the Great Depression. Unemployment insurance was used to backfill this economic crater, keeping food on the table for many Californians and providing critical stability to the economy.

Unlike prior recessions (such as the recent Great Recession), entire sectors of the economy were forced to shut down or operate at severely reduced capacity, due to self-isolation by customers, mandates from government, or broken supply chains. This meant many employers were compelled to terminate much or all of their workforce, and then pay unemployment compensation for this compelled termination. Now, because those payments drained California's unemployment fund, employers are being forced to repay the resulting UI Fund debt.

The question in front of California policy makers is: given that the present debt was caused by California forcing employers to shut down on a statewide scale, how can the state help fix the present insolvency of the UI Fund and prevent tax increases on California employers?

By November 9, 2020, California had accumulated $15.7 billion in debt, and that debt has since risen to $20.5 billion as of November 1, 2024. That debt puts California three times higher than the next closest state (New York with less than $6 billion).

RECENT LEGISLATION AND BUDGET DISCUSSIONS

Although Governor Gavin Newsom proposed allocating $3 billion to the UI Fund in California's 2022 budget cycle, that payment eventually was reduced $250 million in 2022–2023, with commitments to make future payments and aid in subsequent budget years. Now, as leaner budget times have taken hold, those commitments have evaporated. Recent legislation also has offered no aid to California employers here, with proposals being discussed during the 2024 legislative session to raise taxes, but not to provide aid for employers.

Looking forward, there is no reason to expect any aid — either from California or federally. California's budget outlook in the coming years remains tight. The federal government also is incredibly unlikely to provide any relief for California's UI Fund, given that President Donald Trump and congressional Republicans will likely see little reason to provide funding that would aid only California's employers.

HIDDEN EMPLOYER TAX INCREASES DURING THE GREAT RECESSION AND NOW

Because the UI Fund remained insolvent for two years, employers across California have seen their payroll taxes rise by $21 per employee per year, and those taxes will continue to rise by this amount every year until the debt to the federal government is repaid. In 2023, this tax increase cost employers $396 million, and is projected to rise to $812 million in 2024 — and to rise more than $1 billion in the following years. Notably, because it is not a "new" tax, many employers will not see these increases coming and will discover them only when receiving a much higher-than-expected bill.

The critical question is — How long will employers be paying these increased taxes? And when will these increased taxes be sufficient to pay down the UI Fund's debt? It is hard to speculate how many years this will take, but the Great Recession provides a somewhat useful comparison.

During the Great Recession, California's UI Fund bottomed out at $10.3 billion in debt. This was a record at the time, and was not a result of a statewide shutdown, but a result of financial panic. The subsequent recession created massive unemployment, but nothing compared to the rapidity and extent of the pandemic economic crisis. Employers paid elevated per-employee taxes from 2011 to 2017, when the fund returned to solvency.

Presently, the UI Fund is significantly deeper into debt, with a total debt of more than $20 billion heading into 2025. Assuming no federal or state relief, California employers will face an increased tax burden on a per-employee basis — which will disincentivize hiring — for years to come. Although the duration of the debt (and increased taxes) will depend on economic circumstances and workforce participation, California employers will likely pay increased UI taxes through the year 2031.

What does that look like for a normal employer, as opposed to pre-pandemic times? In a normal year, employers pay $42 per employee for the UI Fund (with some adjustment depending on their past experience and industry). In 2023, an employer paid $21 more per employee, or $63 per employee … then that rose to $84 in 2024, and will rise further to $105 in 2025. Looking down the road to 2030, employers will be paying $210 per employee in FUTA taxes — an increase of 400% over a normal year.

There also is considerable concern about a nationwide recession, with significant belt tightening at the federal level to confront inflation. Should a recession develop, California employers will be even less able to absorb these tax increases, and decreased labor force participation (as businesses fail and close) will mean that California's UI Fund will remain in debt even longer.

FRAUD CONCERNS AND RECOVERY EFFORTS

The unprecedented surge of unemployment applicants caused by the state-mandated economic shutdowns also laid bare the technological and logistical shortcomings in the EDD. Outdated technology and organizational bottlenecks around claims processing caused a huge backlog of applications, with some claimants waiting months for their claims to be processed. The EDD also failed to catch significant fraud due to its rush to distribute benefits. EDD estimates that California paid around $20 billion in fraudulent payments, with at least $1 billion coming from California's UI Fund, although the Legislative Analyst's Office asserted that it disputes this number and believes the total fraud attributable to California's fund is lower.

Regardless of the exact amount, the core issue for California employers is the same: when EDD makes mistakes in its distribution of funds (either through fraud or unintentional overpayments), employers end up paying the bill to replace the mistakenly distributed funds. As a matter of fairness, EDD must take proactive steps to improve its distribution process and minimize fraudulent (or mistaken) distribution of benefits. Notably, EDD has recovered approximately $6 billion of the $20 billion lost to fraud — but it is impossible to determine how much of that $6 billion recovery was allocated to federal overpayments, as opposed to losses from California's fund.

CALCHAMBER POSITION

California employers will face years of increased taxes due to the COVID-19 pandemic crashing the UI Fund. The California Chamber of Commerce supports future proposals to reduce the UI Fund's insolvency and aid employers with the rising taxes that they are facing, and opposes measures that would increase employer taxes without protecting solvency.

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