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Monopsony in Manufacturing

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For additional details, see see the full working paper at https://research.upjohn.org/up_workingpapers/364.

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How Federal Pandemic Relief Helped Replenish State Unemployment Reserves

Christopher J. O'Leary and Kenneth J. Kline

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, more than four times the previous peak quarter, in early 2009. Consequently, 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 (ARP) 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 kept states from cutting UI 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. State UI benefits are mainly financed by taxes on employer

ARTICLE HIGHLIGHTS

- *Unemployment insurance (UI) claims reached all-time records during the COVID pandemic, with 35.4 million applications in the second quarter of 2020 alone.*
- *Despite federal incentives following the Great Recession for states to shore up their UI reserves to pay benefits, state balances were inadequate to cover the unprecedented pandemic surge.*
- *The federal government paid 80 percent of the total $937 billion in UI benefit spending in 2020 and 2021.*
- *Consequently, many states used special federal funds to add to their own UI reserves or borrowed from the U.S. Treasury to avoid negative balances.*
- *Although the federal government backstopped the UI system, its actions may delay states from fixing structural financing issues that will remain a problem.*

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 provide income to unemployed workers to counter economic downturns, but they also dampen expansions during recoveries through business tax increases 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.[1] 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 increased the share of payroll wages that get taxed, but others were reluctant to raise UI taxes quickly for fear of choking off business recovery and labor demand (Johnston 2021). Many states prevented rate increases on employers, preferring instead to repay debt by taking smaller federal UI credits. Eight states cut potential durations of regular state benefits, and one of these also cut weekly benefit amounts.[2]

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 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 ARP Act).[3] 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 and, 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. Additional, miscellaneous federal contributions added another $174 billion in benefits, collectively bringing the federal total to $752 billion.

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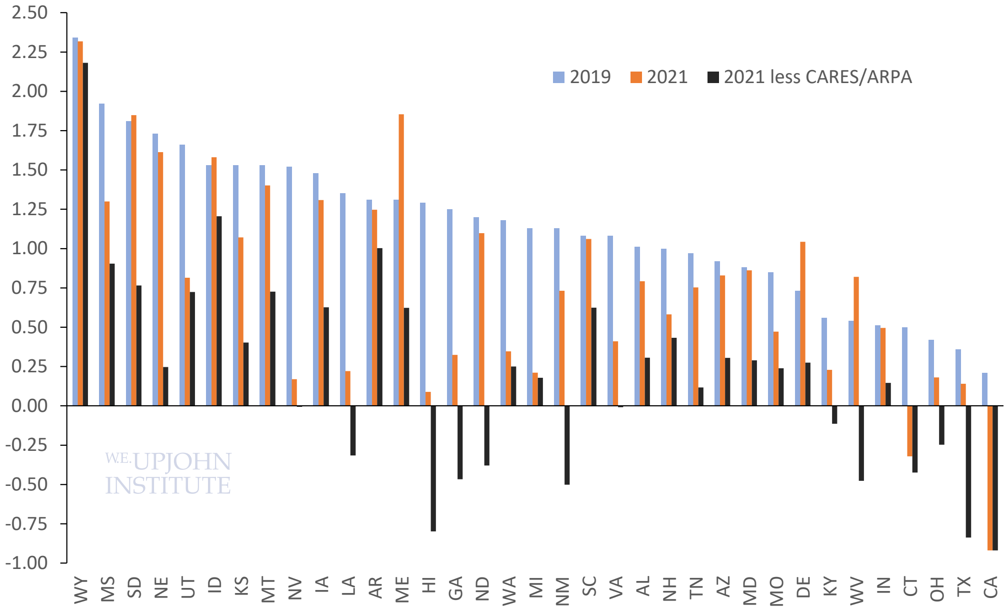
Additional Federal Relief to States and Use for UI Reserves

Besides these direct federal outlays for UI benefits, other funds from the CARES and ARP Acts may have forestalled states' need to reduce UI benefits or increase taxes to avoid exhausting their UI reserves or having to borrow. Thirty-five states tapped CARES and/or ARP in 2020 and 2021 to shore up their UI trust funds—by a total of over $25 billion. Of these 35 states, California and Connecticut still had negative net reserves at the end of 2021, although California used just $6.5 million from the 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).

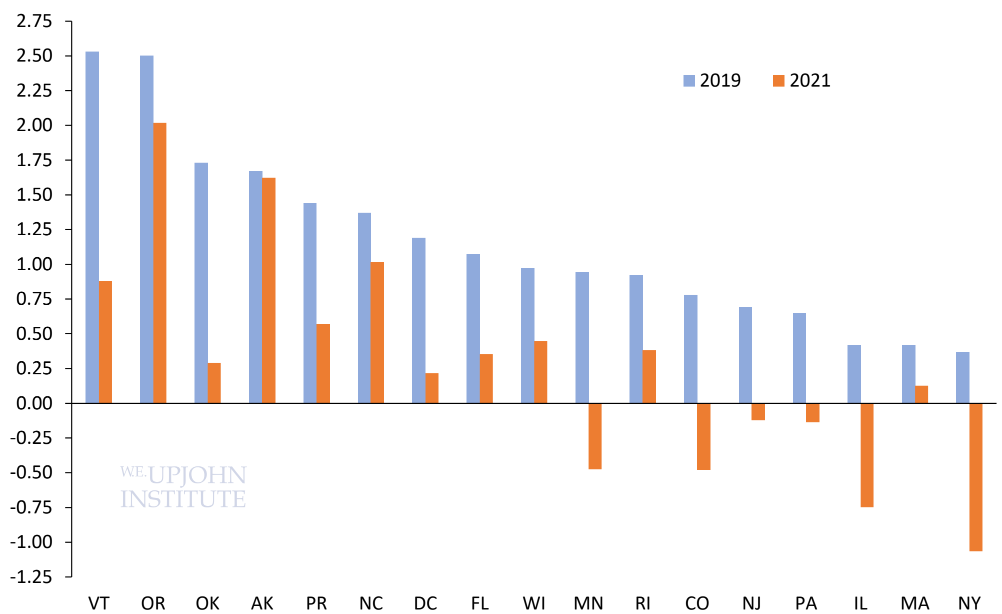
Prior to the pandemic, at year-end 2019, these 35 states had average reserves of 1.14 (in AHCM terms); by the end of 2021, their AHCMs averaged 0.77—or just 0.20 without the cash infusions (ET 394, NCSL, authors' calculations adding wage data from [UI Quarterly Data Summary]). Of the 17 states (and territories) that did not use CARES or ARP funds to boost their

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.

reserves, their 2019 year-end AHCMs averaged 1.16, which fell to 0.29 by the end of 2021 (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

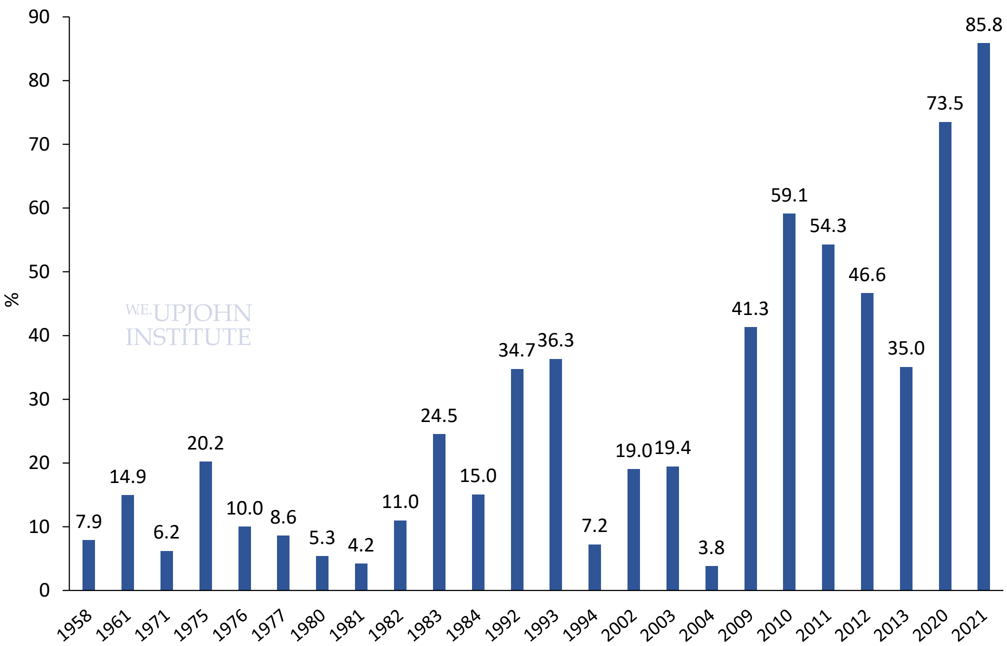
During the Great Recession, there were no sources of federal funding to replenish state UI reserves. In contrast, during the pandemic in 2020 and 2021, nearly 100 laws modified state UI systems but none reduced benefits. Many of these laws instead temporarily increased benefit receipt, often through time-limited suspension of both work search requirements and experience rating of UI tax rates (Levine 2021). Other laws mostly improved financing and benefits. Colorado and Connecticut raised their taxable wage bases; Virginia and West Virginia established work sharing programs (allowing partial benefits for workers whose hours are reduced); and California, Georgia, Maine, New York, and Oregon allowed workers a higher earnings threshold before losing UI eligibility. Furthermore, while eight states issued municipal bonds to finance UI debt after the financial crisis, only Massachusetts did so in the pandemic. Boosting UI reserves through CARES and ARP funds thus may have forestalled states from restricting UI and may have even accommodated expansions.

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 64 percent of the total. 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.

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 response also may have discouraged 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.

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.

Notes

1. 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.

2. See O'Leary and Kline (2020) for a discussion of states accepting reductions in the Federal Unemployment Tax Act (FUTA) credit to repay outstanding debt, as well as the list of states that reduced benefits.

3. 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.

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