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HOW FEDERAL PANDEMIC RELIEF HELPED REPLENISH STATE UNEMPLOYMENT RESERVES

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ABSTRACT

Unemployment insurance (UI) is a state-administered program that pays temporary partial earnings replacement to involuntarily unemployed workers while they seek reemployment. During the COVID-19 pandemic, UI claims surged and became a primary source for income replacement for workers who lost their jobs. However, despite previous federal incentives for states to shore up their UI funding reserves, the scale of claims during the pandemic was unprecedented, and the federal government needed to step in to help pay not only for direct, expanded benefits but for additional assistance to states themselves. Although this effort helped backstop the successful operation of states' UI programs, it continued the trend of the federal government paying for an increasing share of benefits during crises, and weakening incentives for state UI systems to be independent and self-financing.

JEL Classification Codes: H74, H76, J65

Key Words: Unemployment Insurance, Benefit Financing, COVID-19, CARES, ARPA, Forward Fund, Reserve Adequacy, Average High Cost Multiple

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HOW FEDERAL PANDEMIC RELIEF HELPED REPLENISH STATE UNEMPLOYMENT RESERVES

Unemployment insurance (UI) pays temporary partial earnings replacement to involuntarily unemployed workers while they seek reemployment. Starting in March 2020, as states implemented economic shutdowns to stop the spread of the novel coronavirus (COVID-19), UI became a prime mechanism for income replacement for the many workers laid off during this time. However, the claims for UI were unprecedented in scope—35.4 million initial applications for state regular benefits were filed in the second quarter of 2020, compared to 8.8 million in the first quarter of 2009 and 8.4 million in the first quarter of 1982 (and just 2.7 million in the strong economy of the second quarter of 2019). As a result of the high claim volume during the pandemic, many states ran out of UI reserves and had to borrow from the U.S. Treasury to pay benefits. After passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act in March 2020 and the American Rescue Plan (ARPA) Act in March 2021, several states chose to use some of these federal relief funds to buttress their reserves. We argue this choice improved states' UI reserves and likely forestalled states from making changes to reduce UI program costs—such as cutting benefits.

How States Normally Finance Their UI Programs

Regular state UI programs can quickly replace at least some income for unemployed workers. States establish weekly benefit amounts, the potential duration of benefits, and tax systems for financing these regular benefits. From the 1950s until after the 2008–2009 financial crisis, all states paid up to 26 weeks of regular UI benefits and usually replaced about 50 percent

of prior earnings, up to state maximum weekly benefit amounts.[1] State UI benefits are mainly financed by taxes on employer payrolls, with employers with more UI beneficiaries paying higher rates (a mechanism called experience rating). States are incentivized to "forward fund" benefits by building sufficient reserves, which are held in accounts with the Unemployment Trust Fund at the U.S. Treasury. Forward funding is part of what makes state UI systems countercyclical—they inject income for consumer spending to unemployed workers to counter economic downturns, but they also somewhat dampen expansions through business tax increases during recoveries in order to rebuild reserves. However, deep downturns can upset this balance. Benefits paid during and after the financial crisis exhausted UI reserves in 36 states, forcing them to borrow from the U.S. Treasury to continue benefit payments.

To incentivize states to build larger reserves for the future, the U.S. Department of Labor in 2014 made available zero-interest short-term loans, with a goal of states having reserves equal to at least one year of recession-level benefits by 2019. This threshold, called the average high-cost multiple (AHCM), was thus set at a minimum of 1.0, for one year's worth of benefits.[2] In 2007, before the financial crisis, only 19 states had reached the 1.0 standard; the average AHCM across states was 0.52. Following the financial crisis, the UI debt problem led to a range of state responses to either increase revenue or decrease benefits (O'Leary and Kline 2019). Some states allowed their existing tax systems to trigger higher tax rates and a few states increased the share of payroll wages that get taxed, but other states were reluctant to raise UI taxes quickly for fear of choking off business recovery and labor demand (Johnston 2021). Many states prevented rate

[1] For this latter period, also called the Great Recession, the National Bureau of Economic Research's Business Cycle Dating Committee determined the business cycle peak was in December 2007 and the trough in June 2009.

[2] Technically, the AHCM is the number of years of benefits available in state reserves when paid out at the rate of the average of the three highest annual payout rates in the previous 20 years.

increases on employers, preferring instead to repay debt by taking smaller federal UI credits.[3] Eight states cut potential durations of regular state benefits, and one of these also cut weekly benefit amounts.[4]

The Surge in Federal UI Funding during the Pandemic

At the end of 2019, on the eve of the pandemic, 31 states had reserves that exceeded the 1.0 AHCM reserve standard, but the average across all states was still just 0.80, despite the federal incentives and record low unemployment (ET Financial Data Handbook, 394). These reserve levels would not have been adequate to finance benefits in the Great Recession, let alone for the unprecedented claims during the COVID-19 pandemic, and the federal government needed to step in. UI expenditures for 2020 and 2021 totaled $937 billion, of which the states (through normal employer payroll tax channels) paid only $185 billion (ETA 2112 and ET 394). The remaining 80 percent of spending was shouldered by the federal government through special UI programs.

The biggest share of federal spending went to providing supplements to weekly unemployment benefits. The Federal Pandemic Unemployment Compensation (FPUC) program added $600 per week to all UI benefit checks from early April through July 2020 (under the CARES Act), $300 per week from late December 2020 to mid-March 2021 (under the Continued Assistance Act), and $300 per week from mid-March 2021 to early September 2021 (under the

[3] See O'Leary and Kline (2020) for a discussion of states accepting reductions in the Federal Unemployment Tax Act credit to repay outstanding debt.

[4] Potential durations were cut to less than 26 weeks in Arkansas, Florida, Georgia, Kansas, Michigan, Missouri, North Carolina, and South Carolina. North Carolina also reduced the maximum weekly benefit amount from $504, allowing for inflation adjustments, to a fixed $350, where it has remained since 2013. Also, Illinois cut potential duration to 25 weeks in 2013 but raised it back to 26 weeks the following year. See O'Leary and Kline (2020) for details.

ARP Act).[5] The FPUC payments totaled $349 billion through year-end 2021. The Pandemic Unemployment Assistance program provided $124 billion in benefits to persons not eligible for regular UI, which covers only employees with sufficient earnings and workforce attachment. Another federal program, Pandemic Emergency Unemployment Compensation, extended the duration of regular state UI benefits, distributing an additional $89 billion in federal funding. Under the CARES and ARP Acts, the federal government also paid for 100 percent of benefits under the permanent Extended Benefits program, which extends UI benefit durations when certain state-level unemployment rate "triggers" are met. By statute, the cost of those program benefits is nominally shared 50-50 between federal and state governments, but the federal government paid $12 billion of the states' share during the pandemic.[6] Additional, miscellaneous federal contributions added another $174 billion in benefits, collectively bringing the federal total to $752 billion.

Additional Federal Relief to States and Use for UI Reserves

Besides these direct federal outlays for UI benefits, funds from the CARES and ARP Acts to provide more general financial assistance may have forestalled states' need to reduce UI benefits or change tax structures in order to avoid exhausting their UI reserves or having to borrow. Thirty-five states used funds from CARES and/or ARP in 2020 and 2021 to shore up their UI trust funds—by a total of over $25 billion (Table 1). Among these 35 states, after accounting for outstanding loans from the U.S. Treasury, California and Connecticut still had negative net reserves at the end of 2021, although California used just $6.5 million from the

[5] In an effort to address labor shortages, some states ended one or more of the federal unemployment assistance programs before the September 2021 expiration. Coombs et al. (2021) found these early withdrawals increased employment rates slightly, but estimated gains in earnings were small compared to the loss in benefits, such that net aggregate income fell.

[6] The normal federal share of Extended Benefits is paid from funds collected through the federal unemployment tax on employers and is held in the federal Employment Security Administration Account.

CARES Act while borrowing more than $19 billion from the Treasury. Had it not been for the infusion of cash, an additional 11 states would have had negative reserve positions at the end of 2021 (Figure 1). Prior to the pandemic, at year-end 2019, the 35 states that would use CARES or ARPA money had average reserves (expressed in AHCM terms) of 1.14. As of year-end 2021, their AHCMs averaged 0.77—or just 0.20 without the cash infusions (ET 394, NCSL, author's calculations adding wage data from UI Quarterly Data Summary).

Seventeen states (and territories) did not use CARES or ARP funds to boost their reserves. At year-end 2019, their AHCMs averaged 1.16. Currently, these states/territories have an average AHCM of 0.29 (ET 394, NCSL) (Figure 2).

During 2020 and 2021, despite the availability of federal funds, 23 states and territories still borrowed money for their UI programs from the U.S. Treasury. Collectively, their outstanding debt peaked at $55.2 billion in April 2021. Fifteen of these states used CARES and/or ARP funds to buttress reserves, and 10 still had outstanding debt at the end of 2021. Just two states, California and Connecticut both used CARES/ARP money and had outstanding debt at the end of 2021 (NCSL, U.S. Department of Treasury, fiscaldata.treasury.gov).

State Legislative Responses to the Pandemic Surge in Benefit Payments

As mentioned above, in the early years after the financial crisis of 2008–2009, 36 states had to borrow to pay UI benefits, and eight states with accumulated debt passed laws reducing benefit generosity. At the time, there were no sources of federal funding to replenish state UI reserves. In contrast, during the pandemic in 2020 and 2021, there were nearly 100 pieces of legislation modifying state UI laws, and none of the changes in state laws reduced benefits. Much of the legislation addressed temporary changes suggested by U.S. Department of Labor to increase rates of benefit receipt. These included temporary suspension of both work search

requirements and experience rating of UI tax rates (Levine 2021).[7] The pandemic era changes in state UI laws mostly improved financing and benefits. Colorado and Connecticut passed laws to raise their taxable wage bases; Virginia and West Virginia established work sharing programs for short time compensation (allowing partial benefits for workers whose hours are reduced but are not laid off); and California, Georgia, Maine, New York, and Oregon increased earnings disregards for partial UI benefits (allowing higher earnings before losing UI eligibility). Furthermore, while eight states turned to the municipal bond market to finance UI debt after the financial crisis, only Massachusetts did so in the pandemic. It appears that the option to boost UI reserves from CARES and ARP funds forestalled state legislation to restrict UI and may have even accommodated expansions in some state UI programs.

Conclusion

The federal government has extended unemployment benefits during every period of high unemployment since 1958. The federal share of all benefit payments was 7.9 percent that year and did not exceed 25 percent until 1983 (Figure 3). Between 2009 and 2013, UI benefit payments totaled $742 billion, with federal spending accounting for $427 billion, or 64 percent of the total. In 2010 alone, federal spending accounted for 72.7 percent of all UI benefits paid. Despite this federal generosity for UI, 36 states ended up borrowing from the U.S. Treasury, as their own UI reserves proved insufficient, and eight states cut benefit durations to reduce future obligations.

[7] Seventeen states and territories (Arizona, California, Connecticut, D.C., Georgia, Illinois, Kentucky, Louisiana, Michigan, Mississippi, Nevada, Oregon, Pennsylvania, Puerto Rico, Texas, Vermont, Washington, Wyoming) plus the District of Columbia and Puerto Rico suspended benefit charging by legislation. Some other states, such as Maryland, suspended charging by executive order of the governor (Maryland Executive Order 12-10-2020).

Despite these measures, the majority of states were still unprepared for the unprecedented spike in UI claims in 2020 when the pandemic hit and public health measures caused work stoppages beyond the control of employers. Federal financial support for UI was impressive, accounting for 88.2 percent of all benefits paid in 2021. For states reluctant to finance regular UI benefits, federal actions in the pandemic showed that help for workers during unemployment crises is possible even if state programs are modest. However, the generous federal UI response also may have served to discourage states with meager UI systems from improving them. Without federal standards for state benefit amounts and durations, and only weak incentives for states to adequately build up their reserves, the nature of state UI programs as independent, self-financing systems for social insurance rests on tremulous foundations.

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Data Sources

UI Financial Transaction Summary, ETA 2112
https://oui.doleta.gov/unemploy/DataDownloads.asp

Unemployment Insurance Financial Data Handbook, ET Financial Data Handbook 394
https://oui.doleta.gov/unemploy/hb394.asp

UI Quarterly Data Summary
https://oui.doleta.gov/unemploy/data_summary/DataSum.asp

National Conference of State Legislatures
https://www.ncsl.org/research/fiscal-policy/arpa-state-fiscal-recovery-fund-allocations.aspx

United States Department of Treasury
https://www.treasurydirect.gov/govt/reports/tfmp/tfmp_advactivitiessched.htm

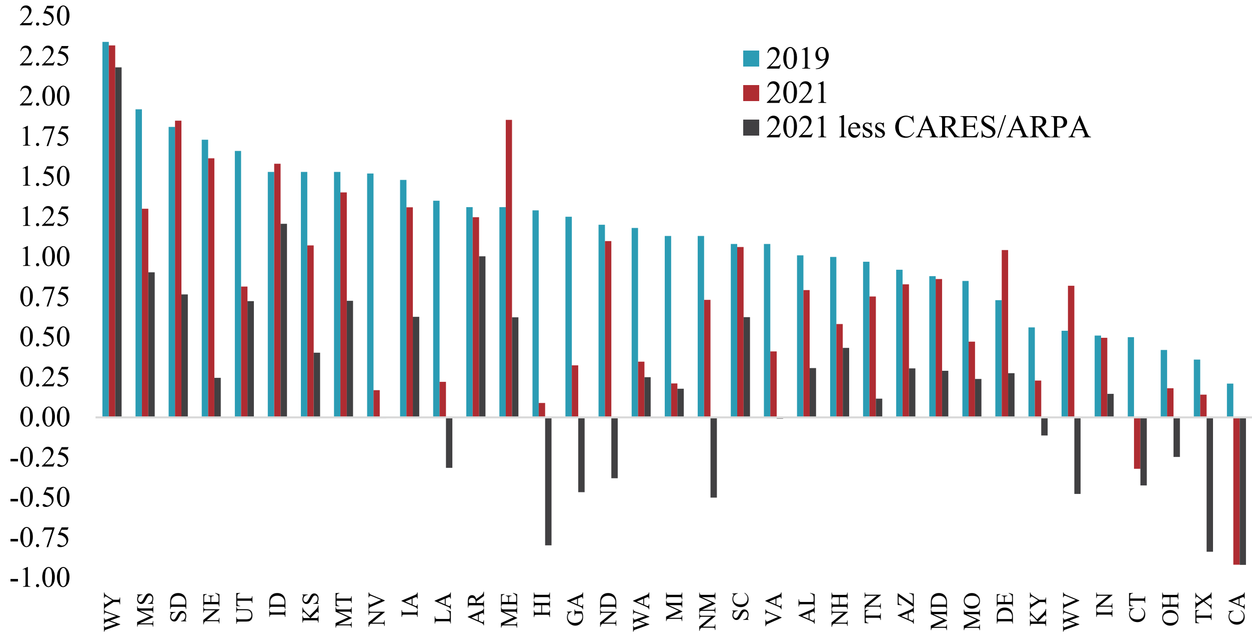
Table 1 State Borrowing from U.S. Treasury for UI During the Pandemic, and Cash Infusion from CARES/ARPA into UI Trust Funds ($, millions)

	Peak Loan Balance in the Year		Cash Infusion		Year-End 2021	
State	2020	2021	CARES	ARPA	Debt to Treasury	Net Trust Reserves
Alabama			385.0			628.1
Arizona				759.0		1,200.6
Arkansas			165.0			844.1
California	17,834.6	23,836.8	6.5		19,778.4	−19,201.3
Colorado	749.4	1,014.2			1,013.1	−961.2
Connecticut	506.0	725.1		155.0	568.3	−481.5
Delaware	32.9		200.0			271.5
Georgia	885.8	118.8	2,250.0			923.4
Hawaii	722.9	734.7		703.0		70.8
Idaho			200.0			844.1
Illinois	3,314.3	4,512.6			4,512.6	−4,176.3
Indiana	123.0		400.0	250.0		923.5
Iowa			490.0	237.5		1,395.2
Kansas				500.0		801.5
Kentucky	505.7	505.7		505.7		338.2
Louisiana	133.5	184.1	85.0	490.0		237.2
Maine			295.0	80.0		565.1
Maryland	0.0	68.5		830.0		1,250.5
Massachusetts	2,201.2	2,268.0			2,268.0	585.5
Michigan				150.0		963.2
Minnesota	969.2	1,333.3			1,207.1	−1,156.5
Mississippi			181.8			596.5
Missouri			300.0			609.2
Montana			204.0			423.4
Nebraska			427.0			504.0
Nevada	61.9	332.4		335.0		323.6
New Hampshire			50.0			195.7
New Jersey	703.6	1,038.1			644.5	−592.9
New Mexico	206.2	296.4		657.6		390.4
New York	9,241.4	10,391.6			9,436.0	−9,362.2
North Dakota			355.6			264.3
Ohio	1,324.7	1,471.8		1,472.0		622.0
Pennsylvania	821.5	1,559.4			835.3	−805.9
South Carolina			500.0			1,213.2
South Dakota			100.0			170.7
Tennessee			939.0			1,111.2
Texas	6,002.5	6,916.0		7,200.0		1,037.0
Utah				100.0		902.1
Virgin Islands	85.0	97.4			96.2	−96.0
Virginia	121.5	42.6	210.0	862.0		1,049.8
Washington				500.0		1,790.2
West Virginia	132.1	184.9	502.2			317.5
Wyoming			25.0			424.7

NOTE: The table lists the 43 states that either used CARES/ARPA funding to supplement their UI reserves or borrowed from the U.S. Treasury.

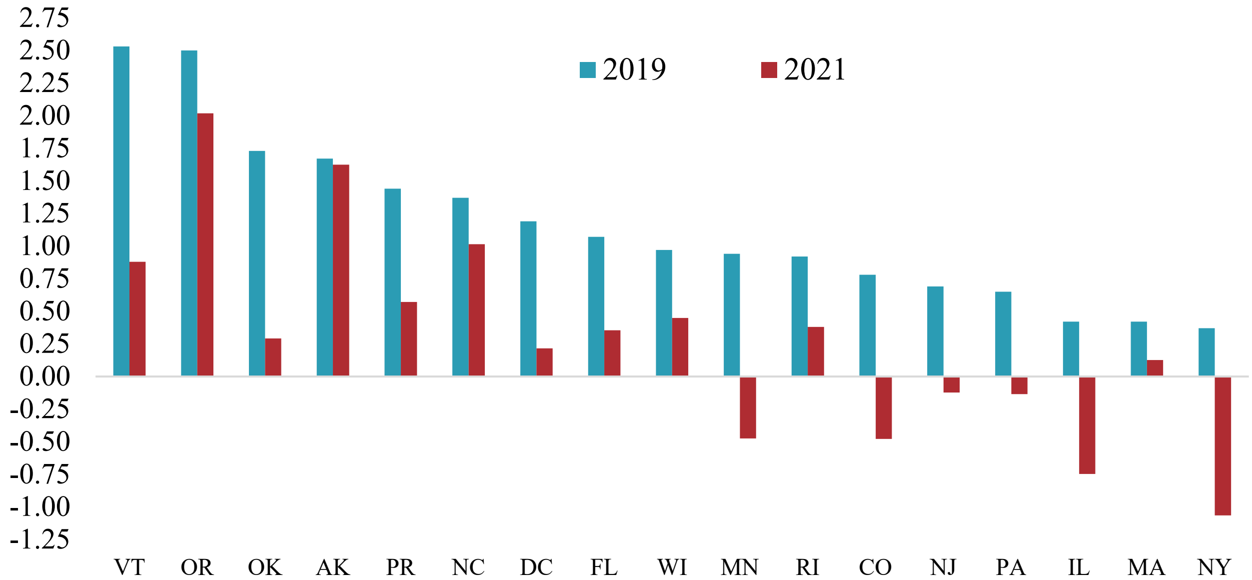
SOURCE: Title XII loans from https://fiscaldata.treasury.gov/datasets/ssa-title-xii-advance-activities/advances-to-state-unemployment-funds-social-security-act-title-xii.Year-end UI trust balances from https://www.treasurydirect.gov/govt/reports/tbp/account-statement/report.html. Cash infusion from CARES/ARPA from the National Conference of State Legislatures (NCSL), https://www.ncsl.org/research/fiscal-policy/arpa-state-fiscal-recovery-fund-allocations.aspx.

Figure 1 Average High-Cost Multiples among States Shoring Up Their UI Trusts With Federal Funds, by Year and Impact of Funds Infusion



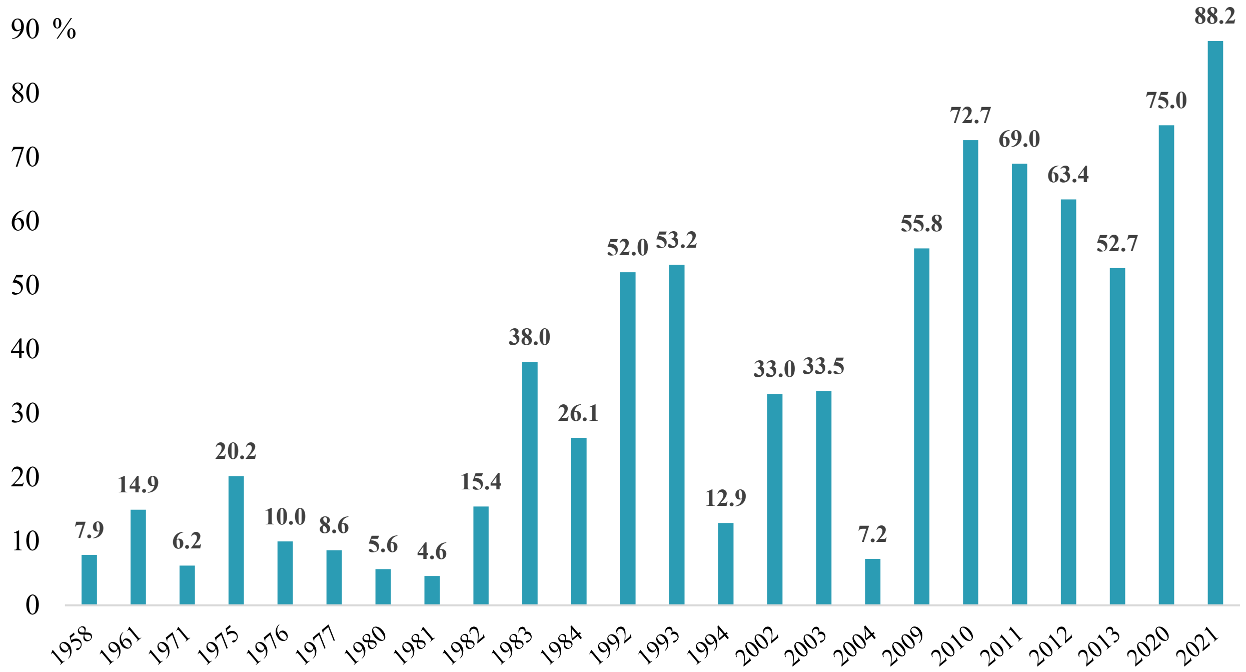
NOTE: The average high-cost multiple (AHCM) is the ratio of UI reserves to the average of paid benefits over the three highest payout years in the previous two decades. The chart includes the 35 states that infused CARES or ARP funds into their UI trust funds and shows AHCMs by year, with and without the federal funds infusions.
SOURCE: ET Handbook 394, National Conference of State Legislatures, and authors' calculations.

Figure 2 Average High-Cost Multiples among States Not Using Federal Funds to Supplement Their UI Trusts, by Year



NOTE: See note to Figure 1 for definition of AHCM. This chart includes the 17 states and territories that did not use CARES or ARP funds to supplement their UI trust funds.
SOURCE: ET Handbook 394, National Conference of State Legislatures, and authors' calculations.

Figure 3 Federal Share of Total UI Benefits in Recession Years and Shortly After



SOURCE: U.S. Department of Labor, Employment and Training Administration: 1) UI Financial Transaction Summary, ETA 2112; 2) ET Handbook 394; and 3) Monthly Program and Financial Data.