Unemployment Insurance Trust Fund Status

Background

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's UI programs 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 law, and administration of the program. California administers its UI program through the Employment Development Department (EDD) within the guidelines established under federal law.

One federal requirement is that all contributions (UI tax paid by employers) collected under state laws be deposited in the Unemployment Trust Fund (UI Trust Fund) of the U.S. Treasury Department. States withdraw money from their account in the trust fund exclusively to pay UI benefits to displaced workers. 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.

(For more background about the UI program, please see "UI Trust Fund Deficit Continues into 2018; Employer Federal Tax Increases Again" in the *2017 Business Issues and Legislative Guide*.)

Funded by Federal and State Taxes on Employers

California's UI program is funded exclusively by employers, from state and federal taxes on wages paid by employers, except for temporary federal grants for administration, and certain emergency and extended benefits that have been paid from federal general revenue. Employees do not pay any UI taxes.

The federal UI tax is a fixed rate for all employers in the state, normally due on wages paid by employers at 6%, offset by a 5.4% credit for employers in states that comply with federal UI laws, resulting in a payable rate of 0.6%, which is $42, on wages up to $7,000 a year. Federal Unemployment Trust Account (FUTA) taxes are due January 31 following the year in which the taxes are applied (for example, 2017 taxes are due January 31, 2018). Employers receive the 5.4% credit when the state program is in compliance with the federal UI program rules.

The Problem

Federal statute requires the federal government to incrementally reduce the offset credits to employers in states that do not timely repay their federal UI Trust Fund loans. As a result of the Great Recession that began in 2009, California remains the only state, other than the U.S. Virgin Islands, carrying debt to the federal fund. Each year that a balance is owed to the federal fund, California employers lose 0.3 % of the offset credit, thus paying a higher federal UI tax. In addition to the higher tax on employers, the state must pay interest on the outstanding debt. It is projected that by the end of 2018, employers will have paid an estimated $9.5 billion in increased FUTA taxes and the state will have paid more than $1.4 billion in interest on the loan.

The resulting federal tax increase is $21 (0.3%) per employee, per year until the debt is eliminated. For the 2017 tax year, employers will pay $189 per employee, an increase of $147 over the normal tax per employee.

The federal UI tax is applied directly to the state's debt, and then builds a reserve for future benefit payouts from the federal unemployment account. California's deficit is projected to be paid off in 2018, returning the tax rate to the normal 0.06% if the economy continues as predicted and no state or federal structural changes are made to the system.

UI Fund Insolvency

California's UI Trust Fund technically became insolvent in January 2009, and by November 2009 the state had borrowed more than $5.5 billion from the federal unemployment fund to pay benefits to California's unemployed. As of September 2012, outstanding federal loans to 28 states totaled $37 billion, with California comprising more than 27% of the total. At the end of 2012, California's outstanding federal loan was $10.2 billion, more than $6.5 billion greater than the next highest state loan, New York. By the end of 2016, California's loan fell to $3.9 billion due to increased federal taxes on employers.

California has taken by far the largest loan. In 2011, 10 states had loans exceeding $1 billion (but less than $2 billion). Eight states eliminated their outstanding debt in 2014, and an additional five states eliminated their debt in 2015. The remaining

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states—Connecticut and Ohio—eliminated debt in 2016, leaving only California and the U.S. Virgin Islands with debt. Seven states issued tax-exempt bonds to restructure their UI Trust Fund debt before 2014: Idaho, Texas, Michigan, Nevada, Pennsylvania, Illinois and Colorado. The other five states either utilized special funds or addressed solvency issues early in the year and did not have deficits as high as other states. In 2015, UI debt was eliminated by five states—Indiana, Kentucky, New York, North Carolina and South Carolina—all of which cut benefits and/or raised taxes.

California has not made UI system changes to address the insolvency but rather has relied upon the increasing federal tax on employers to pay down the debt.

Unemployment Levels and Benefit Payout

California's total unemployment rate has decreased to 4.9% (October 2017), from 7.5% in 2014—significantly lower than the high of 12.1% in 2010. The rate increased steadily from 2006 to 2011 before beginning a gradual reversal. California's rate of unemployment is higher than the national rate of 4.1% (U.S. Bureau of Labor Statistics).

The large increases in the ranks of the unemployed for so many years, coupled with benefit increases in 2001, led to a dramatic increase in expenditures from the UI Trust Fund. The regular UI benefit payments were $5.4 billion in 2015, and were forecast to be $5.4 billion in 2016, $5.6 billion in 2017, and $5.4 billion in 2018. Total benefits paid out from the trust fund have finally been trending downward; however, the benefit payout projected for 2019 is slightly higher at $5.5 billion.

CalChamber Position

The California Chamber of Commerce believes that the state must be diligent in its policy making to improve the business climate in California to create more jobs, while striving to combat increased unemployment and seeking a more stable UI Trust Fund.

The UI system cannot be viewed in isolation from the overall business climate in the state and in surrounding states that compete for California businesses. The state needs a sustainable UI system that protects both workers who are temporarily unemployed through no fault of their own, and employers who spur investments and job creation.

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