San Jose Mercury News

Opinion: California should retire unemployment debt like other states did

Leaving $18.5 billion obligation to the federal government unpaid is not only fiscally imprudent, it harms employers

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February 24, 2023

By committing not to tap $36 billion in state reserves amidst declining tax revenues, Gov. Gavin Newsom appears to be taking a fiscally prudent stance in 2023-24 budget negotiations. Unfortunately, Newsom does not plan to repay the $18.5 billion California owes the federal government for state unemployment insurance benefits it covered during the COVID-19 crisis.

Leaving this balance unpaid is not only fiscally imprudent, but harms California employers.

After COVID-19 struck in March 2020, 22 states took federal unemployment loans. But by the end of 2022, all but four of these states had repaid their federal debts. Illinois cleared its balance in January 2023, leaving only Connecticut, New York and California on the hook.

To repay the loan, the federal government is now charging California employers $42 extra unemployment tax per employee this year. It will ramp up the extra tax by an additional $21 each year until the balance is zeroed out. The Legislative Analyst expects the loan to be fully paid off in 2029 or 2030, unless another recession hits the state in the interim.

The tax surcharge, which should top out at around $168 per employee per year, may seem small, but it comes on top of California's already high employment costs. The state has a relatively high minimum wage of $15.50 per hour, which applies not only to affluent areas but also to economically challenged regions such as the High Desert and Central Valley. California's minimum is higher than that of all adjacent states, and employers cannot count a portion of employee tips toward the state minimum as they can in Arizona.

One reason California has so much unemployment debt relative to other states is that it failed to clamp down on widespread unemployment fraud during the pandemic. According to the state's Employment Development Department, this fraud resulted in the payment of $20 billion in unwarranted unemployment compensation, an amount close to the state's outstanding loan balance. An independent estimate from the Lexis/Nexis governments division placed the losses at $32.6 billion or more.

California also had the opportunity to use American Rescue Plan Act (ARPA) funds to pay off the loan but devoted only $250 million of the $27 billion it received from the federal government for this purpose. This contrasts with Hawaii, which used $800 million of the $1.6 billion in ARPA funds it received to fully extinguish its federal unemployment loan by early last year. Arizona, Colorado, Minnesota and Nevada are among the states that, relative to California, committed much larger proportions of their ARPA grants to repaying their federal unemployment loans and/or building up their state unemployment trust funds to avoid future borrowing.

California also could have used its large FY 2022-23 surplus to pay off the loan, but instead used the money for other priorities. Now, with revenues flagging, the Newsom administration has decided to cancel plans to pay $750 million of the $18.5 billion loan balance in FY 2023-24 and to use $500 million in general fund money to offset the unemployment tax increase now being faced by small employers.

The administration seems to think it can get the federal government to cancel part of the loan. When Assemblymember Vince Fong, R-Bakersfield, asked Erika Li, chief deputy of budgets at California Department of Finance about administration plans for the unemployment loan at a recent budget hearing, she responded, “we continue to lobby at the federal level … in regards to forgiveness.”

This is not a plausible strategy. Senators from the 47 states that do not have outstanding loan balances will wonder why the other three states should get special treatment, and the GOP-led House, which is now investigating California unemployment insurance fraud, will not be doing us any favors.

Instead, the Legislature should consider drawing down state reserves to pay off the federal loan and provide employers some much needed tax relief.

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