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Fact Sheet

California's Broken Unemployment Insurance System

(Rev. 10/13)

California operates one of the most expensive unemployment insurance (UI) systems in the nation. However, the employer-paid taxes needed to fund the system are not enough to support it. California's UI fund deficit was $10.2 billion at the end of 2012. Absent financing reforms, the California Employment Development Department (EDD) projects a deficit of $9.7 billion at the end of 2013, $8.8 billion at the end of 2014, and $7 billion at the end of 2015 (EDD October 2013 UI Fund Forecast).

California's UI Fund has been insolvent since January 2009. To continue uninterrupted UI benefit payments to claimants, the state borrowed $10 billion from the federal government. Under federal law, when a state defaults on a loan from the federal UI account for two consecutive years, employers must begin the repayment process.

California defaulted on its federal loan 2011. Thus, employers had to begin repaying it, starting in January 2012. The loan is repaid through higher federal employment taxes in the form of a Federal Unemployment Tax Act (FUTA) credit reduction. FUTA is a federal tax on employers covered by a state's UI program. The standard FUTA tax rate is 6.0 percent on the first $7,000 of taxable wages. However, employers generally may receive a credit of 5.4 percent when they file their federal Form 940. The net result is a FUTA tax rate of 0.6 percent, or 6.0 percent - 5.4 percent.

The FUTA credit reduction in 2012 (for wages paid in 2011) was 0.3 percent. The FUTA credit reduction increases 0.3 percent every year until the loan is repaid. Each 0.3 percent FUTA credit reduction means up to an additional $21-per-employee employment tax increase.

The increase in federal employment taxes equated to a $291 million hit via the FUTA credit reduction in 2012 (for wages paid in 2011). The EDD expects FUTA credit reductions of $602.8 million in 2013, $932.3 million in 2014, and $1.3 billion in 2015. Again, these costs represent losses of 0.3 percent FUTA credit for 2011, 0.6 percent for 2012, 0.9 percent for 2013 and 1.2 percent for 2014. In 2018, the year economists expect the state's UI fund loan to be repaid in full, employers can expect to pay an additional $2.3 billion in federal employment taxes. At that point, California's UI fund will be flat lined, and we can begin to build a reserve. That reserve again will be depleted when the next recession hits California, unless changes are made to California's UI financing structure.