

The Great Recession and State Unemployment Insurance Funds

BY RICK KAGLIC

Roughly 8.8 million nonfarm payroll jobs were lost nationwide during the labor market downturn of the Great Recession, and fewer than 3.5 million have been generated since the recovery got under way in mid-2009. The official unemployment rate in the United States has come down a bit from recession highs, yet remains well above the peaks established following the recessions in 1991 and 2001. Perhaps the most striking statistic in labor market data, however, is that the percentage of officially unemployed workers who have been out of work for 27 weeks or more has been stuck in a range between 40 percent and 45 percent (see chart below). This is sharply higher than the previous peak established during the deep double-dip recessions of the early 1980s, when the share of long-term unemployed hit roughly 26 percent.

The persistence of long-term unemployment increased the average length of time that workers were collecting benefits and stressed states' regular unemployment reserves, in many cases exhausting them entirely. Yet even if a state's fund becomes insolvent, it is still statutorily obligated to continue paying benefits to qualifying unemployed workers. To do so, many states had to borrow money from the federal government simply to meet their regular benefits obligations. (This article sets aside the issue of extended benefits since most were paid for by the federal government during much of the period being discussed here.)

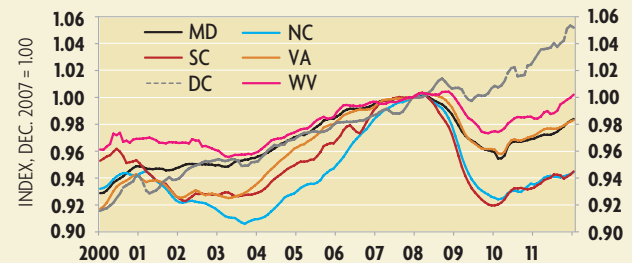
The recent downturn has had major effects on the unemployment insurance programs in Fifth District states, especially those hardest hit, and has required states to take various measures to meet their unemployment insurance promises. Those measures, in turn, are likely to have effects on businesses, workers, states' budgets, and possibly even the program itself.

The Unemployment Experience in the Fifth District

The unemployment insurance program is a joint federal-state initiative that began back in 1935 to ease the burdens on workers following the Great Depression. When workers become unemployed due to circumstances beyond their control, they may become eligible to receive unemployment insurance benefits. The state pays these claims from an unemployment insurance trust fund derived from taxes on employers. Benefit levels, as well as the tax rates and the portion of wages that are taxable, vary considerably across states. The revenues from the state's unemployment insurance taxes are held by the federal government in individual accounts for each state.

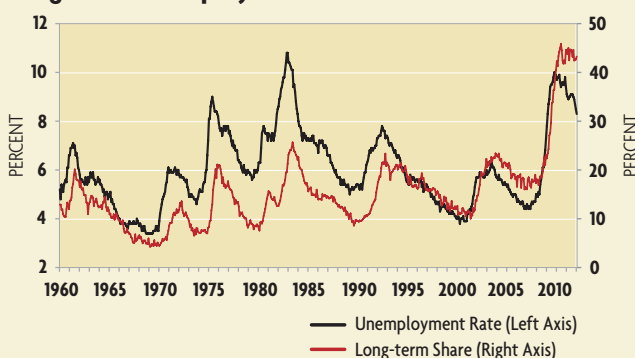
Payroll Employment

(Three-month moving average)



SOURCE: U.S. Department of Labor, BLS

Long-Term Unemployment in the U.S.



SOURCE: U.S. Department of Labor, BLS

The adjustments that Fifth District states have had to make, or will have to make, to their programs as a result of the downturn depend primarily on two factors: the depth and longevity of the state's labor market contraction and how well positioned its trust fund was heading into the downturn. With regard to the first factor, the Fifth District on average lost fewer jobs than the nation as a whole, but there was considerable variation across the region. States with stronger ties to the federal government and military (Maryland and Virginia) and the District of Columbia fared better than those tied to manufacturing and construction industries (North Carolina and South Carolina). In the Carolinas, the recession resulted in combined job losses amounting to nearly 500,000 from peak to trough, or 8.1 percent of total payrolls. (The 8.8 million lost nationwide represent 6.3 percent of the national total.) In the rest of the District, job losses totaled 4.5 percent (see chart).

Beyond the magnitude of the job contraction in the District, this cycle is notable for its prolonged and

disappointing recovery. Employment growth during the most recent expansion pales in comparison to recoveries from prior deep recessions, contributing to longer spells of unemployment. Outside of the District of Columbia, where the recession was comparatively short, employment in each of the states remains below prerecession levels, with the states having varying degrees of success recapturing the jobs that were lost. On the far ends of the spectrum, West Virginia's economy has regenerated more than 95 percent of its lost jobs, while North Carolina has regained less than a third. This jobs gap has left unemployment, and unemployment benefits payments, elevated in much of the Fifth District.

The second factor, how well positioned the state's unemployment trust fund was to weather the sudden surge in unemployment insurance claims, was more within the control of policymakers. State governments have to perform a careful balancing act with their unemployment insurance funds. On the one hand, policymakers want to have enough in reserves to meet their obligations and mitigate the shock of rising unemployment to the economy during a recession. On the other hand, they want to minimize the tax costs associated with hiring a new worker so as not to stifle labor demand during expansions.

One measure that can be used to gauge a state's preparedness is its Average High Cost (AHC) multiple. A useful way to think about the AHC multiple is the length of time, measured in years, that it would take for the state's trust fund to run out of reserves if a significant recession were to occur. For the calculation of the AHC multiple, "significant" is the average of the three highest insurance payout years in the last 20 years. A multiple of 1.00 suggests that the state would have enough money in its trust fund to pay those benefits for one year if a severe recession were to hit. While there is no federal statutory definition of "adequately funded," the U.S. Department of Labor suggests that states should have a multiple of at least 1.00 heading into a recession to be considered minimally solvent.

So how adequately funded were the Fifth District's unemployment trust funds heading into the downturn? Here again, there is quite a bit of variation across the region. Prerecession multiples ranged from a high of 1.11 in the District of Columbia to lows of 0.23 and 0.26 in North Carolina and South Carolina, respectively (see table). Based on the multiples, it appears that the District of Columbia had the only trust fund that was "minimally solvent" according to the Labor Department standard. While Maryland, Virginia, and West Virginia were not adequately prepared to deal with a significant recession, North Carolina and South Carolina appeared even less so.

Of course, prepared is a relative concept. No state was

Preparedness and Generosity (as of 2007 Q4)

	Average High Cost Multiple	AWBA as a % of AWW*
DC	1.11	22.4
MD	0.78	33.0
NC	0.23	38.7
SC	0.26	35.7
VA	0.70	33.1
WV	0.45	39.2

NOTE: *AWBA denotes Average Weekly Benefit Amount, AWW denotes Average Weekly Wages.
SOURCES: U.S. Department of Labor, ETA, OWS, Division of Fiscal and Actuarial Services

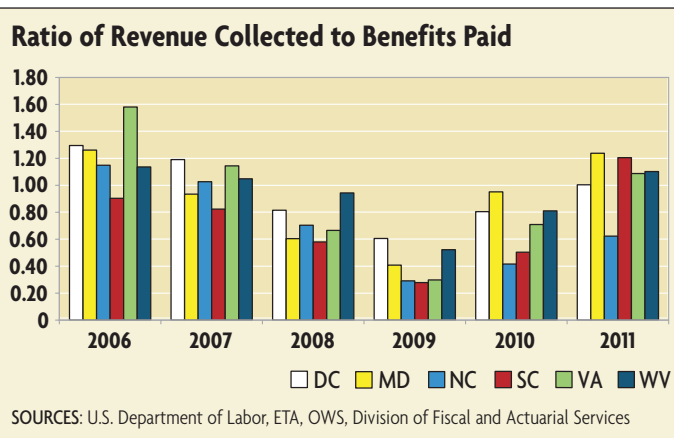
positioned well to deal with the severity of the Great Recession. The years used to calculate states' AHC multiples generally fell in the era known as the "Great Moderation," a period characterized by relatively prolonged economic expansions and two short and very shallow recessions in 1991 and 2001. Thus, the last two deep recessions, those in the mid-1970s and early 1980s, were not used to calculate the multiples.

An additional factor influencing the current health of states' trust funds is how generous their unemployment insurance benefits were. In more normal

economic times, states often sought to maximize the benefits paid to furloughed workers to help them through short stretches of unemployment. These benefits help workers to provide for their families during the unemployment spell, while at the same time helping to stabilize overall economic activity by minimizing the shock to aggregate demand. States have a lot of flexibility in determining the level of benefit payments to individuals. Most use a formula that pays half the worker's wage up to a certain maximum, which may be adjusted for the number of dependents and other factors. To get a sense of relative generosity in each state, the actual average weekly benefit amount (AWBA) as a percent of the average weekly wage (AWW) can be used as a rudimentary proxy. A higher number suggests a relatively more generous benefits program. Based on this criterion, the programs in West Virginia, North Carolina, and South Carolina were relatively more generous at the start of the recession than that of the District of Columbia.

Pressure on the Trust Funds

To show how pressures began to materialize when the recession started, we can look at inflows and outflows for each state's unemployment trust fund. The chart below shows the ratio of revenues collected to benefits paid by jurisdiction for the period 2006 to 2011. The revenues component refers only to those payroll taxes collected from employers for the purpose of funding the state's unemployment insurance



program. A ratio greater than 1.0 indicates that the state was collecting more in state unemployment taxes than it was paying out in unemployment insurance benefits; less than 1.0 means the state was paying out more than it was taking in.

At the beginning of the period, prior to the recession, inflows were exceeding outflows in each state but South Carolina, and trust fund balances were rising. In 2007, however, initial unemployment claims increased from the prior year in four of the District's six jurisdictions, and benefits payments increased in five. (Virginia was the lone exception.) With that, the revenue-to-benefits-payments ratios began to fall. Still, only two states, Maryland and South Carolina, experienced trust fund deficits for the year.

It was not until 2008, as the Great Recession got under way in earnest and job losses mounted quickly, that benefits payments exceeded revenues by significant margins in most jurisdictions. The pressure came from both directions: Not only did unemployment claims increase dramatically, but also the pool of taxable employees dwindled. As a result, District-wide benefits payments jumped 41 percent in 2008 while revenue collections dipped 5 percent. Conditions worsened considerably in 2009: Benefits payments in the District doubled from 2008 while revenues continued to fall. Revenue-to-benefits ratios plunged everywhere.

The shortfalls in 2009 were particularly severe in the Carolinas and Virginia, where the states were collecting roughly 35 cents in revenue for each dollar that was being paid out in benefits. The Carolinas had a twofold problem: Far more jobs were lost during the downturn and benefits were relatively more generous. In addition to the increase in benefits payments, these two states experienced the biggest declines in revenue collections of District states. Virginia's problems, in contrast, were mostly on the benefits side; benefits payments increased dramatically while collections declined only slightly. The District of Columbia, Maryland, and West Virginia experienced their own difficulties, but to a lesser extent.

Despite rapidly falling trust fund balances, states were still statutorily bound to continue paying benefits to qualified unemployed workers, even if that balance fell to zero. If the state can no longer go to its trust fund to meet its obligations (if it reaches insolvency), the state then has to borrow money from the federal government to continue making those payments. During the course of this downturn, and the continued strains on labor markets in its wake, four states — Maryland, North Carolina, South Carolina, and Virginia — were forced to borrow money from the federal government. South Carolina's fund was the first to reach insolvency in late 2008, but the others were not far behind.

Unfortunately, those strains have continued. As of Sept. 31, 2011, three of the four had

outstanding balances with the federal government. North Carolina had the largest balance at roughly \$2.5 billion (which ranked as the nation's fifth highest). South Carolina had a balance of more than \$850 million and Virginia owed about \$211 million. Maryland had borrowed roughly \$90 million in early 2010 to meet its obligations but was able to pay the balance off by year-end.

Thus, while the District of Columbia, Maryland, and West Virginia have put their respective trust funds on more solid footing, North Carolina, South Carolina, and Virginia remained indebted to the federal government at the end of 2011. In addition to paying interest on that debt, employers in these states have seen their effective Federal Unemployment Tax Act (FUTA) taxes increase by 0.3 percent as a penalty for the state having continuous unpaid loan balances for more than two years. That penalty will rise until the state's debt is paid off.

Closing the Gap

So what is a state to do in order to restore health to its trust fund in times of continued stress? On the expenditure side, states have few practical options. They can cut weekly benefits payments, reduce the maximum duration for which those payments are made, or carry out some combination of the two. None of the above is a politically appealing option, however, especially during a downturn when they all fly in the face of the spirit of the program. The hurdles to reducing benefit levels and duration are even greater because of the severity of the most recent recession. (As part of the American Recovery and Reinvestment Act, the federal government temporarily provided 100 percent of the funding for states' extended benefits programs, plans usually funded 50 percent by the state, but the law prohibited states that accepted the funding from reducing benefit levels unless existing state law allowed for it.)

At the time of the recession, the vast majority of states (including all of those in the Fifth District) had a maximum benefit period of 26 weeks written into state law. As is the case with reducing benefit levels, cutting the number of weeks of eligibility is an unappealing option during times of high and sustained unemployment. Nationally, few states have done so. In the Fifth District, only South Carolina has opted to take this step. In mid-2011, the state's legislature voted to reduce the maximum to 20 weeks from 26 weeks.

As a practical matter, with little political appetite to slash benefits when needs are perceived to be the greatest, much of the adjusting is left to be done on the revenue collection side. States often make adjustments to the unemployment taxes they impose on employers based on the relative health of their trust funds. Some are triggered automatically when the trust fund attains a certain level of duress (as was the case in

QUICK FACT

If a state can no longer go to its trust fund to pay unemployment benefits — if the trust fund runs out of money — the state has to borrow money from the federal government to cover the cost of paying the benefits. North Carolina, South Carolina, and Virginia remained indebted to the federal government at the end of 2011.

Maryland, Virginia, and West Virginia), while others require further legislative intervention (as in North Carolina and South Carolina).

The two variables through which a state can easily affect the revenue stream are the tax rate and the taxable wage base. States have a range of unemployment tax rates that are assessed to employers based on their past experience with the unemployment insurance fund (more claims against the fund equal higher tax rates), as well as a separate rate for new employers. The average tax rates have increased in each Fifth District jurisdiction since 2007 (see chart).

States also have the option to increase the taxable wage base. Because the federal unemployment tax applies to the first \$7,000 of a covered employee's wages, all states have a minimum tax base of at least \$7,000. Individual states are free to set the base as they see fit, however. In the Fifth District, taxable wage bases range from a low of \$8,000 in Virginia to a high of \$19,700 in North Carolina. Since 2009, three states — North Carolina, South Carolina, and West Virginia — have raised the taxable wage base to help shore up their trust funds. Of those, North Carolina's increase was the smallest, as its base increased by just \$400.

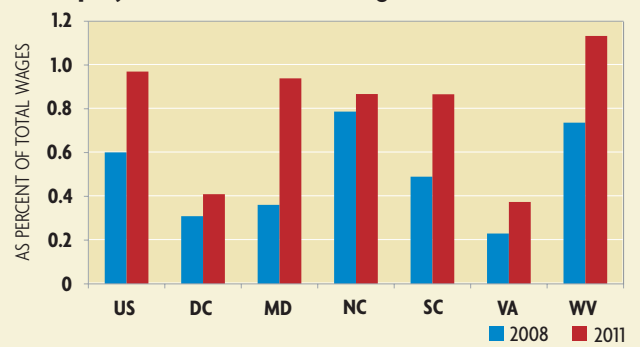
Unsurprisingly, the result of the changes in rates and bases has been higher taxes on employers. The average tax rate expressed as a percent of total wages, which reflects changes in both the tax rates and the taxable base, has increased in all Fifth District states since the trust funds came under severe pressure. The most significant increase has taken place in Maryland, where the average tax rate more than doubled from 0.36 percent in 2008 to 0.94 percent in 2011. The least significant increase took place in North Carolina, where the average tax rate edged up from 0.79 percent to 0.87 percent. It is perhaps surprising that North Carolina's adjustments on both the tax rate and tax base are comparatively lower, considering that its trust fund woes are the most challenging of District states.

Conclusion

As in most of the rest of the nation, unemployment insurance funds in Fifth District states came under extreme pressure during the Great Recession. In its aftermath, states have taken a variety of steps to continue paying unemployment insurance claims and to replenish reserves in their trust funds. With significant political constraints to cutting benefits, states mostly accomplished this by raising taxes on employers.

Virginia has triggers written into state law that automatically adjust tax rates when its unemployment trust fund reaches certain thresholds (up when needed, down when possible). In contrast, rates in North Carolina and South

Unemployment Insurance Average Tax Rates



SOURCES: U.S. Department of Labor, ETA, OWS, Division of Fiscal and Actuarial Services

Carolina adjust only on legislative initiative. While legislators in the Carolinas ultimately raised tax rates, it appears the automatic triggers in Virginia's law helped the state stabilize its revenues sooner and in a more orderly fashion. And Virginia expects that those tax increases, along with some revenue transfers and the increase in Federal Unemployment Tax Act (FUTA) tax dollars, will enable it to pay off its unemployment insurance debt by 2012. That would allow the commonwealth to avoid further interest payments and would reduce the FUTA taxes that employers pay.

South Carolina's tax increases and stronger job growth are expected to allow the state to pay off its debt by 2015. In contrast, North Carolina's trust fund remains out of balance and the state's job growth lags other District states. Moreover, its path forward is unclear. Without more decisive policy actions, North Carolina's trust fund problems will persist for the foreseeable future. This means that employers in the state will be facing higher unemployment insurance taxes, and considerable uncertainty surrounding them, at a time when labor demand is already weak.

Critics of the unemployment insurance program have argued that unemployment insurance benefits are contributing to persistently high unemployment rates by reducing the cost of being unemployed. Meanwhile, proponents argue that unemployment insurance also provides workers with some latitude to find "the right job," one that makes the best use of their skill sets. As policymakers (federal and state) rethink their programs in the wake of the Great Recession, they are well advised to do so with an eye toward doing more than simply resolving trust fund imbalances. In the end, a well-rounded program that ties unemployment insurance benefits to efficient skills training and job matching programs may help ease labor market friction and speed the healing process.

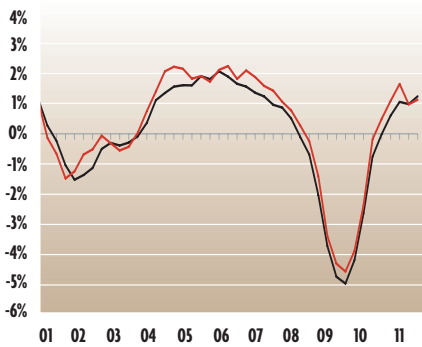
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State Data, Q3:11

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000s)	727.5	2,550.0	3,922.3	1,836.6	3,681.8	756.2
Q/Q Percent Change	0.3	0.5	-0.1	0.2	0.1	0.7
Y/Y Percent Change	2.4	1.0	1.2	1.0	1.0	1.0
Manufacturing Employment (000s)	1.1	113.6	434.9	218.3	229.2	49.6
Q/Q Percent Change	3.2	0.2	0.1	1.5	-0.7	0.3
Y/Y Percent Change	0.0	-0.4	0.4	5.3	-0.2	0.5
Professional/Business Services Employment (000s)	149.7	397.0	512.5	229.6	660.1	62.7
Q/Q Percent Change	0.5	0.6	0.0	-0.3	-0.7	1.1
Y/Y Percent Change	1.3	2.2	4.8	4.1	0.9	3.0
Government Employment (000s)	244.3	508.6	695.6	342.3	707.9	152.6
Q/Q Percent Change	-1.9	0.6	-0.1	0.7	-0.4	1.8
Y/Y Percent Change	-0.1	1.1	-0.5	-1.8	0.7	0.1
Civilian Labor Force (000s)	342.5	3,070.3	4,655.4	2,159.1	4,310.5	798.9
Q/Q Percent Change	-0.3	0.1	0.1	0.1	0.5	0.1
Y/Y Percent Change	-0.5	0.2	1.0	0.3	1.3	-0.2
Unemployment Rate (%)	10.5	7.2	10.7	10.4	6.4	8.1
Q2:11	10.2	7.1	10.5	10.4	6.2	7.9
Q3:10	10.1	7.8	10.7	10.9	6.8	8.5
Real Personal Income (\$Mil)	39,720.4	261,512.9	306,567.3	138,230.8	326,347.0	54,615.8
Q/Q Percent Change	0.3	0.5	0.1	-0.2	0.3	0.0
Y/Y Percent Change	2.5	1.8	1.4	1.4	1.4	1.3
Building Permits	889	3,228	7,844	3,638	6,163	517
Q/Q Percent Change	24.0	15.2	-9.6	-12.0	12.9	12.4
Y/Y Percent Change	278.3	3.3	-7.6	7.9	1.4	22.2
House Price Index (1980=100)	573.8	416.3	308.2	309.8	400.7	216.8
Q/Q Percent Change	0.3	1.8	0.6	0.8	1.1	2.3
Y/Y Percent Change	1.0	-4.0	-3.7	-4.4	-2.7	-1.4
Sales of Existing Housing Units (000s)	8.4	70.4	129.2	69.6	106.0	27.2
Q/Q Percent Change	-8.7	-7.4	-4.7	-0.6	1.9	7.9
Y/Y Percent Change	5.0	10.0	18.3	19.2	3.5	9.7

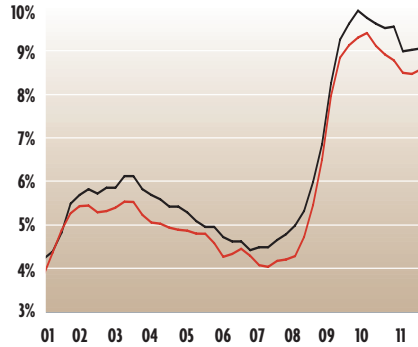
Nonfarm Employment

Change From Prior Year
First Quarter 2001 - Third Quarter 2011



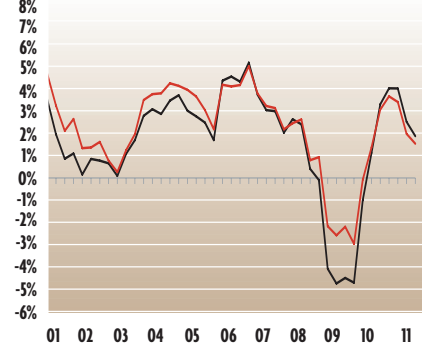
Unemployment Rate

First Quarter 2001 - Third Quarter 2011



Real Personal Income

Change From Prior Year
First Quarter 2001 - Third Quarter 2011

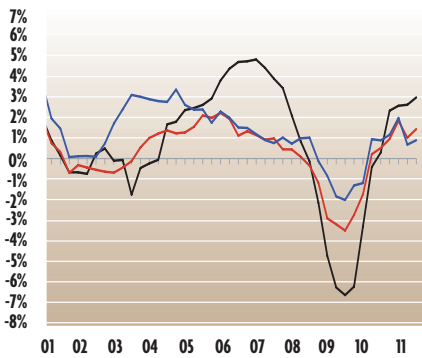


— Fifth District

— United States

Nonfarm Employment Metropolitan Areas

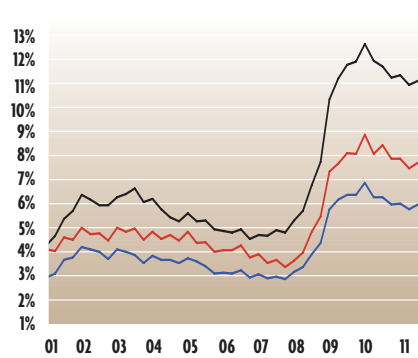
Change From Prior Year
First Quarter 2001 - Third Quarter 2011



— Charlotte — Baltimore — Washington

Unemployment Rate Metropolitan Areas

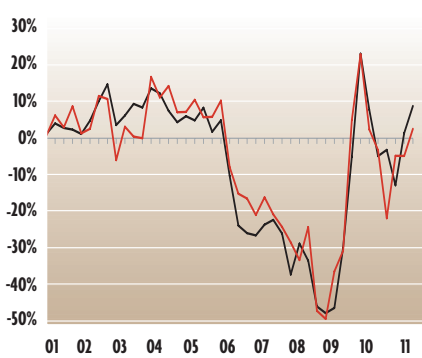
Change From Prior Year
First Quarter 2001 - Third Quarter 2011



— Charlotte — Baltimore — Washington

Building Permits

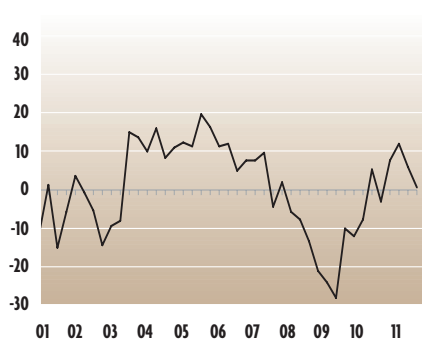
Change From Prior Year
First Quarter 2001 - Third Quarter 2011



— Fifth District — United States

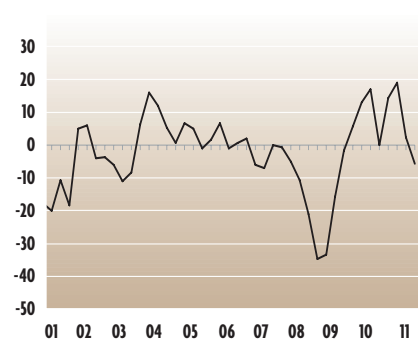
FRB—Richmond Services Revenues Index

First Quarter 2001 - Third Quarter 2011



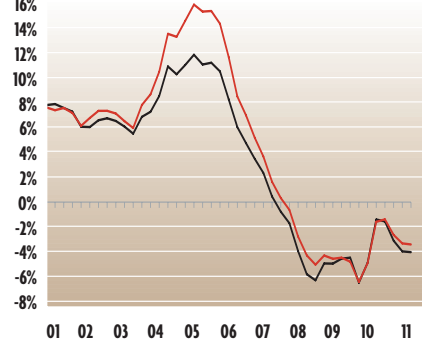
FRB—Richmond Manufacturing Composite Index

First Quarter 2001 - Third Quarter 2011



House Prices

Change From Prior Year
First Quarter 2001 - Third Quarter 2011



— Fifth District — United States

NOTES:

- FRB-Richmond survey indexes are diffusion indexes representing the percentage of responding firms reporting increase minus the percentage reporting decrease. The manufacturing composite index is a weighted average of the shipments, new orders, and employment indexes.
- Building permits and house prices are not seasonally adjusted; all other series are seasonally adjusted.

SOURCES:

- Real Personal Income: Bureau of Economic Analysis/Haver Analytics.
 Unemployment rate: LAUS Program, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
 Employment: CES Survey, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
 Building permits: U.S. Census Bureau, <http://www.census.gov>.
 House prices: Federal Housing Finance Agency, <http://www.fhfa.gov>.

Metropolitan Area Data, Q3:11

	Washington, DC	Baltimore, MD	Hagerstown-Martinsburg, MD-WV
Nonfarm Employment (000s)	2,433.2	1,295.0	97.6
Q/Q Percent Change	-0.1	-0.3	-1.6
Y/Y Percent Change	0.9	1.4	0.0
Unemployment Rate (%)	6.0	7.6	9.3
Q2:11	5.7	7.4	9.3
Q3:10	6.1	7.8	10.1
Building Permits	4,827	1,285	156
Q/Q Percent Change	11.0	42.0	10.6
Y/Y Percent Change	43.4	-1.7	5.4
	Asheville, NC	Charlotte, NC	Durham, NC
Nonfarm Employment (000s)	168.3	825.2	272.0
Q/Q Percent Change	-1.0	-0.6	-0.7
Y/Y Percent Change	0.7	3.0	0.2
Unemployment Rate (%)	8.3	11.1	7.8
Q2:11	7.8	10.5	7.2
Q3:10	8.4	11.4	7.5
Building Permits	349	1,868	527
Q/Q Percent Change	22.5	19.1	-3.5
Y/Y Percent Change	-36.8	51.3	-16.1
	Greensboro-High Point, NC	Raleigh, NC	Wilmington, NC
Nonfarm Employment (000s)	339.0	508.5	137.9
Q/Q Percent Change	-1.3	-0.1	-1.0
Y/Y Percent Change	0.0	1.6	0.1
Unemployment Rate (%)	10.7	8.5	10.7
Q2:11	10.1	7.8	9.7
Q3:10	10.8	8.4	10.0
Building Permits	451	1,419	515
Q/Q Percent Change	9.5	-33.4	13.9
Y/Y Percent Change	-15.9	8.7	26.5

	Winston-Salem, NC	Charleston, SC	Columbia, SC
Nonfarm Employment (000s)	205.7	295.7	344.0
Q/Q Percent Change	0.5	-0.5	-0.8
Y/Y Percent Change	1.7	2.8	0.4
Unemployment Rate (%)	9.7	9.3	9.6
Q2:11	9.3	8.6	8.7
Q3:10	9.9	9.2	9.2
Building Permits	345	773	715
Q/Q Percent Change	2.4	-25.0	-8.3
Y/Y Percent Change	11.7	16.9	-8.6
	Greenville, SC	Richmond, VA	Roanoke, VA
Nonfarm Employment (000s)	304.3	609.4	155.9
Q/Q Percent Change	0.1	-0.7	-0.5
Y/Y Percent Change	2.6	1.2	0.9
Unemployment Rate (%)	9.3	7.0	6.4
Q2:11	8.5	6.8	6.4
Q3:10	9.5	7.6	7.2
Building Permits	413	864	98
Q/Q Percent Change	-16.4	12.9	-3.0
Y/Y Percent Change	29.9	-16.4	-13.3
	Virginia Beach-Norfolk, VA	Charleston, WV	Huntington, WV
Nonfarm Employment (000s)	742.3	148.6	112.3
Q/Q Percent Change	-0.2	0.5	-1.2
Y/Y Percent Change	0.3	-0.1	-0.4
Unemployment Rate (%)	7.0	7.3	8.3
Q2:11	6.8	7.9	8.5
Q3:10	7.3	8.4	8.9
Building Permits	1,409	43	21
Q/Q Percent Change	19.9	38.7	-27.6
Y/Y Percent Change	31.9	4.9	133.3

For more information, contact Sonya Ravindranath Waddell at (804) 697-2694 or e-mail Sonya.Waddell@rich.frb.org