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S&P: U.S. State Unemployment Insurance Claims Are Not An Immediate Challenge To State Liquidity

NEW YORK (S&P Global Ratings) March 23, 2020–While the economic fallout from potentially massive unemployment levels will be a credit challenge for U.S. states, S&P Global Ratings does not believe that near-term state liquidity pressure will stem directly from payments on unemployment insurance claims that have recently spiked because of the coronavirus pandemic.

This is because the program structure allows states to receive federal loans, if necessary, to cover state unemployment insurance trust fund deficiencies, if any, under current law. These federal loans must eventually be paid back to the federal government, however, through higher taxes on businesses or through other means.

During the Great Recession, some of these federal loans became quite substantial (see "Unemployment Insurance Fund Bonds Help States Pay Off Federal Unemployment Loans," published Sept. 6, 2012, on RatingsDirect) and in some cases prompted states to issue bonds carrying lower interest rates to pay off higher-interest federal unemployment insurance loans. In the first quarter of 2012, loans from the federal unemployment account reached $40.7 billion. In 2011, California's unemployment loan from the federal government peaked at $11.0 billion alone. As of Dec. 31, 2019, federal unemployment account loans were only $63.3 million, attributable entirely to the Virgin Islands, and aggregate state unemployment trust fund balances were $75.7 billion. While the federal government has indicated that certain states have below-optimal levels of state trust fund balances (such as California at $3.3 billion as of Jan. 1, 2020), we believe the ability to tap into federal loans relieves short-term unemployment trust fund liquidity pressures for any particular state.

If states meet certain technical requirements and maintain a certain threshold of unemployment insurance tax rates on businesses over time, they can initially receive these federal unemployment trust fund loans interest-free. Qualifying states receive interest-free federal unemployment loans if a state takes a federal advance after Jan. 1, and repays it by Sept. 30, of the same year. After that, interest charges are imposed and if the state continues to fail to repay the loan by Nov. 10, of the year in which a second Jan. 1, has passed, then all taxable employers in a state will be subject to a reduced credit of 0.3% on the Federal Unemployment Tax Act tax, for which the credit reduction grows in subsequent years depending on state tax rates and changes in state law. For 2020, 31 states meet the eligibility criteria for interest-free borrowing.

The Louisiana Workforce Commission announced on March 19 that employers within the state will get a temporary deferral from paying their first-quarter 2020 unemployment taxes to June 30. If similar deferrals spread to other states, it could cause the amount of federal unemployment loans to rise higher than what they might be otherwise, but again would be unlikely to cause near-term state liquidity issues. These funds would still need to be repaid to the federal government from later business taxes, but potentially at a higher tax rate.

S&P Global Ratings will continue to monitor unemployment insurance trust funds and the extent to which higher taxes that are imposed on businesses to replenish these funds could reduce economic competitiveness, or cause a state to issue tax-backed debt to repay federal loans. However, we believe the short-term credit effects are limited.

This report does not constitute a rating action.

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