



POLICY PAPER

The Arizona Solution to Unemployment Insurance: A state-based solution for adequate benefits and a solid trust fund

October 5, 2020

Dave Wells, Ph.D., Research Director

With assistance from Max Goshert, MA, Associate Director, Alex Tam, Research Associate, and James Cooper, Research Associate

Edited by Amy Pedotto, Executive Director

TABLE OF CONTENTS

Executive Summary	4
Key Findings & Recommendations	6
Introduction	7
Unemployment Programs Defined	9
Recommendations for Modernizing Arizona’s Unemployment Insurance Program	10
Background on Arizona’s UI Status Quo	10
Recommendations: Increasing Arizona’s UI Benefits.....	11
Recommendations: Sustainable Financing of Arizona’s UI Trust Fund	14
Maximizing Federal Unemployment Assistance Dollars	18
Status – Arizonans Receiving Pandemic Unemployment Assistance (PUA).....	18
Status – Arizonans Receiving Regular State UI.....	19
Status – Arizonans Receiving PEUC & EB	19
Status – Partially-Employed People Currently Excluded from Arizona’s UI System.....	21
Economic Impact of Leveraging Federal Unemployment Assistance Dollars	22
Increased Federally-Funded PEUC & EB Benefits.....	23
Increased Federally-Funded PUA Benefits	24
Increased Incentive to Work	24
State-Funded Increased Weekly Benefit Cap.....	26
Financing Benefits and Improving the Long-Term Stability of Arizona’s UI Trust Fund	27
Summary	28
Technical Appendix	30
Unemployment Recipients in Arizona.....	30
Determinants of a Robust UI Trust Fund	30
Impact on PUA Benefit if State Increases UI Benefit Amount.....	32
Impact on PEUC and EB Benefit if State Increases UI Benefit Amount.....	33
Multiplier Effects.....	33

EXECUTIVE SUMMARY

Contrary to Governor Doug Ducey's repeated assertion that "Arizona has done its part," state public policy leaders have done nothing to address Arizona's catastrophically inadequate unemployment benefits. Arizona has the opportunity to significantly change its poorly designed unemployment insurance (UI) program. The timing is ripe to improve benefits, as state regular UI benefits are mirrored in payments provided by federally-funded UI programs including Pandemic Unemployment Insurance (PUA), Pandemic Emergency Unemployment Compensation (PEUC) and Extended Benefits (EB).

In this policy brief, the Grand Canyon Institute (GCI) proposes a series of recommendations for UI benefits that are in line with most other states and recommendations for how Arizona's UI trust fund can be sustainably financed to recover from the current economic crisis and to guarantee sufficient financing for future recessions.

If Arizona's leaders adopt GCI's recommendations put forward in this policy brief, the state's unemployed workers will receive an additional \$675 million in UI benefits paid for by federal programs. This move would generate a \$1.6 billion net economic benefit for the state and \$107 million in state and local revenue.

Acting immediately is critical, as unemployed people in Arizona are beginning to transfer from regular state UI benefits to federal programs at which point their benefit amounts will be locked in at the current rate, which is the second lowest in the nation. *If state leaders elect not to act, now, the state will fail to maximize federal unemployment payments to Arizonans and place them at great risk if Congress does not provide a supplement, whereas unemployed workers in other states will receive significantly higher benefits through federal UI programs.*

GCI acknowledges that there is a cost to these reforms however the return on investment — for the state's 400,000 insured unemployed and the state's ravaged economy — warrant adopting these changes now along with the proposed financing mechanisms that will ensure future financial sustainability of the state's UI trust fund at modest expense to the state's employers.

These recommendations are put forward in the context of a severe economic crisis that is even more unequal than usual, according to former Federal Reserve Board Chair Ben Bernanke. "The sectors most deeply affected by covid disproportionately employ women, minorities and lower-income workers."

If Arizona's leaders adopt GCI's recommendations put forward in this policy brief, the state's unemployed workers will receive an additional \$675 million in UI benefits paid for by federal programs.

This move would generate a \$1.6 billion net economic gain for the state and \$107 million in state and local revenue.

While recessions often have a greater impact on poor households, this one is doing so at a scale that is the worst in generations according to a Washington Post analysis. Across the nation, nearly half of lost jobs have been regained, yet several key demographic groups have recovered more slowly, including mothers of school-age children, Black men, Black women, Hispanic men, Asian Americans, and younger Americans (ages 25 to 34), and people without college degrees.¹

A drop in consumer spending of 5.8% this year is driving Arizona's economic downturn, with significant declines in business fixed investment, residential investment, and net exports as well.² Increasing UI benefits represents an important financial support to Arizona's unemployed and a stabilizing force for the economy as it grapples with the impact of severely reduced spending.

"The sectors most deeply affected by COVID disproportionately employ women, minorities and lower-income workers."

Former Federal Reserve Board Chair Ben Bernanke.

¹ Long, Heather, Andrew Van Dam, Alyssa Fowers, and Leslie Shapiro (2020), "The covid-19 recession is the most unequal in modern U.S. history," Washington Post. Retrieved on September 30, 2020 from <https://www.washingtonpost.com/graphics/2020/business/coronavirus-recession-equality/>.

² Hammond, George W., Ph.D. (2020), "Arizona's 30-Year Outlook: Short-Run Trouble, Long-Run Growth: 3rd Quarter 2020 Arizona Economic Forecast," University of Arizona Economic and Business Research Center. Retrieved on Sept. 30, 2020 from <https://eller.arizona.edu/departments-research/centers-labs/economic-business-research/arizona-economic-outlook>.

KEY FINDINGS & RECOMMENDATIONS

- Immediately increasing Arizona's unemployment insurance benefits will impact 400,000 people and leverage \$420 million in federal funding as unemployed people exhaust their state UI benefits and transfer to federal UI programs. Importantly, a person's benefit amount is locked in at the rate they are receiving when they transfer to the federal UI program, so the earlier benefits are increased the more people will be impacted as tens of thousands of people will be transferring from the state to federal UI program.
- GCI projects that by the end of 2021 the state's UI trust fund will be in deficit by about \$210 million and continuing to decline if the state government takes no action. GCI's recommendations, at a cost of \$600 million over a 15-month period, will ensure that Arizona's UI trust fund achieves long-term sustainability.
- GCI provides recommendations to overhaul financing of Arizona's UI trust fund to ensure that it can afford the proposed benefit increases as well as future sustainability during economic downturns, an issue faced during the current crisis. In anticipation of the UI trust fund going into deficit due to the pandemic, these reforms should see Arizona's UI trust fund achieve a positive balance by 2023. Specifically, GCI's recommendations include:
 - Expand the taxable wage base to \$12,000 immediately, and increase it incrementally until it reaches 20 times the average weekly wage when certain triggers are met.
 - Establish a temporary employer surcharge of 0.1% of all employee wages (not just the taxable wage base to limit the impact on small businesses) that remains in place until the state repays its anticipated federal loans that will be necessary to replenish Arizona's UI trust fund.
 - Establish a reducible employee tax of 0.1% on all employee wages (or \$1, on every \$1,000 earned), not just the taxable wage base, that would continue until Arizona's anticipated federal UI loan is paid off and the UI trust fund reaches an average high-cost multiple of 1.0 at which point it would be gradually reduced to zero once the average high-cost multiple reaches 2.0.
 - Adopt a tax on contract/self-employed workers' reported income to enable them to contribute to the UI trust fund and draw benefits, if needed.
- The long-term impact on employer costs is modest at an estimated average annual amount per employee of \$300 in 2021, up from the 2010-2019 range of \$148 - \$209. State UI taxes paid by employers are currently less than 4% of all business taxes—among the lowest in the nation.
- Increasing UI benefit amounts according to GCI's recommendations while leveraging federally-funded UI benefits will have the following economic impact:
 - Provide \$675 million in federal funds, bringing in \$1.6 billion in economic benefits at a cost of \$600 million to the state,

- Result in a net gain to the state of nearly \$3 in overall growth per \$1 invested arising from both added local spending and maximizing federally-funded Pandemic Emergency Unemployment Compensation (PEUC) and Extended Benefits (EB).
- Generate \$110 million in additional state and local tax revenue.
- While difficult to calculate here, increasing the UI benefits of 400,000 Arizonans will also stave off financial hardships such as mortgage defaults, evictions, utility cut offs, and stress related to meeting a family's daily needs.

INTRODUCTION

The status quo fails us all — Arizona pays a maximum unemployment benefit of \$240 a week — the second lowest benefit in the nation. The current benefit levels and employer unemployment insurance (UI) tax structure leaves tens of thousands of Arizonans at great financial risk.

The current catastrophic unemployment crisis in Arizona caused by the COVID-19 pandemic, has been significantly magnified by Arizona's unemployment insurance (UI) law. There are two fundamental problems with Arizona's UI program. Both must be addressed to minimize the negative impact of an economic crisis on the state's economy because both problems feed off of each other.

First, Arizona's unemployment insurance benefits offer the lowest benefits paid in the nation — based on the current low weekly benefit cap, low income disregard, and high income eligibility threshold.³ Arizona's current UI policy directly impacts the ability for households to meet the financial burdens caused by job loss.

Second, Arizona's UI trust fund remains grossly underfunded and barely viable. Despite a record setting number of consecutive quarters of job growth in the last expansion, the Arizona's UI trust fund never reached the minimum financing standard of the U.S. Department of Labor. Arizona employers pay into the fund based on the smallest taxable wage base allowable by federal law.

Wide agreement exists among public policy leaders and unemployment claimants that Arizona's UI benefits are devastatingly low—typically replacing on average, a measly one-third or less, of a worker's earnings. (The national average in UI allows a weekly benefit that replaces and is capped at half of a person's weekly wage.) This drastic

Contrary to Governor Doug Ducey's repeated assertion that "Arizona has done its part," state public policy leaders have done nothing to address Arizona's catastrophically inadequate unemployment benefits.

³ The CARES Act waived state income eligibility thresholds; therefore, this has been less of an issue during the COVID-19 pandemic. However, in normal times, Arizona's current income eligibility threshold denies access to the state's unemployment insurance program to many low-wage earners and recent entrants to the workforce.

reduction in household income is catastrophic. Low UI benefits have been linked to negative impacts to health among the unemployed compared to unemployed people in higher unemployment benefits states.⁴ In addition, these households have lost spending power for such essentials as food, transportation, utilities and housing.

In addition, approximately 40,000 Arizonans as of this date, are working reduced hours due to the pandemic. These workers with reduced hours should be able to rely upon Arizona's UI system to make up the gap in earnings. Unfortunately, due to the structure of Arizona's UI system compared to other states these workers receive no assistance to make up for their lost wages.

While increasing benefits now comes at an estimated cost of \$600 million over the coming 15-month period, that investment would lead to a \$1.6 billion net gain in economic activity—a pay-off of nearly \$3 for every \$1 spent by the state.

Arizona has the opportunity to significantly improve its poorly designed unemployment insurance program with the federal government covering the cost of increased benefits through federal UI programs. The timing is ripe to improve benefits, as unemployed people in Arizona exhaust their regular state UI benefits and transfer to federally-funded UI programs that provide the same benefit amounts as the state where the claim is filed.

GCI's recommended UI benefit reforms put forward in this paper reflect the norm in other states. While increasing benefits now comes at an estimated cost of \$600 million over the coming 15-month period, that investment would lead to a \$1.6 billion net gain in economic activity—a **pay-off of nearly \$3 for every \$1 spent by the state**. This aid is especially effective as it is targeted to households that are in the gravest

need due to unemployment. These are households who spend every dollar they have on rent, food, transportation, utilities and clothes. Targeting assistance in this manner ensures that the funds will be spent and therefore reinjected in the state's economy.

On the state level, GCI's recommended reforms can also make permanent coverage for those workers previously not covered by UI until Pandemic Unemployment Assistance (PUA) was introduced in the CARES Act.

GCI's analysis presented in this policy brief projects how Arizona could leverage federal dollars — even in the absence of a new COVID relief bill from Congress — while also developing a long-term solution to improve the health of Arizona's UI trust fund. The projection relies on a sample pool of workers on UI benefits through December 31, 2020. **It also assumes immediate adoption of the legislative changes of the reforms described below.** While the current environment makes an accurate forecast difficult,

⁴ Cylus, Jonathan, M. Maria Glymour, and Marucio Avendano (2015), "Health Effects of Unemployment Benefit Program Generosity," *American Journal of Public Health*, February 105(2): 317-323, <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4318319/>.

this analysis relies on one that is reasonable to illustrate how different programs can fit together and be funded in a sustainable, long-term manner.

UNEMPLOYMENT PROGRAMS DEFINED

Arizona’s State Unemployment Insurance (UI): Workers qualify if they earned at least \$4,680 in a calendar quarter and \$7,000 over a four calendar quarters and lose their job through no fault of their own. They receive a maximum weekly benefit of \$240 a week, the second lowest in the country. UI payments are meant to replace half a worker’s prior earnings up to the cap—due to Arizona’s low cap many workers receive far less than half of their prior earnings. State UI is available for up to 26 weeks.


Pandemic Unemployment Assistance (PUA): Included in the CARES Act legislation, PUA is designed based on Disaster Unemployment Assistance for people who do not qualify for state UI either because their base year earnings are too low or they are contract workers/self-employed so no unemployment insurance payments were made on their behalf to the state’s UI trust fund. PUA benefits are paid based on the relevant state’s UI payment formula and can last up to 39 weeks. PUA is federally funded through Dec. 31, 2020, is likely to be extended though the 39-week limit on coverage might not change.

Pandemic Emergency Unemployment Compensation (PEUC): The CARES Act provides PEUC for workers whose state UI benefits have been exhausted and provides an additional 13 weeks of assistance. PEUC pays the same as state UI but is completely federally funded. PEUC expires on Dec 31, 2020 but is likely to be extended, but the number of weeks covered may not change.

Extended Benefits (EB): As long as a state meets the trigger requirements (effectively high unemployment), then workers can qualify for an additional 13 weeks of benefits paid for at the state UI formula level. As soon as a state no longer meets the trigger requirements the EB program ends.⁵ The CARES Act provides full federal funding for EB through Dec. 31, 2020, although normally the cost is split 50/50 between the state and federal government. It’s likely to remain federally funded in 2021.

⁵ Arizona hit all three possible triggers in the second quarter of 2020. Based on current economic conditions, it seems likely that the state will likely continue to qualify for EB through the second quarter of 2021, but after then it depends on economic conditions. See “DES Announces Launch of Extended Benefits,” July 17, 2020, <https://des.az.gov/sites/default/files/media/newsrelease-7-17-2020-DES-Announces-Launch-of-Extended-Benefits.pdf>.

Table 1: Unemployment Insurance Programs Available to Unemployed Workers in Arizona



<u>AZ State Unemployment Insurance</u> (State UI)	<u>Pandemic Emergency Unemployment Compensation</u> (PEUC)	<u>Extended Benefits</u> (EB)	<u>Pandemic Unemployment Insurance</u> (PUA)
Funding Source: Arizona UI trust fund	Funding source: CARES Act	Funding source: Federal UI funds	Funding source: CARES Act
Eligibility: Must be covered by state UI program	Eligibility: Must have exhausted 26 weeks of state UI benefits	Eligibility: Must have exhausted 13 weeks of PEUC benefits	Eligibility: For workers who do not qualify for state UI, including contract workers/self-employed
Benefit Amount: Based on AZ state UI law. \$240 maximum weekly benefit.	Benefit Amount: Fixed at rate received from state UI before transferring to PEUC.	Benefit Amount: Fixed at rate received from state UI before transferring to PEUC.	Benefit Amount: Mirrors state UI rate, will increase with state benefit increase.
Duration: 26 weeks	Duration: 13 weeks	Duration: 13 weeks	Duration: 39 weeks

RECOMMENDATIONS FOR MODERNIZING ARIZONA’S UNEMPLOYMENT INSURANCE PROGRAM

The purpose of UI programs is to provide temporary financial assistance to unemployed workers who have lost their jobs through no fault of their own. The following recommendations are based on a review of UI policy in other states and a statistical analysis of financing practices that ensure robust and sustainable UI trust funds.

BACKGROUND ON ARIZONA’S UI STATUS QUO

Governor Ducey’s office has repeatedly indicated that raising UI benefits was off the table because it would push Arizona’s UI trust fund into deficit, triggering the need to increase UI taxes on employers. Under normal periods of increased lay offs, employers’ UI tax rates would increase after increased layoffs as a natural function of how the state’s UI

trust fund works — when an employer’s past workers rely more heavily in on the state’s trust fund in a given year, that employer’s UI taxes increase. However, following the requirements in the Families First Act, Gov. Ducey on March 20, 2020 issued Executive Order 2020-11 that among other things noted that employers’ experience rating be held harmless in 2021 from the impact of unemployment due to COVID in 2020.⁶ This will mean that UI trust fund revenues will only increase modestly because of an adjustment to rates due to the UI trust fund losing about half its total deposits from January through July 2020—the point used to determine the subsequent year’s employer rates.⁷ Consequently, Arizona’s UI trust fund will inadequately respond to this time of skyrocketing demand for UI benefits, further exacerbating the strain on its balance. It is anticipated that Arizona’s UI trust fund will reach a zero balance by February or March 2021, and GCI anticipates that it will be in deficit by around \$210 million at the end of 2021.

GCI’s recommendations to increase UI benefits leverage \$675 million in federal resources through benefits paid by federal UI programs (PUA, PEUC and EB) while incurring a cost to the state of an additional \$600 million through December 2021. The expense is worth the investment with a \$1.6 billion net economic gain to the state, while reducing the amount of hardship experienced by families impacted by unemployment across the state.

RECOMMENDATIONS: INCREASING ARIZONA’S UI BENEFITS

GCI proposes that Arizona bring its UI benefits in line with states such as Texas and Utah. GCI’s policy brief [Arizona Needs to Address Unemployment Compensation to Ensure Families are Protected Before the Next Recession](#)⁸ published in December 2019 provides the underlying research for the following recommendations.

⁶ See Executive Order 2020-11 at <https://azgovernor.gov/executive-orders>.

⁷ See ARS 23-730 <https://www.azleg.gov/ars/23/00730.htm>.

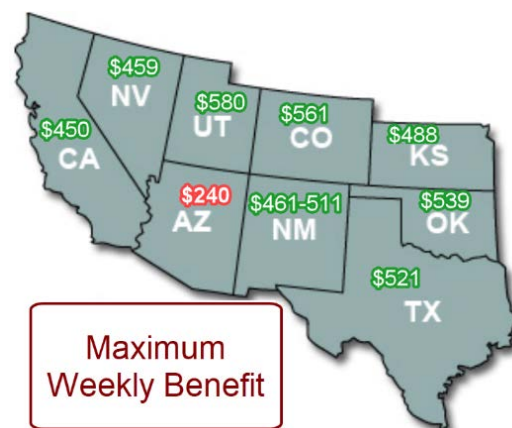
⁸ Wells, David, Ph.D., (2019) “Arizona Needs to Address Unemployment Compensation to Ensure Families are Protected Before the Next Recession,” The Grand Canyon Institute, December 2019. Retrieved on Oct. 1 from <https://grandcanyoninstitute.org/arizona-needs-to-address-unemployment-compensation-to-ensure-families-are-protected-before-the-next-recession/>.

Weekly benefit cap

Arizona’s current maximum weekly benefit is \$240, last adjusted in 2004. It is the second lowest weekly benefit cap in the country (only Mississippi is lower). UI benefits are intended to replace half a person’s weekly income. Arizona’s low benefit cap falls far short of that amount for anyone earning more than minimum wage.

Recommendation: Increase the maximum weekly benefit cap to half the state’s average weekly wage⁹ of covered workers. In Arizona, this amounts to \$490 per week in 2020 and would automatically adjust to \$510 in 2021 based on US Department of Labor Data.

Figure 1: Arizona's Current Weekly Benefit Cap



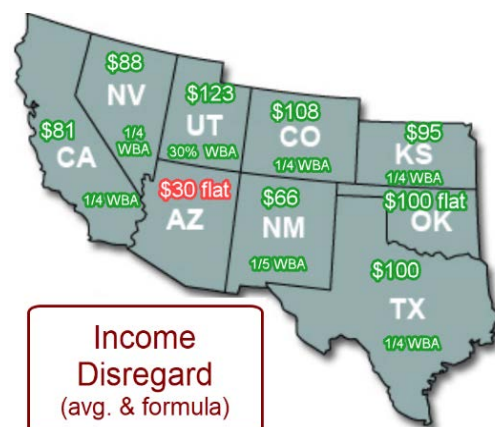
Income disregard

The income disregard is the amount that a person can earn through partial employment while receiving UI benefits before having benefits reduced before unemployment benefits are offset by their wages.

Arizona's current income disregard is up to \$30, the lowest in the country. However, once a person earns the equivalent of their weekly benefit amount, the income disregard is no longer applied and effectively becomes \$0.

Recommendation: In conjunction with the increased benefit cap, increase the amount workers can earn to supplement UI benefits to one-fourth of the worker’s maximum weekly benefit amount, to a maximum of \$122.50 (\$127.50 in 2021). Thirty-four states and the District of Columbia have adopted the proposed recommended formula or something functionally similar. Seven states have an even higher income disregard, usually one half of the weekly benefit amount.

Figure 2: Arizona's Current Income Disregard



⁹ The Average Weekly Wage would be determined by the Department of Labor’s annual report for the most recent full year, e.g., 2018 for 2020 rates and 2019 for 2021 rates.

Eligibility Threshold

Eligibility for Arizona’s UI system is based on income earned over a four calendar quarter base period. The eligibility threshold is determined base period is the first four of the last five calendar quarters.

Currently, Arizona has the highest income eligibility threshold in the country by a significant margin. A person must earn at least \$4,680 (390 hours X minimum wage) in a calendar quarter and at least \$7,020 over the four calendar quarter base period (1.5 X \$4,680) to qualify for UI benefits. This is not an issue during the pandemic due to PUA but is an issue that must be addressed long-term.

Recommendation: Lower the earnings threshold to qualify for UI benefits to 200 times the minimum wage in the highest earnings quarter, which is equal to minimum earnings of \$2,400 during a 3-month calendar quarter and \$3,600 over the four calendar quarter base period. Arizona would still be on the high end of eligibility thresholds with this recommendation.

Delay effective date until expiration of PUA.

Alternative Eligibility Base Period

Arizona does not currently have an alternative eligibility base period which results in low-wage earners, seasonal workers, and recent entrants to the workforce being disqualified for UI benefits. It can be applied to those who do not qualify for UI benefits according to the regular eligibility base period.

Figure 3: Arizona's Current UI Eligibility Threshold Compared to Other States

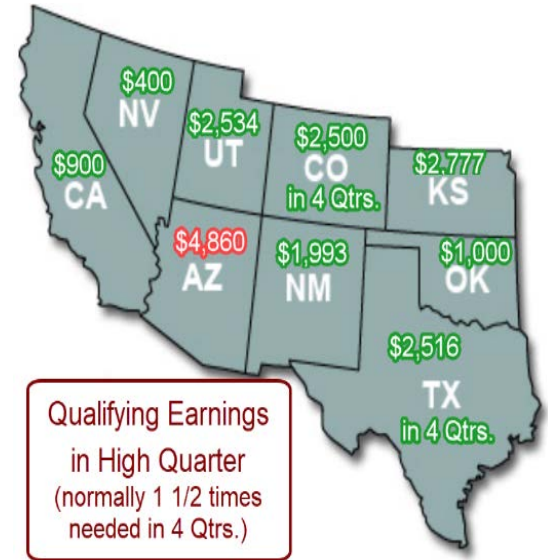
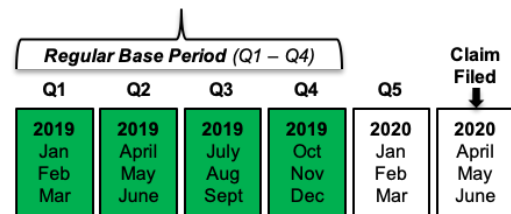


Figure 4: Eligibility — Regular Base Period

Regular Base Period

- Income eligibility based on first four completed quarters worked.



The alternative base period is calculated based on the last four completed calendar quarters worked.

Recommendation: Introduce an alternative base period to give workers two different formula options to qualify for state UI. Delay effective date until expiration of PUA.

Adopt an alternative base period to determine eligibility based on the last four calendar quarters worked for people who do not qualify for unemployment benefits according to the regular base period.

Delay effective date until expiration of PUA.

Include self-employed/contract workers

Currently, self-employed/contract workers are not covered by Arizona's UI program. Currently, 220,000 unemployed people in Arizona are receiving federally-funded PUA benefits through the CARE's Act.

Recommendation: Establish a system for self-employed/contract workers to pay into the state's UI trust fund so they can qualify for benefits if needed in the future. See financing mechanism in the following section.

Delay effective date until expiration of PUA.

RECOMMENDATIONS: SUSTAINABLE FINANCING OF ARIZONA'S UI TRUST FUND

Public policy leaders will need to embrace the difficult decision to raise revenue from Arizona employers to address the current crisis and to prepare for future economic downturns. The added costs to employers are modest relative to the economic gains.

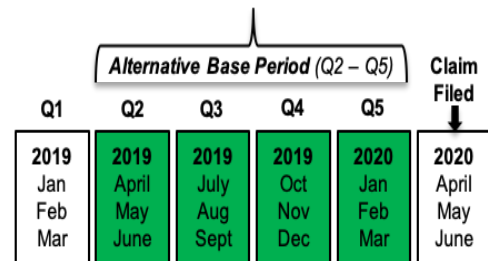
GCI's recommendations for financing Arizona's UI trust fund provide an economically sustainable approach that can withstand future economic downturns and minimize the need to borrow from the federal government to meet state UI obligations. It likely will take more than a decade to reach that target level, which minimizes the negative impact on businesses. These recommendations have been informed by a statistical analysis performed by GCI of the 50 state UI trust funds plus the District of Columbia for the calendar years 2018 and 2019 at the height of the expansion to determine what parameters indicate a robust UI trust fund. See the Technical Appendix for this information.

GCI proposes the following recommendations to be in effect as of January 2021:

Figure 5: Eligibility — Alternative Base Period

Alternative Base Period

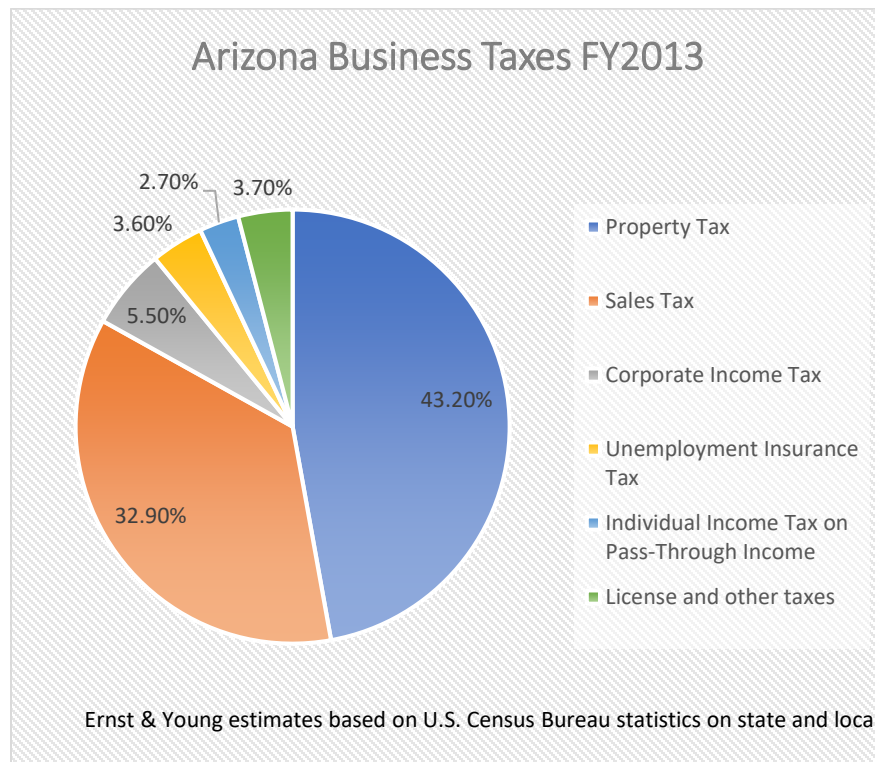
- Income eligibility based on last four completed quarters worked.



UI taxable wage base

Unemployment insurance taxes are a very small percent of overall business taxes. In FY2013 coming out of the Great Recession when unemployment taxes were higher than they are currently, they were 3.6% of overall business taxes—representing less than 40 cents for every \$10 paid in business property taxes.

Figure 6: Arizona Business Taxes FY2013



Typical state UI programs have a taxable wage base of \$14,000 and GCI's model (see technical appendix) indicates states with higher taxable wage bases generally have more stable trust funds. Utah, for instance, has a very high taxable wage base, average benefits considerably higher than Arizona, but employers pay similar UI taxes because the state's UI trust fund has remained well-funded. This should be the long-term goal for Arizona.

Recommendation: Increase the UI taxable wage base from \$7,000 to \$12,000, then gradually expand the taxable wage base by \$1,000 per year, after the triggers below are met, until it equals 20 times the average weekly wage of covered workers (i.e., 20 x \$1,020 for 2021). Triggers that must be met before increasing the taxable wage base by \$1000 include:

- State GDP growth from prior 2Q to 2Q exceeds 2%,
- Job growth from prior 3Q to 3Q exceeds 1.5%, and
- Average unemployment rate in the most recent third quarter is less than 6%.

GCI proposes that once the taxable wage base reaches 20 times the average weekly wage of covered workers the triggers expire, and the taxable wage base should adjust annually. For 2021, GCI projects this change will lead to an average employer unemployment insurance tax of only \$254.

Temporary employer surcharge

In response to the Great Recession, DES with legislative approval, charged employers a special assessment of about \$60 per employee per year across 2011 and 2012 to fund repayment of Arizona's federal UI loan. The special assessment was a per-employee amount regardless of what the employee earned.

It is widely anticipated that Arizona's UI trust fund will reach a negative balance in early 2021 and that the state will be required to borrow from the federal government to meet its UI obligations. GCI recommends a different approach than was adopted in the Great Recession to repay these loans and to cover costs associated with proposed benefit reforms that is designed to shield lower-profit small businesses from some of the cost.

Recommendation: Establish a temporary employer surcharge of 0.1% of all employee wages (not just the taxable wage base to limit the impact on small businesses) that remains in place until the state repays its anticipated federal loans that will be necessary to replenish Arizona's UI trust fund.

This is a very modest add-on — the surcharge for a worker earning \$50,000 would cost \$50 a year, a worker earning \$30,000 would cost \$30.

This surcharge would likely need to continue for three years until Arizona pays off funds it will need to borrow from the federal government, at which point it will terminate. In 2023 or 2024, the federal government might impose a FUTA tax of \$21 per employee in the event that Arizona's UI trust fund would have been in debt for more than two years. If so, the surcharge could be lessened based on the estimated timetable to pay off the debt and the state of the economy. The surcharge would generate approximately \$125 million in revenue annually until it expired.

Institute Small Employee Wage Tax

Three states assess a small tax on employees to help pay for unemployment insurance benefits: Alaska, New Jersey and Pennsylvania. Alaska and New Jersey assess based on the taxable wage base, while Pennsylvania assesses based on all wages.

Recommendation: Establish a 0.1% tax on all employee wages (or \$1, on every \$1,000 earned), not just the taxable wage base, that would continue until Arizona's anticipated federal loan is paid off and the UI trust fund reaches an average high-cost multiple of 1.0 — the minimum funding standard set by the U.S. Department of Labor. Thereafter, the employee wage tax declines by 0.01% for each tenth of a percent that the UI trust balance is above the average high-cost multiple until the tax reaches zero, e.g., if the average high-cost multiple were 1.1, then the tax would drop to 0.09%. This would also generate approximately \$125 million annually until the tax diminished.

Include contract/self-employed workers

Some combination of these recommendations can be used to enable contract workers/self-employed to be eligible for state UI, if there is a program that establishes a payment record reflecting payments for 12 months prior to eligibility. While the program could be voluntary, that could create moral hazard complications if participants start paying into the state's UI trust fund if they realize they are about to start losing earnings.¹⁰

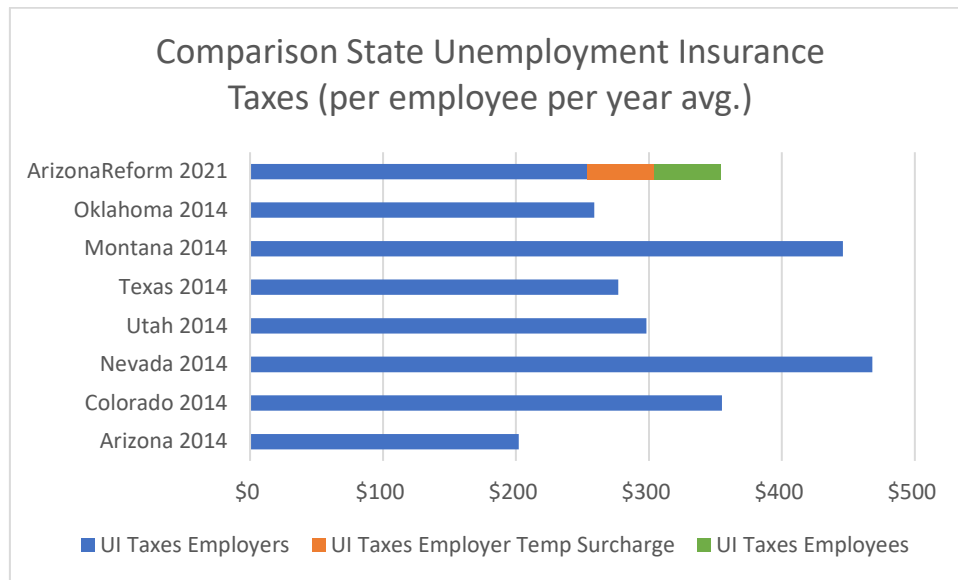
Many people are self-employed or contract workers. They do not work for an employer who pays into the UI trust fund. Their vulnerability in times of an economic crisis have become abundantly clear during the COVID-19 pandemic. Under the CARES Act they are covered by PUA, but long-term UI programs should adjust to cover them which requires a means to enable them to also contribute to the UI trust fund.

Recommendation: Adopt a tax to enable contract/self-employed workers to contribute to the UI trust fund based on the worker's reported income. At least initially, they could be treated like a new employer—paying a 2% tax on the taxable wage base, plus GCI's proposed employee tax of 0.1% on all wages. Once the worker contributes to the state's UI trust fund for 12 months, they would be eligible for UI benefits. DES may find it too administratively complex to adjust their rate annually based on their experience index, in which case they would be charged a fixed rate — which could remain at the level a new employer pays or be a straight percent of wages, which might be a multiple of 0.1%. The state should monitor the program every two years for possible financing and rule adjustments.

The graph below illustrates what this cost structure would look like in 2021 in comparison to what other states had in 2014, a reasonable comparison year as this was a time of rebuilding state UI trust funds after the Great Recession. As can be seen, Arizona would be well within the norm of other states if it adopted this recommendation. Keep in mind, most other states will also be repaying federal government UI loans, and those payments or surcharges are not shown in the graph. After assessments on employers in 2011 and 2012, and an added federal assessment on employers of \$21 in 2013, Arizona used general obligation bonding from the General Fund to pay off the remainder of its debt to the federal government.

¹⁰ Moral hazard relates to people not buying insurance until they are about to need it. Most people are not unemployed, so for the system to work you need people who wish to be eligible paying into the system during good times even though their likelihood of unemployment at that time is very small.

Figure 7: Comparison of state unemployment insurance taxes including GCI's proposed UI taxes for Arizona



MAXIMIZING FEDERAL UNEMPLOYMENT ASSISTANCE DOLLARS

Under the CARES Act, if Arizona increases its weekly UI benefit amount, the increased amount will automatically accrue to people on PUA. If the state increases regular UI benefits available to all eligible workers, the workers will have access to those same benefit amounts when they transfer from state UI programs to PEUC. However, if Arizona increases its UI benefits *after* an individual transfers from state UI to PEUC, then that individual will continue receiving the original lower benefit amount and will miss out on any increase. Since the pandemic and state lock down in mid-March, the first wave of unemployed workers in Arizona are beginning to transfer from state UI to PEUC.

Now is a critical time to raise UI benefits to ensure that individuals begin receiving the increased benefit amount prior to transferring to PEUC. This will benefit unemployed individuals as well as maximize the economic benefit for the state via federal dollars. Authorizing language is detailed in the technical appendix.

Now is a critical time to raise UI benefits to ensure that individuals begin receiving the increased benefit amount prior to transferring to PEUC. This will benefit unemployed individuals as well as maximize the economic benefit for the state via federal dollars.

STATUS – ARIZONANS RECEIVING PANDEMIC UNEMPLOYMENT ASSISTANCE (PUA)

As of August 2020, the Arizona Department of Economic Security (DES) reports approximately 220,000 people were enrolled in PUA (see technical appendix for details). For this analysis, GCI presumes as the economy gradually recovers, that PUA enrollment

will decline to 94 percent of the previous month with approximately 81,000 people still relying on PUA in December 2021. This presumes that the federal government extends funding to cover the program through 2021 (highlighted months). The projection is based in part on prior recoveries, but due to the uncertainties with the pandemic, the forecast is speculative.

Table 2: PUA recipients in Arizona

Date	PUA
20-Aug	220,000
20-Sep	207,000
20-Oct	195,000
20-Nov	183,000
20-Dec	172,000
21-Jan	162,000
21-Feb	152,000
21-Mar	143,000
21-Apr	134,000
21-May	126,000
21-Jun	118,000
21-Jul	111,000
21-Aug	104,000
21-Sep	98,000
21-Oct	92,000
21-Nov	86,000
21-Dec	81,000

STATUS – ARIZONANS RECEIVING REGULAR STATE UI

State UI benefits are paid for from Arizona’s UI trust fund for the first 26 weeks. After 26 weeks of unemployment (and reduced hours in some cases), recipients shift to PEUC for 13 weeks and then, if unemployment levels remain high, they can receive an additional 13 weeks of EB. Most people find employment before reaching these thresholds.

In August, approximately 180,000 Arizonans were on state UI and 15,000 were on PEUC (see technical appendix for details). Because of the unprecedented upsurge in unemployment in March and April of this year and continued upheavals during the summer, people will now begin to reach their 26 week limit for state UI at which point they will transition to PEUC and if still unemployed after 13 weeks will transfer to EB for up to 13 additional weeks (the latter is dependent on whether Arizona continues to hit the qualifying statewide unemployment threshold).

STATUS – ARIZONANS RECEIVING PEUC & EB

PEUC is set to expire in December 2020 and is paid for by the federal government. EB’s costs are normally split 50/50 between the state and the federal government, but the

CARES Act ensured that the federal government would pay the full amount through December 2020. This analysis assumes both programs continue into 2021 and are fully funded with no requirement for state matching funds. During the Great Recession the number of people on federally-funded extended benefits exceeded the number of people receiving state UI. Due to the nature of the pandemic, GCI expects that pattern to repeat itself but to be shorter and that by the end of 2021 the number of people on some form of extended benefits will be on par with the typical rate observed for people with 20 weeks extended benefits during the Great Recession, which was one-fourth of the population relying upon the extended benefits. This analysis excludes a few hundred people in August who were already in the EB program as they will not be eligible for increased benefits.

Table 3: Arizona recipients of state UI, PEUC & EB

	State UI	PEUC & EB	Total	% PEUC & EB
20-Aug	180,000	15,000	195,000	8%
20-Sep	146,000	37,000	183,000	20%
20-Oct	103,000	69,000	172,000	40%
20-Nov	81,000	81,000	162,000	50%
20-Dec	61,000	91,000	152,000	60%
21-Jan	62,000	75,000	137,000	55%
21-Feb	61,000	62,000	123,000	50%
21-Mar	60,000	51,000	111,000	46%
21-Apr	60,000	44,000	104,000	42%
21-May	61,000	37,000	98,000	38%
21-Jun	61,000	31,000	92,000	34%
21-Jul	58,000	28,000	86,000	32%
21-Aug	57,000	24,000	81,000	30%
21-Sep	55,000	21,000	76,000	28%
21-Oct	52,000	19,000	71,000	27%
21-Nov	50,000	17,000	67,000	26%
21-Dec	47,000	16,000	63,000	25%

STATUS – PARTIALLY-EMPLOYED PEOPLE CURRENTLY EXCLUDED FROM ARIZONA’S UI SYSTEM

In addition to increasing the benefit cap, GCI recommends that the income disregard, the amount a person can earn through partial employment while receiving UI assistance, be increased to $\frac{1}{4}$ of an individual’s weekly benefit amount, as opposed to the current amount up to \$30. This change would enable 41,000 Arizonans currently partially employed, whose hours were reduced on average from 38 hours to 18 hours due to the pandemic, to qualify for UI benefits.¹¹ If this recommendation were adopted in October 2020, the assumption is made that all of them would then qualify for state UI (rather than PUA) in October and are included in the numbers below. Five to six months later, they, too would be eligible for PEUC, assuming its continuation. Some might qualify for PEUC before six months if they had some period when they did receive UI benefits during the relevant dates. Assuming a gradual recovery, the estimated additional partially-employed workers added to state UI are listed below.

GCI found that Arizona’s partially employed workers missed out more than \$80 million in added state unemployment or Pandemic Unemployment Assistance payments which would have leveraged an additional \$490 or more in federal supplemental dollars. As a result Arizona lost up to [\\$2 billion in economic activity](#) from April through July because these workers missed out on the \$600 a week federal supplement provided by the CARES Act. They also missed out on the subsequent \$300 a week Lost Wages Assistance payment.

Increasing benefits now would ensure that Arizona employees working reduced hours would be eligible for a future federal unemployment supplement, should one be approved by Congress. This would go a long way to help those struggling to make ends meet.

Table 4: People included in this analysis who are partially employed but currently excluded from Arizona’s UI system

	State UI	PEUC & EB	Total	% PEUC & EB
20-Aug	41,000	0	41,000	
20-Sep	38,000	0	38,000	
20-Oct	36,000	0	36,000	
20-Nov	34,000	0	34,000	
20-Dec	32,000	0	32,000	
21-Jan	23,000	6,000	29,000	20%

¹¹ Calculation based on Outgoing Rotation Group data from the August Current Population Survey with national data following the approach used by GCI in its August 5th [report](https://grandcanyoninstitute.org/arizonas-economy-dragged-down-by-poor-unemployment-system/) (<https://grandcanyoninstitute.org/arizonas-economy-dragged-down-by-poor-unemployment-system/>). While Arizona’s unemployment rate dipped substantially in August, due in large part to a record loss of people from the labor force, GCI didn’t make an unemployment rate adjustment to the national data.

	State UI	PEUC & EB	Total	% PEUC & EB
21-Feb	13,000	13,000	26,000	50%
21-Mar	12,000	11,000	23,000	46%
21-Apr	13,000	9,000	22,000	42%
21-May	13,000	8,000	21,000	38%
21-Jun	13,000	6,000	19,000	34%
21-Jul	12,000	6,000	18,000	32%
21-Aug	12,000	5,000	17,000	30%
21-Sep	12,000	4,000	16,000	28%
21-Oct	11,000	4,000	15,000	27%
21-Nov	10,000	4,000	14,000	26%
21-Dec	10,000	3,000	13,000	25%

ECONOMIC IMPACT OF LEVERAGING FEDERAL UNEMPLOYMENT ASSISTANCE DOLLARS

Unemployment insurance provides an automatic stabilizer to the economy. If Arizona's Governor and Legislature enact increased UI benefits now, the state can leverage federal unemployment dollars through PUA and as Arizonans receiving regular state UI transition to federally-funded unemployment programs including, PEUC and EB.

The pandemic and associated economic effects have struck lower wage workers the hardest in areas like hospitality, restaurants and retail. Based on Oregon which also has a \$12 minimum wage, GCI estimates that if the weekly benefit cap is raised to \$490 (and \$510 in 2021, as it adjusts with the average weekly wage) average UI benefits in Arizona will rise from \$230 to \$355 a week. This will provide typical Arizona unemployed workers an additional \$500 a month—which will be critical during this time. Table 4 presents the number of unemployed that qualify for PUA, PEUC, and EB and the financial impact if they were to receive UI benefits at the amount recommended by GCI. Significantly, as these are federally-funded UI benefits, the federal government would pay the cost of the increased benefits.

GCI estimates that if the weekly benefit cap is raised to \$490 (and \$510 in 2021) average UI benefits in Arizona will rise from \$230 to \$355 a week. This will provide typical Arizona unemployed workers an additional \$500 a month.

The state has not released any information on average benefits for PUA, but since PUA includes people whose earnings were too low to qualify for state UI, GCI presumes a

greater portion of them would not see any change in their benefits. Consequently, rather than an average increase of \$125 for these low-wage earners, GCI presumes an average increase of \$50. GCI has sought to get more precise information from DES but did not receive a response prior to the publication of this paper.

INCREASED FEDERALLY-FUNDED PEUC & EB BENEFITS

Finding: \$247 million gain in federally-funded PEUC and EB UI benefits that generates a \$420 million cumulative economic gain and \$28.5 million in state and local tax revenue by increasing Arizona's weekly benefit cap through Dec. 2021.

Increasing Arizona's weekly benefit cap would result in an estimated income gain of \$420 million due to federally-funded PEUC and EB recipients. This income generates \$28.5 million more in state and local tax revenue. These figures exclude people on PEUC or EB before October who would not qualify for any benefit increase.

Table 5: Economic impact of increased federally-funded PEUC & EB benefits

	PEUC & EB	Economic Gain	Multiplier Effect	Cumulative Gain	State & Local Tax Revenue
20-Aug	15,000		\$0	\$0	\$0
20-Sep	37,000		\$0	\$0	\$0
20-Oct	35,700	\$19,000,000	\$32,000,000	\$32,000,000	\$2,200,000
20-Nov	51,030	\$27,000,000	\$46,000,000	\$78,000,000	\$5,300,000
20-Dec	64,027	\$34,000,000	\$58,000,000	\$136,000,000	\$9,200,000
21-Jan	50,724	\$27,000,000	\$46,000,000	\$182,000,000	\$12,400,000
21-Feb	40,152	\$22,000,000	\$37,000,000	\$219,000,000	\$14,900,000
21-Mar	31,337	\$17,000,000	\$29,000,000	\$248,000,000	\$16,900,000
21-Apr	29,842	\$16,000,000	\$27,000,000	\$275,000,000	\$18,700,000
21-May	26,807	\$14,000,000	\$24,000,000	\$299,000,000	\$20,300,000
21-Jun	23,661	\$13,000,000	\$22,000,000	\$321,000,000	\$21,800,000
21-Jul	22,716	\$12,000,000	\$20,000,000	\$341,000,000	\$23,200,000
21-Aug	20,195	\$11,000,000	\$19,000,000	\$360,000,000	\$24,500,000
21-Sep	18,261	\$10,000,000	\$17,000,000	\$377,000,000	\$25,600,000
21-Oct	17,028	\$9,000,000	\$15,000,000	\$392,000,000	\$26,600,000
21-Nov	15,580	\$8,000,000	\$14,000,000	\$406,000,000	\$27,600,000
21-Dec	14,978	\$8,000,000	\$14,000,000	\$420,000,000	\$28,500,000
Total		\$247,000,000			

INCREASED FEDERALLY-FUNDED PUA BENEFITS

Finding: \$420 million gain in federally-funded PUA benefits that generates \$716 million cumulative economic gain and \$50 million in state and local tax revenue by increasing Arizona's weekly benefit cap through Dec. 2021.

Increasing Arizona's weekly benefit cap will also result in increased PUA benefits and by the end of December 2021 this will lead to an estimated economic gain of \$716 million and will generate nearly \$50 million in state and local tax revenue.

Table 6: Economic impact of increased federally-funded PUA benefits

	PUA	Economic Gain	Multiplier	Cumulative Gain	State & Local Tax Revenue
20-Aug	220,000		\$0	\$0	\$0
20-Sep	207,000		\$0	\$0	\$0
20-Oct	195,000	\$41,925,000	\$71,000,000	\$71,000,000	\$4,800,000
20-Nov	183,000	\$39,345,000	\$67,000,000	\$138,000,000	\$9,400,000
20-Dec	172,000	\$36,980,000	\$63,000,000	\$201,000,000	\$13,700,000
21-Jan	162,000	\$34,830,000	\$59,000,000	\$260,000,000	\$17,700,000
21-Feb	152,000	\$32,680,000	\$56,000,000	\$316,000,000	\$21,500,000
21-Mar	143,000	\$30,745,000	\$52,000,000	\$368,000,000	\$25,000,000
21-Apr	134,000	\$28,810,000	\$49,000,000	\$417,000,000	\$28,300,000
21-May	126,000	\$27,090,000	\$46,000,000	\$463,000,000	\$31,500,000
21-Jun	118,000	\$25,370,000	\$43,000,000	\$506,000,000	\$34,400,000
21-Jul	111,000	\$23,865,000	\$41,000,000	\$547,000,000	\$37,200,000
21-Aug	104,000	\$22,360,000	\$38,000,000	\$585,000,000	\$39,800,000
21-Sep	98,000	\$21,070,000	\$36,000,000	\$621,000,000	\$42,200,000
21-Oct	92,000	\$19,780,000	\$34,000,000	\$655,000,000	\$44,500,000
21-Nov	86,000	\$18,490,000	\$31,000,000	\$686,000,000	\$46,600,000
21-Dec	81,000	\$17,415,000	\$30,000,000	\$716,000,000	\$48,700,000
Total		\$420,755,000			

INCREASED INCENTIVE TO WORK

Finding: Increasing the earnings allowance will provide more people with income protection through the UI system. This will cost the state \$110.3 million while generating a cumulative economic gain of \$90.6 million through December 2021.

GCI's recommendation to increase the income disregard to $\frac{1}{4}$ of an individual's weekly benefit amount will ensure UI benefits for an estimated 36,000 partially-employed Arizonans currently left out of the system. These employees are excluded from the UI system due to Arizona's harsh penalty for returning to work, which reduces benefit payments after the first \$30 of income and denies all assistance once a person earns the equivalent of their weekly benefit amount, meaning the income disregard effectively becomes \$0.

Adopting this change will provide an incentive for people to work, rather than punishing them as the current system does. This change will cost the state \$110.3 million through next December while providing a cumulative gain of \$90.6 million beyond the \$110 million state investment.

GCI's analysis of the Current Population Survey's Outgoing Rotation Group indicates that recipients on average would receive \$100 per week or about \$400 per month instead of currently receiving no assistance at all while having had their hours and pay reduced by half.

For this analysis, GCI assumes all are on state UI, so federal payments only occur once some portion of the population of employees move to PEUC and EB. This benefit includes some funds from the state UI trust fund or borrowing from the federal government. Consequently, the cumulative gain presented here deducts the cost of paying for the benefit. This will generate about \$6 million in added state and local revenue.

Table 7: Economic impact of providing UI benefits to currently excluded workers whose hours have been cut

	State UI	PEUC & EB	Total	% PEUC & EB	Added State UI investment	Added PEUC & EB	Multiplier	Cumulative Gain (inc. adjustment for financing cost)
1-Aug	41,000	0	41,000					
20-Sep	38,000	0	38,000					
20-Oct	36,000	0	36,000		\$15,500,000		\$26,350,000	\$10,850,000
20-Nov	34,000	0	34,000		\$14,600,000		\$24,820,000	\$21,070,000
20-Dec	32,000	0	32,000		\$13,800,000		\$23,460,000	\$30,730,000
21-Jan	23,000	6,000	29,000	20%	\$9,900,000	\$600,000	\$17,850,000	\$38,680,000
21-Feb	13,000	13,000	26,000	50%	\$5,600,000	\$1,300,000	\$11,730,000	\$44,810,000
21-Mar	12,000	11,000	23,000	46%	\$5,200,000	\$1,100,000	\$10,710,000	\$50,320,000
21-Apr	13,000	9,000	22,000	42%	\$5,600,000	\$900,000	\$11,050,000	\$55,770,000
21-May	13,000	8,000	21,000	38%	\$5,600,000	\$800,000	\$10,880,000	\$61,050,000
21-Jun	13,000	6,000	19,000	34%	\$5,600,000	\$600,000	\$10,540,000	\$65,990,000
21-Jul	12,000	6,000	18,000	32%	\$5,200,000	\$600,000	\$9,860,000	\$70,650,000
21-Aug	12,000	5,000	17,000	30%	\$5,200,000	\$500,000	\$9,690,000	\$75,140,000

	State UI	PEUC & EB	Total	% PEUC & EB	Added State UI investment	Added PEUC & EB	Multiplier	Cumulative Gain (inc. adjustment for financing cost)
21-Sep	12,000	4,000	16,000	28%	\$5,200,000	\$400,000	\$9,520,000	\$79,460,000
21-Oct	11,000	4,000	15,000	27%	\$4,700,000	\$400,000	\$8,670,000	\$83,430,000
21-Nov	10,000	4,000	14,000	26%	\$4,300,000	\$400,000	\$7,990,000	\$87,120,000
21-Dec	10,000	3,000	13,000	25%	\$4,300,000	\$300,000	\$7,820,000	\$90,640,000
Total					\$110,300,000	\$7,900,000		

STATE-FUNDED INCREASED WEEKLY BENEFIT CAP

Finding: Arizona achieves an \$350 million net economic gain as a result of increased state-funded UI benefits; This generates \$24 million in state and local tax revenue through December 2021.

Finally, adopting GCI's recommended weekly benefit cap would result in state UI recipients receiving an added \$125 per week or \$500 per month on average. The cumulative gain resulting from this recommendation is lower because these benefits have to be paid for by the state. In effect, the state UI program transfers income from employers and a broad cross-section of employees to people who are unemployed. The unemployed are far more likely to both spend the money quickly and spend it locally on household items, transportation, utilities and housing. GCI has estimated that multiplier at 1.7. By contrast, the assessment on businesses that pay for it are far less likely to have that impact during an economic downturn—being far more likely to hoard the cash. GCI deducts directly the cost of paying for it from state funds, yielding a net multiplier of 0.7 (more details in technical appendix). This benefit has a net positive target impact considering the matching federal dollars and the increased employee tax formula.

Table 8: Economic gains from increased state UI benefits

	State UI	Economic Gain	Multiplier Effect	Cumulative Gain (inc adjustment for financing cost)	State & Local Tax Revenue
20-Aug	180,000				
20-Sep	146,000				
20-Oct	103,000	\$55,000,000	\$94,000,000	\$39,000,000	\$2,700,000
20-Nov	81,000	\$44,000,000	\$75,000,000	\$70,000,000	\$4,800,000
20-Dec	61,000	\$33,000,000	\$56,000,000	\$93,000,000	\$6,300,000
21-Jan	62,000	\$33,000,000	\$56,000,000	\$116,000,000	\$7,900,000
21-Feb	61,000	\$33,000,000	\$56,000,000	\$139,000,000	\$9,400,000

	State UI	Economic Gain	Multiplier Effect	Cumulative Gain (inc adjustment for financing cost)	State & Local Tax Revenue
21-Mar	60,000	\$32,000,000	\$54,000,000	\$161,000,000	\$10,900,000
21-Apr	60,000	\$32,000,000	\$54,000,000	\$183,000,000	\$12,400,000
21-May	61,000	\$33,000,000	\$56,000,000	\$206,000,000	\$14,000,000
21-Jun	61,000	\$33,000,000	\$56,000,000	\$229,000,000	\$15,600,000
21-Jul	58,000	\$31,000,000	\$53,000,000	\$251,000,000	\$17,100,000
21-Aug	57,000	\$31,000,000	\$53,000,000	\$273,000,000	\$18,600,000
21-Sep	55,000	\$30,000,000	\$51,000,000	\$294,000,000	\$20,000,000
21-Oct	52,000	\$28,000,000	\$48,000,000	\$314,000,000	\$21,300,000
21-Nov	50,000	\$27,000,000	\$46,000,000	\$333,000,000	\$22,600,000
21-Dec	47,000	\$25,000,000	\$43,000,000	\$351,000,000	\$23,900,000

Table 9: Total economic benefits from recommended state UI enhancements

Cumululative Gain of Increasing UI Benefits	Economic Benefit
PEUC & EB	\$420 million
PUA	\$716 million
State UI	\$351 million
Added qualifiers due to improve allowance for part-time work	\$91 million
Total Economic Benefit	\$1.6 billion
Added State and Local Revenue from Growth	\$107 million
Total Added Federal Dollars to Arizona	\$675 million

FINANCING BENEFITS AND IMPROVING THE LONG-TERM STABILITY OF ARIZONA'S UI TRUST FUND

Arizona's UI trust fund will likely go into deficit by early next year and will be compounded in 2021 as employers' tax rates will be fixed to 2020 levels. Under normal circumstances, Arizona's employers would anticipate increased UI tax rates in 2021 to provide increased revenues to replenish the UI trust fund. However, the system will under-react to 2020 because, under the CARES Act, employers' UI tax rates have been fixed to their 2020 rate. In other words, they have been held harmless from the widespread furloughs and layoffs resulting from the COVID-19 pandemic. Their UI taxes will increase modestly—but only because the trust fund level will have depleted as of July 2020, the point used to set next year's rates.¹²

¹² See ARS 23-730 <https://www.azleg.gov/ars/23/00730.htm>.

Trust fund taxes will be too low to provide sufficient UI tax revenues to replenish it, thus causing the trust fund to move deeper into deficit. According to GCI's analysis and based on the UI benefits it proposes, Arizona's UI trust fund balance is not set to begin recovering — that is, no longer go further into deficit — before the end of 2021. Revenues may not exceed outlays again until sometime in 2022.

During a normal recession, a former employee's UI benefit costs are charged against what their previous employer paid into the UI trust fund. Tax rates are cyclical, falling during economic expansions when an employer's UI tax credits exceed its payments. Tax rates then increase during a recession when payments to an employer's prior employees exceed credits to the UI system. Arizona already had a refinancing problem with its UI trust fund as demonstrated by the fact that despite a record-long expansion after the Great Recession, its UI trust fund never reached the minimum financing standard set by the U.S. Dept. of Labor, known as the average high cost multiple of 1— an indicator that a UI trust fund has sufficient funds to cover the average of its three worst years in the past two decades.

Improving benefits, while providing a significant stimulus to the state's economy, has the cost of increasing the drain on the trust fund further. GCI anticipates that by the end of 2021, if the state Legislature takes no action, Arizona's UI trust fund will have to borrow \$210 million from the federal government and will have to continue borrowing throughout 2022. If adopted, GCI's reforms will require UI borrowing of about \$300 million by the end of 2021 to replenish the trust fund—less than what Arizona borrowed during the Great Recession. GCI's proposed UI trust fund financing recommendations should get the trust fund back to a positive balance before the end of 2023.

SUMMARY

Arizona can do its part to help those suffering from employment loss during the COVID-19 pandemic and beyond. The state has neglected its UI program and has not made any benefit changes since 2004. While GCI projects that it would cost the state \$600 million to improve benefits in line with states like Utah and Texas, by acting immediately, the state can maximize its gains by leveraging federal funds in a manner that leads to a net economic gain of \$1.2 billion by December 2021. This helps both the state economy and targets aid to those who most need assistance.

Adjustments in the revenue structure for the UI trust fund will ensure its long-term stability similar to what other states have achieved without causing undue financial challenges for employers.

Dave Wells holds a doctorate in political economy and public policy and is the Research Director for the Grand Canyon Institute, a centrist fiscal policy think tank founded in 2011. He can be reached at DWells@azqci.org or by contacting the Grand Canyon Institute at (602) 595-1025 ex. 2.

Max Goshert holds a master's in public policy and serves as the Associate Director for the Grand Canyon Institute. He also works as a Senior Research Analyst at Arizona State University. He can be reached at MGoshert@azgci.org or at (602) 595-1025 ex. 12.

Alex Tam is an undergraduate student at Harvard University and a GCI Research Associate. He assisted with state trust fund and financing comparisons and the regression analysis.

James Cooper is an undergraduate student at Arizona State University and a GCI Research Associate. He researched states that assessed taxes on employees.

The Grand Canyon Institute, a 501(c) 3 nonprofit organization, is a centrist think tank led by a bipartisan group of former state lawmakers, economists, community leaders, and academicians. The Grand Canyon Institute serves as an independent voice reflecting a pragmatic approach to addressing economic, fiscal, budgetary and taxation issues confronting Arizona.

Grand Canyon Institute
P.O. Box 1008
Phoenix, Arizona 85001-1008
GrandCanyonInstitute.org

TECHNICAL APPENDIX

UNEMPLOYMENT RECIPIENTS IN ARIZONA

Obtaining accurate numbers for unemployed people in Arizona and the UI programs they qualify for has been challenging during the pandemic due to the immense strain on Arizona's Department of Economic Security. Therefore, estimates for the number of unemployed people have been used based on the following information.

The number of people on UI and PUA in Arizona of 400,000 is fairly well documented. Ryan Randazzo's reporting in the *Arizona Republic* has cited this figure numerous times from his contacts with DES and the memos to the state during the time of the \$300 LWA indicate payments to the state equal to about 406,000 benefit weeks.¹³ Earlier in August, he reported that 380,000 people were on state UI or PUA with it roughly split.¹⁴ A subsequent phone call with Randazzo gave the impression supported by an analysis during the summer of state UI claims (which again were benefit weeks and an individual could receive multiple weeks at one) that the best estimate of state UI was 180,000. Therefore, PUA amount would be 220,000—and some PUA claimants had been held up due to the state investigating fraud cases. So those are the starting point assumptions used in this analysis.

The Arizona DES UI Dashboard is fairly impossible to use to determine actual individual claimants because it includes back week claims which can include federal supplements.¹⁵ It also may mix UI and PEUC claimants going forward.

DETERMINANTS OF A ROBUST UI TRUST FUND

Arizona's UI Trust Fund failed to recover well from the Great Recession, whereas some other states showed far stronger UI trust funds. Each state has a great deal of latitude in setting up its tax structures to support their UI trust funds.

GCI performed a statistical analysis of the 50 state UI trust funds plus the District of Columbia for the calendar years 2018 and 2019 at the height of the expansion to determine what parameters indicate a robust UI trust fund. GCI looked at three

¹³ Memos forwarded by Senator Sinema's office. See also Randazzo, Ryan (2020), "Extra \$300 unemployment payments are ending in Arizona, federal officials say," *Arizona Republic*, Sept. 10, <https://www.azcentral.com/story/money/business/consumers/2020/09/10/federal-unemployment-boost-300-ending-in-arizona/3456699001/>

¹⁴ Randazzo, Ryan (2020), "\$730M coming to 90,000 displaced Arizona workers who have been waiting for months," *Arizona Republic*, Aug. 20, <https://www.azcentral.com/story/money/business/consumers/2020/08/20/arizona-department-economic-security-delayed-payouts-pandemic-employment-assistance-applicants/5617165002/>.

¹⁵ Arizona Department of Economic Security, Unemployment Insurance Dashboard, https://des.az.gov/sites/default/files/media/Unemployment_Insurance_Dashboard.pdf?time=1601168662132.

independent variables as they related to what is called the average high-cost multiple — which indicates how well a trust fund is situated to weather an average of its three worst years. An average high-cost multiple of 1 is considered to be the minimal indicator of an adequately funded UI trust fund; Arizona's UI trust fund had attained an average high-cost multiple of 0.92 on January 1, 2020 meaning it was under the threshold of being considered adequately funded.

The dependent variables in GCI's statistical analysis were:

Taxable Wage Base: The greater the taxable wage base, the more likely the state is able to better finance its UI trust fund.

Average Weekly Benefit: The higher the average weekly benefit, the greater the strain placed on the UI trust fund.

Ratio of Maximum Employer Tax to Average Employer Tax: Not all employers pay the same tax rate. Employers who are more likely to lay off workers pay a higher UI tax rate. However, if the high-layoff employers have a fairly low capped UI tax rate then they are unlikely to pay their fair share into the UI trust fund which ultimately puts it at financial risk.

Because the taxable wage base and average weekly benefit correlated at 0.5, GCI replaced both with a ratio of average weekly benefit/taxable wage base in thousands. This corrects what could cause an estimated error by combining two variables that are hard to differentiate separately.

The model effectively predicted what a state's average high-cost multiple would be with an F score of 20.87 and a statistical probability of accuracy of essentially 100 percent.

Likewise, each of the variables were statistically significant at 95 percent or better. The benefit-to-tax-base ratio was significant at 99 percent and the employer tax ratio was significant at 95 percent.

Table 10: Analysis of Average High-Cost Multiple Ratio

. reg HighCostMultiple BenefitRatio EmployerRatio						
Source	SS	df	MS	Number of obs	=	102
Model	8.69727504	2	4.34863752	F(2, 99)	=	20.87
Residual	20.6238593	99	.208321811	Prob > F	=	0.0000
				R-squared	=	0.2966
				Adj R-squared	=	0.2824
Total	29.3211343	101	.290308261	Root MSE	=	.45642

HighCostMultiple	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
BenefitRatio	-.0209732	.0046152	-4.54	0.000	-.0301308	-.0118156
EmployerRatio	.0282618	.0138922	2.03	0.045	.0006967	.055827
_cons	1.469455	.1678496	8.75	0.000	1.136405	1.802505

The following table compares key factors of state UI programs. The dependent data is from the calendar year 2019 and the average high-cost multiple is from Jan. 1, 2020.

Table 11: Comparison of state UI programs*

	Average High-Cost Multiple Actual	Average High-Cost Multiple Estimated	Average Weekly Benefit	Taxable Wage Base	Max. Employer Rate	Average Employer Rate	Current Trust Fund Balance
Arizona	0.92	0.93	\$233	\$7,000	\$826	\$148	Positive
California	0.21	0.50	\$335	\$7,000	\$434	\$413	Borrowing from Fed
Texas	0.36	0.57	\$418	\$9,000	\$540	\$220	Borrowing from Fed
Ohio	0.42	0.73	\$378	\$9,500	\$874	\$260	Borrowing from Fed
Montana	1.53	1.45	\$378	\$33,000	\$2,020	\$263	Positive
Utah	1.67	1.84	\$424	\$35,300	\$2,471	\$113	Positive
Oklahoma	1.71	1.18	\$386	\$18,100	\$996	\$175	Positive

* The dependent data is from the calendar year 2019 and the average high-cost multiple is from Jan. 1, 2020.

IMPACT ON PUA BENEFIT IF STATE INCREASES UI BENEFIT AMOUNT

Pandemic Unemployment Assistance:

(d) Amount of Assistance,

1) IN GENERAL.—The assistance authorized under subsection (b) for a week of unemployment, partial unemployment, or inability to work shall be—

(A) (i) the weekly benefit amount authorized under the unemployment compensation law of the State where the covered individual was employed, except that the amount may not be less than the minimum weekly benefit amount described in section 625.6 of title 20, Code of Federal Regulations, or any successor thereto; and

(ii) the amount of Federal Pandemic Unemployment Compensation under section 2104; and

(B) in the case of an increase of the weekly benefit amount after the date of enactment of this Act, increased in an amount equal to such increase.¹⁶

IMPACT ON PEUC AND EB BENEFIT IF STATE INCREASES UI BENEFIT AMOUNT

Based on information conveyed by Senator Kyrsten Sinema's office after consulting with the U.S. Department of Labor (DOL) and the Congressional Research Service (CRS):

First the PEUC amount is defined in Section 2107(4)(A)(i) of the CARES Act — and it is dependent on state law. There is no language on not changing the amount or being dependent on what it was on a certain date. DOL indicates guidance to states was written as broadly as possible.

- (i) the amount of the regular compensation (including dependents' allowances) payable to such individual during such individual's benefit year under the State law for a week of total unemployment;

Second, state law will determine if an increase in the Weekly Benefit Amount (WBA) would apply to current regular UI beneficiaries or just to new approved applicants after its effective date. CRS says that states do not often apply changes to the benefit calculation (both increases or decreases) to those already receiving benefits. This is partially due to the complexity of how states keep track of remaining benefits available. Unless Congress wrote in an explicit limitation – whatever increase in the weekly benefit amount was passed would likely apply to individuals if they subsequently transfer to PEUC.

But if benefits increase after a person transitions to PEUC, the person would not be eligible for the benefit increase.

MULTIPLIER EFFECTS

From a multiplier perspective, federal dollars are new dollars into Arizona's economy that would not have otherwise impacted it. During recessions, multiplier impacts are larger. The Congressional Budget Office suggests fiscal multipliers for transfer

¹⁶ CARES Act <https://www.congress.gov/bill/116th-congress/house-bill/748/text>.

payments like UI as high as 2.1 during a recession and as low as 0.4 during an expansion. National multipliers can sometimes be less than local multipliers since models at the national level need to take into account financing mechanisms. From Arizona's perspective, those financing impacts would be spread throughout the economy regardless of whether a particular infusion reaches Arizona. So the infusions are only positive.

The following studies support a multiplier of 1.7 or possibly higher. Because UI benefits are higher than usual, lower-end estimates are used.

1. Whalen and Reichling, Congressional Budget Office (2015) Transfer Payments to Individuals During Recession Multiplier 2.1¹⁷
2. Vromus and Bemus (2010) National and State UI Multipliers 1.9 to 2.0 based on Great Recession¹⁸
3. DiMaggio and Kermani (2015) Local Fiscal Multiplier of UI 1.9¹⁹
4. Arizona Public University Enterprise (U of A, ASU and NAU) for FY2017 Payroll Multiplier 1.7²⁰

When the dollars need to be financed, GCI assumes instead the multiplier is 0.7, which equates to taking out the money to pay for it from the economic benefit.

The presumption here is that the source of the funds—primarily employers and to a lesser extent the wide scope of employees with the 0.1% wage tax—would be less likely to expend the funds and expend them in Arizona. Instead they would be more likely to hoard cash or spend it elsewhere—which might be helpful to them (similar to getting a stimulus check and saving it) but does not help Arizona's economic recovery.

The economic literature supports this view. Whalen and Reichling, noted above, during slack economic times place the multipliers for one-year tax cuts for higher-income people at 0.6 and the one for lower and middle income people at 1.5. Due to the level

¹⁷ Whalen, Charles J. and Felix Reichling (2015), "The Fiscal Multiplier and Economic Policy Analysis in the United States," Congressional Budget Office, February, Working Paper 2015-02, https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/workingpaper/49925-FiscalMultiplier_1.pdf.

¹⁸ Vroman, Wayne and Jacob M. Benus (2010), "The Role of Unemployment Insurance as an Automatic Stabilizer," Urban Institute and IMPAQ International, July, https://wdr.doleta.gov/research/FullText_Documents/ETAOP2010-10.pdf.

¹⁹ DiMaggio, Marco and Amir Kermani (2016), "The Importance of Unemployment Insurance as an Automatic Stabilizer," National Bureau of Economic Research Work Paper 22625, September, <https://www.nber.org/papers/w22625.pdf>.

²⁰ Elliot D. Pollack and Company (2019), "Economic and Fiscal Impact of Arizona Public University Enterprise," Prepared for Arizona Board of Regents, <https://www.azregents.edu/sites/default/files/reports/Economic-Impact-Report-FY17.pdf>. Calculation based on Ratio of Economic Output to Labor Income for University Payroll & Employment on p. iii for fiscal year 2017.

of income inequality, the top-quintile receives just over half the income.²¹ The average of the two multipliers is approximately 1.

This differential spending rates of the CARES Act economic stimulus payments was also tracked by Baker et al., noting that low income and low liquidity households were the most aggressive short-term spenders of the funds.²² Karger and Rajan found similar results in their Chicago Fed analysis of the stimulus payments.²³

Whalen and Reichling place the impact of corporate tax provisions with a multiplier of 0.4, lower than 1. Since this is a small tax on larger tax base than simply net income, it could have a slightly higher multiplier—but 1 appears to be a reasonable, if not high, estimate overall from exploring the literature.²⁴

²¹ Statista, “Shares of household income of quintiles in the United States from 1970 to 2019,” <https://www.statista.com/statistics/203247/shares-of-household-income-of-quintiles-in-the-us/>

²² Baker, Scott R., R. A. Farrokhnia, Steffen Meyer, Michaela Pagel, and Constantine Yannelis (2020), “Income, Liquidity, and the Consumption Response to the 2020 Economic Stimulus Payments,” May 25, https://www8.gsb.columbia.edu/fintech/sites/fintech/files/Corona_Stimulus.pdf

²³ Karger, Ezra and Astha Rajan (2020), “Heterogeneity in the Marginal Propensity to Consume: Evidence from Covid-19 Stimulus Payments,” Federal Reserve of Chicago Working Paper No. 2020-15, May 28, <https://www.chicagofed.org/publications/working-papers/2020/2020-15>

²⁴ Batini, Nicoletta, Luc Eyraud, Lorenzo Forni and Anke Weber (2014), “Fiscal Multipliers: Size, Determinants, and use in Macroeconomic Projections,” International Monetary Fund Fiscal Affairs Department, September, <https://www.imf.org/external/pubs/ft/tnm/2014/tnm1404.pdf>