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State Unemployment Insurance Returns to Crisis

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Summary

- The last national economic crisis was twelve years ago. Pennsylvania's unemployment compensation fund went into debt at that time.
- In January of this year, the commonwealth finally repaid the debt but it never sufficiently replenished fund resources.
- A new crisis has arisen, and the unemployment compensation fund is headed straight back into debt.
- The unemployment system needs to be reformed after this crisis passes. The guiding principle of such reform should be to maintain worker protection without distorting incentives.
- Reforms might include netting items such as severance pay and vacation pay from unemployment claims payable, ensuring that the duration of unemployment payouts does not exceed time worked and capping the duration and amount of emergency supplemental coverage the legislature can add in any single vote.

How Unemployment Insurance Works

Unemployment insurance (UI) was conceived in the 1930s as a means of helping people who are temporarily and involuntarily without work. Unemployed workers apply to the state government, which administers claims while referring workers to federally administered job referral and re-employment services.

UI is funded jointly through state and federal unemployment taxes, which are both paid by employers on all wages. Federal unemployment tax is 6 percent on the first \$7,000 of every worker's wages.¹ Pennsylvania state unemployment tax varies by formula from the low single digits to about 10 percent, with employers in industries with a high frequency of worker layoffs (construction, for instance) paying more.² While such an arrangement is standard among the 50

¹ United States Department of Labor. *Unemployment Insurance Director's Guide*. March 2020.

https://oui.doleta.gov/unemploy/docs/ui_directors_Mar2020.pdf

² "Types of Rates." Pennsylvania state government website. <https://www.uc.pa.gov/employers-uc-services-uc-tax/uc-tax-rates/Pages/Types-of-Rates.aspx>

states, Pennsylvania's tax is among the highest³, largely because the fund from which it pays claims has historically been in poor financial condition.

Benefits are similar across states. Pennsylvania and most others give up to 26 weekly taxable cash payments sized to approximately half of lost average weekly wages. A worker may apply immediately upon losing his job, but will not receive cash for several more weeks. Under ordinary circumstances unemployment benefits do not cover the first week of unemployment.⁴ An unemployed worker must file bi-weekly benefit requests to certify his continuing unemployment and weekly job search requirements begin in the third week of benefits. A UI recipient, with exceptions, must apply for two jobs and participate in one approved work search activity each week. A return to full time work ends UI payments, but part-time work or reduced hours may still qualify a worker for compensation. Seasonal workers may not claim unemployment.

Emergency Measures

The Pennsylvania Department of Labor and Industry has waived the one-week waiting period and suspended work search requirements in response to the present viral epidemic.⁵

On Thursday, April 2 the federal government reported 6.6 million initial jobless claim applications, compared with a maximum weekly claims number of about 650,000 during the 2008-2009 banking crisis.⁶ In Pennsylvania half a million people filed during the first week of government-ordered business suspensions.⁷

Federal emergency legislation provides:⁸

- Extension of UI duration to a maximum of 39 weeks. This is the standard 26 weeks plus thirteen weeks of emergency benefits for those who exhaust the standard benefits. The extended benefits will be available through December 31.
- A \$600 federally-funded addition to regular state weekly benefits, through July.
- Expansion of coverage to freelance workers, furloughed workers and non-profit and government workers.

³ Tax Foundation 2020 State Business Tax Climate Index. <https://taxfoundation.org/2020-state-business-tax-climate-index/>

⁴ "What to Expect." Pennsylvania state government website. <https://www.uc.pa.gov/unemployment-benefits/file/Pages/Whattoexpect.aspx>

⁵ "Information for Pennsylvania Workers Impacted by COVID-19." <https://www.uc.pa.gov/Pages/covid19.aspx>

⁶ Initial jobless claims: Federal Reserve FRED economic database. <https://fred.stlouisfed.org/series/ICSA>

⁷ Penn Live. "PA Unemployment Claims Skyrocket." March 25, 2020. <https://www.pennlive.com/news/2020/03/pa-unemployment-claims-skyrocket-to-540000-since-statewide-coronavirus-shutdown-shattering-records.html>

⁸ Concise summary from *Fortune* magazine: <https://fortune.com/2020/03/27/coronavirus-unemployment-benefits-stimulus-package-who-eligible-when-start-how-much-long-faq-relief-bill/>

- Separate from UI expansion, a \$1,200 check will be mailed to most adults making less than \$75,000, with payments scaling down above that threshold. \$500 will be mailed for each dependent child in qualifying households.

Insufficient Reserves

Unemployment taxes flow into the State Unemployment Insurance Trust Fund at the U.S. Treasury. Benefits are paid out of these accounts. If a state's account runs out of money, it can borrow from the federal government. Ideally, states build up balances in good times to fund recessionary times, and the national system as a whole never goes into debt. The national trust fund contains \$75.7 billion. Pennsylvania's fund contains \$3.4 billion.⁹

The fund's solvency is measured by the Average High Cost Multiple (AHCM). Simplified, the AHCM is the fund balance divided by a smoothed average of recessionary year claims. The federal government uses a value of 1 as a solvency standard. Pennsylvania's AHCM is 0.65, indicating it would be unlikely to pay all claims in an ordinary recession without borrowing. Pennsylvania is the 12th worst in the nation by this measure. Worst are California (0.21) and New York (0.36). Best are Vermont (2.5) and Oregon (2.5). Given the likely short-term size of unemployment due to the virus epidemic, however, these ordinal rankings are less relevant: \$600 dollars per week times three million unemployed people is \$1.8 billion per week, which would drain the entire national trust fund in a month. Barring a near-immediate return to something like normal business conditions it appears that the unemployment trust fund will have to be backstopped by the federal government, and the states will need to pay their share of benefits from current cash flows or borrowing.

Repeating History

The banking crisis of 2008-2009 is instructive. At that time, millions of people nationwide drew benefits, eligibility and duration of benefits were expanded, and, even though much of the expansion was paid for by the federal government, Pennsylvania depleted its UI trust fund. Collections in prior years had been insufficient to build a high enough AHCM. In fact, Pennsylvania has not achieved an AHCM of 1 since 1971.

Around March 2009 Pennsylvania borrowed \$2 billion from the federal government at interest, but unemployment continued to grow. As of February 2010, the commonwealth was paying out about \$75 million per week in unemployment benefits. Eventually the commonwealth refinanced its federal loan with a \$2.8 billion bond offering, and added a 1.1% interest factor to employer's unemployment compensation taxes in the years 2013-2019. Just this year, in January 2020, twelve years after the banking crisis, Pennsylvania finally paid off the

⁹ This and all subsequent data from United States Department of Labor. *Unemployment Trust Fund Solvency Report*. <https://oui.doleta.gov/unemploy/docs/trustFundSolvReport2020.pdf>

bond.¹⁰ Less than two months later, the viral pandemic arrived. A return to debt now appears inevitable.

Reforms Needed

After the present crisis passes, policy makers should take steps to prevent a third repetition of state unemployment fund insolvency. A one-time refill of the fund to achieve a prudent solvency ratio should be combined with benefit reform. The guiding principle of such reform should be to maintain worker protection without distorting incentives. Reforms might include netting items such as severance pay and vacation pay from unemployment claims payable, ensuring that the duration of unemployment payouts does not exceed time worked and capping the duration and amount of emergency supplemental coverage the legislature can add in any single vote. Emergency measures can be extended as a crisis period continues, but the temptation for lawmakers to vote in massive increases and extensions at the outset must be removed. Nobody knows how fast a crisis will end, and oversized packages rushed through as a reflexive overreaction risk deterring a return to work as business normalizes.

¹⁰ "Pennsylvania Pays Off Unemployment Compensation Debt." Bucks County Courier-Times. <https://www.buckscountycouriertimes.com/news/20200124/pennsylvania-pays-off-28b-unemployment-compensation-debt>