

Lessons Left Unlearned: Unemployment Insurance Financing After the Great Recession

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This policy brief summarizes the main findings of our briefing paper, *Lessons Left Unlearned: Unemployment Insurance Financing After the Great Recession*. Contrary to popular perception, extensive state borrowing to pay unemployment insurance (UI) claims in recent years was not an inevitable consequence of the Great Recession or excessive benefit payments. Rather, a decade of unprecedentedly low employer contributions left most state UI trust funds depleted of reserves and woefully unprepared for even a modest downturn. Rising UI costs are the consequence of irresponsible financing practices. Yet, lawmakers in many states are choosing instead to make permanent cuts to their UI programs that will drastically reduce benefit payments and ensure that fewer job seekers are covered by UI in the future.

KEY FINDINGS

Today's unemployment insurance financing crisis was not an inevitable consequence of the Great Recession or excessive benefit payments.

- The number of states requiring loans to pay unemployment insurance claims and the amount borrowed are unprecedented.
- A decade of historically low employer contribution rates left most state UI trust funds unprepared for even a modest economic downturn.
- If all state trust funds held the minimum amount of pre-recession reserves recommended by UI financing experts, the number of states borrowing and the total amount borrowed would have been substantially reduced.
- Contributions to UI trust funds in most borrowing states were far below the amount necessary to have accumulated the recommended amount of reserves. Going forward, contributions must be substantially higher than current levels for state trust funds to be ready for the next recession.

The number of states requiring loans and the amount borrowed during the downturn were unprecedented.

- Thirty-six states relied on loans from the federal government to pay UI benefits over the past four years.
- As of May 2012, 26 states still had outstanding federal loans or municipal bond debt totaling \$43.5 billion (Table 1A).¹
- As a result of federal loans, states have paid over \$3 billion in interest and penalties (Table 1A), while the cost of borrowing is expected to increase substantially in future years.

Historically low employer contribution rates—not excessive benefits—contributed to today’s insolvency crisis and the rising cost of UI to employers.

- Between 1995 and 2005, 31 states reduced employer contribution rates by at least one-fifth (Henchman 2011, 16), causing the nation’s average employer contribution rate over the decade leading up to the Great Recession to fall to its lowest point in the program’s 75-year history.
- As state trust fund debts mounted, the reason for borrowing (i.e., excessive tax breaks) was soon forgotten, and state lawmakers began searching for ways to pin the blame for borrowing on unemployed workers.
- The capacity of the UI program to insure families against unexpected job loss and stabilize the economy during downturns is at serious risk. At least ten states have passed legislation to reduce the number of weeks of benefits available, severely restrict eligibility, or impose measures designed to discourage people from filing UI claims.

Had all states entered the recession with adequate trust fund reserves, the number of states requiring loans, and the amount borrowed, would have been substantially less.

- Relative to wages covered by the UI system, benefit payments were higher during the milder recessions of 1970s and 1980s than compared to the recent downturn. Despite the historic nature of the recent downturn, nearly every state trust fund experienced a more significant single-year benefit payout rate at some other point in the past 50 years.
- Prior to the recession, state UI trust funds collectively held in reserve half of the \$76 billion necessary to meet the minimum solvency standard recommended by UI financing experts (Table 2a). Unsurprisingly, 30 of 34 states that did not meet the minimum solvency standard had to borrow during the downturn, compared with only 6 of 19 states that went into the recession with adequate reserves.
- If all states entered the recession with the recommended trust fund balance, the number of states borrowing at the end of 2010 could have been reduced from 31 to 13, and the total amount borrowed from \$42 billion to \$9 billion (Table 1).

¹ Unless otherwise noted, all of the 53 unemployment insurance jurisdictions (i.e., the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands) are counted as states.

Table 1**Actual Versus Hypothetical Unemployment Insurance Trust Fund Borrowing (2010)**

| Pre-recession Trust Fund Reserve Balance (December 2007) | Number of States | Number of States Borrowing (Year-End 2010) | Amount Borrowed (Year-End 2010) | Percentage of States Borrowing | Loan as a Percentage of Total Wages Paid in Borrowing States |
|--|------------------|--|---------------------------------|--------------------------------|--|
| Actual Borrowing | | | | | |
| Met Solvency Benchmark | 19 | 5 ^a | \$2.9 | 26% | 0.77% |
| Did not Meet Solvency Benchmark | 34 | 26 | \$39.3 | 76% | 1.17% |
| Total | 53 | 31 | \$42.2 | 58% | 1.13% |
| Hypothetical Borrowing | | | | | |
| Assumed 34 insolvent states met benchmark in 2007 | | | | | |
| Met AHCM Benchmark in 2007 | 19 | 5 ^a | \$2.9 | 26% | 0.77% |
| Did not Meet AHCM Benchmark | 34 | 8 | \$5.9 | 24% | 0.55% |
| Total | 53 | 13 | \$8.8 | 25% | 0.61% |

Source: NELP analysis of U.S. Department of Labor, Handbook 394. See Methodology section of accompanying full report.

^a An additional state (New Hampshire) borrowed, but repaid its loan before the end of 2010.

Most states lack the foresight to responsibly finance UI benefits. Without a significant commitment, the UI trust fund system will continue to be vulnerable to economic downturns.

- Following the 2001 recession, the nation’s net trust fund balance fell to just over \$22 billion by the end of 2003, leaving just four years to close a \$54 billion gap between actual and recommended trust fund reserves by year-end 2007 (Table 2A).
- In the four years prior to the recession (2004 to 2007), employers in the 34 unprepared states contributed an average of \$288 per employee each year. To have accumulated the recommended amount of pre-recession reserves, employers in these states would have had to contribute \$374 per employee on average.
- States will need a combined \$86 billion to meet recommended trust fund reserve levels by the end of 2016. Because the system is currently running a net negative balance, reaching the recommended balance will require the accumulation of \$120 billion worth of reserves.
- Setting aside this amount of reserves over five years (2012 through 2016) would require an average annual per-employee contribution of \$530 per employee, or a 50 percent increase over the 2010 per-employee average (Table 3A).
- The path back to solvency will be substantially more difficult for those states that entered the recession with inadequate reserves. Employers in the 34 states that were unprepared for the recession contributed an average of \$362 per employee in 2010. For these states to regain solvency by the end of 2016, we estimate that per-employee contributions must increase by over 60 percent on average to \$591 per employee, per year (Table 3A).

CONCLUSION

The trust fund solvency crisis was not an inevitable consequence of the Great Recession. Much of today's borrowing, as well as interest payments on loans, federal repayment penalties, and state employer contribution rate increases could have been avoided had states entered the recession with the recommended amount of trust fund reserves. Had more states remained solvent during the downturn, there would have been substantially less pressure to make draconian benefit cuts that will permanently undermine the integrity of UI programs in many states.

Accumulating adequate pre-recession reserves requires a long-term commitment and foresight on the part of state lawmakers and employers to raise or maintain employer contributions when there is no existing crisis. Recent observers have pointed out that there is little incentive for myopic state lawmakers to accumulate adequate trust fund reserves (Galle 2012, 2–5). Those predominately large states that were not prepared for the recent recession needed to collect substantially more tax revenue from employers following the 2001 recession to have met recommended solvency measure. Going forward, an even greater commitment will be necessary from insolvent states for the entire trust fund system to return to solvency over the next five years.

Public choice theory predicts that political opposition—via employers—to UI taxes will be stronger than the corresponding support for UI benefits, particularly given the fact that mobile employers have greater bargaining power (Galle 2012, 5). Over the last two years, theory has played out in practice. With few exceptions, insolvent states have relied almost entirely on benefit cuts as a means to return state trust funds to zero (NELP 2011a), but there is no indication that most states have the political will to accumulate the reserves necessary for state trust funds to be truly solvent and able to withstand the next recession. Without substantial intervention from the federal partner, states will continue to be trapped in a race to the bottom, providing increasingly inadequate benefits with little promise of ever reaching recommended reserve balances in the foreseeable future.

WORKS CITED

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Table 1A

Summary of Federal Loans, Municipal Bonds, and Costs Related to Federal Loans (as of May 1, 2012)

| State | Federal Loans (\$ million) ^a | Municipal Bonds (\$ million) ^b | Total Borrowing (\$ million) | Borrowing-Related Costs | |
|----------------------|--|--|---------------------------------|---|---|
| | | | | 2011 Interest Payment (\$ million) ^c | Estimated 2011 Repayment Penalty (\$ million) ^d |
| United States | \$38,340 | \$5,182 | \$43,522 | \$1,238 | \$1,787 |
| Alabama | \$99 | --- | \$99 | \$3.9 | --- |
| Arizona | \$382 | --- | \$382 | \$8.2 | --- |
| Arkansas | \$317 | --- | \$317 | \$10.1 | \$22.1 |
| California | \$10,741 | --- | \$10,741 | \$303.5 | \$295.0 |
| Colorado | \$435 | --- | \$435 | \$11.4 | --- |
| Connecticut | \$810 | --- | \$810 | \$22.6 | \$31.7 |
| Delaware | \$76 | --- | \$76 | \$1.7 | --- |
| Florida | \$1,809 | --- | \$1,809 | \$56.1 | \$151.8 |
| Georgia | \$761 | --- | \$761 | \$21.0 | \$77.5 |
| Hawaii | --- | --- | --- | \$0.2 | --- |
| Idaho | --- | \$188 | \$188 | \$5.5 | --- |
| Illinois | \$2,103 | --- | \$2,103 | \$71.4 | \$108.0 |
| Indiana | \$2,035 | --- | \$2,035 | \$60.4 | \$106.8 |
| Kansas | \$142 | --- | \$142 | \$4.6 | --- |
| Kentucky | \$961 | --- | \$961 | \$28.2 | \$32.9 |
| Michigan | --- | \$3,323 | \$3,323 | \$106.0 | \$216.4 |
| Minnesota | --- | --- | --- | \$14.9 | \$47.3 |
| Missouri | \$796 | --- | \$796 | \$23.3 | \$48.2 |
| Nevada | \$832 | --- | \$832 | --- | \$25.5 |
| New Jersey | \$880 | --- | \$880 | \$48.0 | \$74.9 |
| New York | \$3,759 | --- | \$3,759 | \$95.4 | \$154.3 |
| North Carolina | \$2,842 | --- | \$2,842 | \$78.5 | \$72.5 |
| Ohio | \$2,283 | --- | \$2,283 | \$70.7 | \$93.3 |
| Pennsylvania | \$3,875 | --- | \$3,875 | \$104.6 | \$101.7 |
| Rhode Island | \$288 | --- | \$288 | \$7.1 | \$8.3 |
| South Carolina | \$782 | --- | \$782 | \$26.5 | --- |
| Texas | --- | \$1,671 | \$1,671 | --- | --- |
| Vermont | \$78 | --- | \$78 | \$2.1 | --- |
| Virgin Islands | \$34 | --- | \$34 | \$0.7 | \$0.7 |
| Virginia | \$350 | --- | \$350 | \$8.8 | \$69.8 |
| Wisconsin | \$869 | --- | \$869 | \$42.3 | \$48.6 |

^a U.S. Department of Labor, Outstanding Loans from the Federal Unemployment Account, Balances as of May 1, 2012.

^b For information on Idaho, Michigan, and Texas bonds, see the Municipal Securities Rulemaking Board, "Electronic Municipal Market Access," <http://emma.msrb.org/default.aspx>. In addition to the three states noted here, Arkansas, Illinois, and Kentucky all approved legislation allowing the state to issue debt in the private bond market. However, as of April 2012, none of these states have issued debt.

^c U.S. Department of Labor, "Interest on Title XII Advances for FY2011," http://www.workforcesecurity.doleta.gov/unemploy/docs/Interest_pay_FY11TXII.xls.

^d The repayment penalty (i.e., FUTA tax credit reduction) automatically increases federal unemployment insurance taxes in those states that have had outstanding loan balances for over two years. The proceeds are used to pay down state debt. NELP state-by-state estimates based on estimated number of covered workers and past FUTA tax receipts. The President's FY 2013 budget estimated total FUTA credit reductions of \$1.87 billion in FY 2012.

Table 2A

Summary of Actual and Recommended Pre-Recession Reserves (Year-End 2007)

| | Average High-Cost Multiple (2007) | Recommended Reserves for an AHCM of 1.0 (\$ millions) | Actual Pre-Recession Net Reserves (\$ millions) | Difference [Actual - Required] (\$ millions) |
|----------------------|--|--|--|--|
| United States | 0.52 | \$76,296 | \$38,168 | -\$38,127 |
| Alabama | 0.52 | \$794 | \$411 | -\$384 |
| Alaska | 1.07 | \$309 | \$331 | Met Benchmark |
| Arizona | 1.12 | \$886 | \$990 | Met Benchmark |
| Arkansas | 0.32 | \$479 | \$151 | -\$328 |
| California | 0.27 | \$9,338 | \$2,533 | -\$6,805 |
| Colorado | 0.67 | \$943 | \$630 | -\$312 |
| Connecticut | 0.54 | \$1,106 | \$598 | -\$508 |
| Delaware | 0.90 | \$193 | \$174 | -\$19 |
| District of Columbia | 1.10 | \$364 | \$400 | Met Benchmark |
| Florida | 1.05 | \$2,100 | \$2,204 | Met Benchmark |
| Georgia | 0.97 | \$1,315 | \$1,282 | -\$33 |
| Hawaii | 1.88 | \$296 | \$556 | Met Benchmark |
| Idaho | 0.47 | \$418 | \$196 | -\$222 |
| Illinois | 0.34 | \$5,230 | \$1,802 | -\$3,428 |
| Indiana | 0.29 | \$1,066 | \$307 | -\$759 |
| Iowa | 0.88 | \$840 | \$740 | -\$99 |
| Kansas | 0.97 | \$657 | \$638 | -\$19 |
| Kentucky | 0.21 | \$1,076 | \$231 | -\$845 |
| Louisiana | 0.94 | \$1,540 | \$1,445 | -\$95 |
| Maine | 1.64 | \$293 | \$479 | Met Benchmark |
| Maryland | 0.78 | \$1,296 | \$1,017 | -\$279 |
| Massachusetts | 0.50 | \$2,559 | \$1,290 | -\$1,268 |
| Michigan | -0.03 | \$3,809 | -\$103 | -\$3,912 |
| Minnesota | 0.38 | \$1,455 | \$546 | -\$909 |
| Mississippi | 1.70 | \$428 | \$728 | Met Benchmark |
| Missouri | 0.12 | \$962 | \$113 | -\$849 |
| Montana | 1.45 | \$193 | \$281 | Met Benchmark |
| Nebraska | 1.19 | \$235 | \$279 | Met Benchmark |
| Nevada | 1.02 | \$777 | \$793 | Met Benchmark |
| New Hampshire | 1.19 | \$201 | \$240 | Met Benchmark |
| New Jersey | 0.21 | \$3,157 | \$650 | -\$2,507 |
| New Mexico | 1.88 | \$307 | \$576 | Met Benchmark |
| New York | 0.08 | \$5,086 | \$430 | -\$4,656 |
| North Carolina | 0.23 | \$1,684 | \$394 | -\$1,290 |
| North Dakota | 0.79 | \$171 | \$134 | -\$37 |
| Ohio | 0.12 | \$3,666 | \$445 | -\$3,221 |
| Oklahoma | 1.51 | \$552 | \$831 | Met Benchmark |
| Oregon | 1.45 | \$1,329 | \$1,933 | Met Benchmark |
| Pennsylvania | 0.30 | \$5,120 | \$1,546 | -\$3,574 |
| Puerto Rico | 1.00 | \$528 | \$529 | Met Benchmark |
| Rhode Island | 0.38 | \$422 | \$160 | -\$262 |
| South Carolina | 0.26 | \$772 | \$199 | -\$573 |
| South Dakota | 0.32 | \$76 | \$25 | -\$51 |
| Tennessee | 0.48 | \$1,186 | \$566 | -\$620 |
| Texas | 0.45 | \$3,987 | \$1,775 | -\$2,212 |
| Utah | 1.46 | \$576 | \$843 | Met Benchmark |
| Vermont | 1.20 | \$148 | \$178 | Met Benchmark |
| Virgin Islands | 0.80 | \$28 | \$22 | -\$5 |
| Virginia | 0.70 | \$1,100 | \$775 | -\$325 |
| Washington | 1.53 | \$2,475 | \$3,794 | Met Benchmark |
| West Virginia | 0.45 | \$544 | \$245 | -\$299 |
| Wisconsin | 0.29 | \$2,012 | \$592 | -\$1,420 |
| Wyoming | 1.15 | \$212 | \$244 | Met Benchmark |

Source: National Employment Law Project analysis of U.S. Department of Labor, Handbook 394.

Table 3A

Actual 2010 Net Reserves and Employer Contributions Versus Amounts Necessary to Be Solvent by 2016

| | Actual 2010 Net Reserves (\$ million) | Required Reserves to Reach Solvency by December 2016 (\$ million) | Required Average Contribution per Employee 2012 to 2016 | Actual Average Contribution per Employee 2010 |
|----------------------------|--|--|--|--|
| United States | -\$32,674 | \$86,271 | \$530 | \$350 |
| 34 Insolvent States | -\$35,981 | \$70,684 | \$591 | \$362 |
| Alabama | -\$194 | \$658 | \$307 | \$290 |
| Arkansas | -\$279 | \$615 | \$545 | \$374 |
| California | -\$9,363 | \$12,551 | \$852 | \$390 |
| Colorado | -\$413 | \$1,263 | \$414 | \$243 |
| Connecticut | -\$483 | \$1,491 | \$882 | \$529 |
| Delaware | -\$31 | \$229 | \$544 | \$271 |
| Georgia | -\$513 | \$1,744 | \$368 | \$212 |
| Idaho | -\$97 | \$423 | \$530 | \$578 |
| Illinois | -\$2,374 | \$4,218 | \$783 | \$426 |
| Indiana | -\$1,937 | \$1,502 | \$601 | \$245 |
| Iowa | \$310 | \$787 | \$375 | \$440 |
| Kansas | -\$45 | \$646 | \$358 | \$302 |
| Kentucky | -\$796 | \$985 | \$631 | \$323 |
| Louisiana | \$896 | \$745 | \$246 | \$131 |
| Maryland | \$200 | \$1,472 | \$391 | \$441 |
| Massachusetts | \$18 | \$3,544 | \$948 | \$649 |
| Michigan | -\$3,522 | \$3,103 | \$993 | \$496 |
| Minnesota | -\$536 | \$1,650 | \$577 | \$466 |
| Missouri | -\$704 | \$1,128 | \$446 | \$279 |
| New Jersey | -\$1,572 | \$4,055 | \$1,031 | \$716 |
| New York | -\$3,100 | \$6,955 | \$883 | \$444 |
| North Carolina | -\$2,283 | \$2,481 | \$658 | \$258 |
| North Dakota | \$96 | \$133 | \$283 | \$278 |
| Ohio | -\$2,210 | \$2,506 | \$588 | \$309 |
| Pennsylvania | -\$2,915 | \$4,883 | \$1,004 | \$540 |
| Rhode Island | -\$188 | \$550 | \$1,154 | \$640 |
| South Carolina | -\$880 | \$854 | \$511 | \$185 |
| South Dakota | \$26 | \$70 | \$128 | \$242 |
| Tennessee | \$159 | \$1,116 | \$358 | \$327 |
| Texas | -\$1,667 | \$4,729 | \$400 | \$276 |
| Virgin Islands | -\$17 | \$37 | \$787 | \$41 |
| Virginia | -\$284 | \$1,405 | \$306 | \$183 |
| West Virginia | \$77 | \$366 | \$465 | \$370 |
| Wisconsin | -\$1,361 | \$1,791 | \$732 | \$418 |
| 19 Solvent States | \$3,307 | \$15,587 | \$422 | \$328 |
| Alaska | \$245 | \$334 | \$781 | \$478 |
| Arizona | -\$225 | \$1,143 | \$316 | \$166 |
| District of Columbia | \$301 | \$436 | \$398 | \$329 |
| Florida | -\$1,855 | \$3,411 | \$363 | \$195 |
| Hawaii | -\$12 | \$429 | \$551 | \$386 |
| Maine | \$279 | \$360 | \$319 | \$315 |
| Mississippi | \$340 | \$361 | \$217 | \$137 |
| Montana | \$112 | \$225 | \$324 | \$317 |
| Nebraska | \$215 | \$241 | \$155 | \$295 |
| Nevada | -\$589 | \$1,230 | \$709 | \$284 |
| New Hampshire | \$4 | \$286 | \$271 | \$327 |
| New Mexico | \$225 | \$411 | \$343 | \$426 |
| Oklahoma | \$269 | \$610 | \$219 | \$137 |
| Oregon | \$911 | \$1,580 | \$638 | \$639 |
| Puerto Rico | \$294 | \$542 | \$526 | \$247 |
| Utah | \$313 | \$573 | \$260 | \$155 |
| Vermont | -\$37 | \$199 | \$648 | \$367 |
| Washington | \$2,392 | \$3,023 | \$667 | \$604 |
| Wyoming | \$124 | \$194 | \$303 | \$425 |

Source: NELP analysis of U.S. Department of Labor, Handbook 394. See Appendix of full report for more information.