Testimony for the Subcommittee on Health, Employment, Labor, and Pensions of the House Committee on Education and Labor
Hearing on Examining the Administration of the Unemployment Insurance System

Lessons from the Unprecedented Fraud and Abuse of the Unemployment Benefits System during the Pandemic

MATT WEIDINGER
Senior Fellow

September 21, 2022

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Matt Weidinger, Senior Fellow
American Enterprise Institute

Chairman DeSaulnier, Ranking Member Allen, and other members of the Subcommittee on Health, Employment, Labor, and Pensions, thank you for inviting me to testify at this morning's hearing examining the administration of the Unemployment Insurance system. My name is Matt Weidinger, and I am a senior fellow and Rowe Scholar in poverty studies at the American Enterprise Institute. I previously served on the staff of the House Committee on Ways and Means, including for 15 years as the staff director of its subcommittee with jurisdiction over the nation's unemployment benefits system.

Background on the unemployment benefits system

The nation's Unemployment Insurance (UI) program was created in 1935 in response to the Great Depression. It remains a shared partnership between the federal government and the states – which generally determine eligibility for, the amount of, and the duration of weekly UI benefit checks.[1] The federal role includes providing states funds to administer benefits, as well as in recent decades legislating temporary federal programs offering extended benefits for those who exhaust up to 26 weeks of state UI checks. A permanent federal/state program called Extended Benefits (EB) was created in 1970; during the past two recessions that program was temporarily supported with 100 percent federal funds. States administer both state and federal unemployment benefits, and state payroll taxes paid by employers on behalf of covered workers support state benefit costs. A federal payroll tax supports the cost of permanent law federal responsibilities, including program administration and the normally 50 percent federal share of EB program expenses. Other federal costs, such as for the extraordinary benefits provided during the pandemic, have been supported with federal general revenue and added to the deficit.[2]

Congress legislated an unprecedented unemployment benefit expansion in response to the pandemic

The coronavirus pandemic and the federal government's response to it unleashed unparalleled

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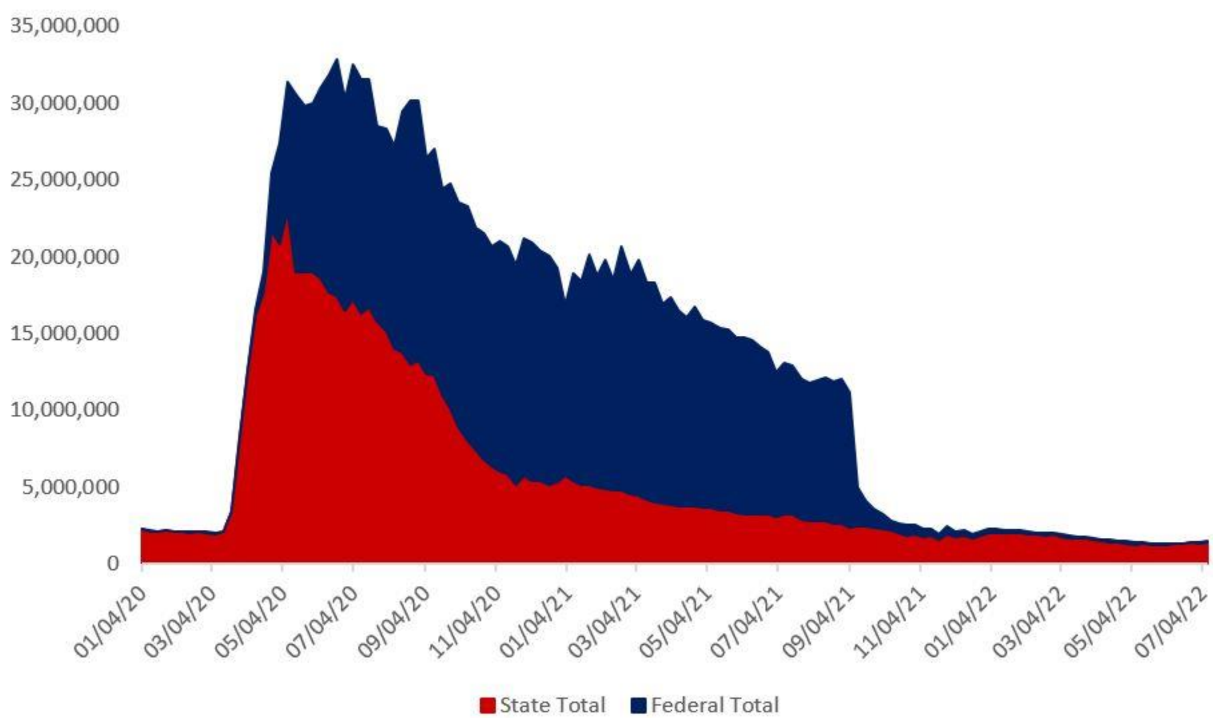
[1] There are 53 "state" UI programs, including in the District of Columbia, Puerto Rico, and the US Virgin Islands.

[2] Congress has in the past employed federal payroll tax hikes to finance extraordinary temporary federal benefit expansions. For example, that was the original purpose of the 0.2 percent FUTA "surtax" collected from 1977 through 2011. As I reviewed in 2020, if that practice were repeated today, "[T]oday's federal UI tax of typically $42 per worker per year would grow to $482—a 1,048 percent increase—and stay there for a decade. The federal UI tax rate would skyrocket from 0.6 percent to 6.6 percent." While employers nominally pay payroll taxes, most economists believe they result in lower wages for workers.

and immediate demand for unemployment benefits starting in March 2020. Major federal pandemic benefit expansions initiated in March 2020 included unprecedented $600-per-week (and later $300-per-week) benefit supplements,[3] extended benefits payable under both a new temporary federal program as well as the newly federalized EB program, and expanded eligibility covering groups never before eligible for weekly unemployment benefits.[4] Those policies resulted in record numbers claiming benefits, which placed extraordinary strain on the administration of the nation's unemployment benefits system. As depicted in Figure 1, the months after March 2020 saw an enormous surge in claims for state and federal benefits, which reached a record total of 33 million claims per week in June 2020. That compares with a prior record of 12 million claims during the Great Recession.[5]

Figure 1. State and Federal Unemployment Benefit Continuing Claims, January 2020-Present



Source: US Department of Labor.

In all, nearly *1.6 billion* weekly state and federal unemployment benefit checks were paid out during the 18 months between when the pandemic struck and temporary federal programs

[3] While the $600 federal supplement was available, two-thirds of recipients collected more in unemployment benefits than they earned while working. After the supplement dropped to $300 per week, nearly 40 percent collected more in benefits than from working.
[4] A detailed review of federal benefits paid during the pandemic is available here.
[5] Instead of providing the number of *individuals* collecting benefits (as was often reported), official data provided the total number of benefit *claims* in a week. As the Department of Labor noted at the time, "Backdated claims data may be included in these figures." Thus while total benefit claims reached over 30 million per week between May and July 2020, there were likely fewer individuals actually collecting benefits than that suggests. Large back payments resulted from the massive surge in demand for state UI benefits, which delayed first payments, along with the rollout of the new federal PUA program.

expired on Labor Day 2021. That's the equivalent of three full months of benefit checks for each of the 121 million households in the US. Averaged across the 18-month duration of temporary federal programs, that figure is also the equivalent of 21 million unemployment benefit checks paid each week. Meanwhile, the number of officially unemployed individuals was far less, averaging around 12.2 million per month during this period. The difference is attributable to backdated checks for retroactive payments, payments to individuals who "would not be working even without a pandemic," according to the University of Chicago's Casey Mulligan, and fraud.

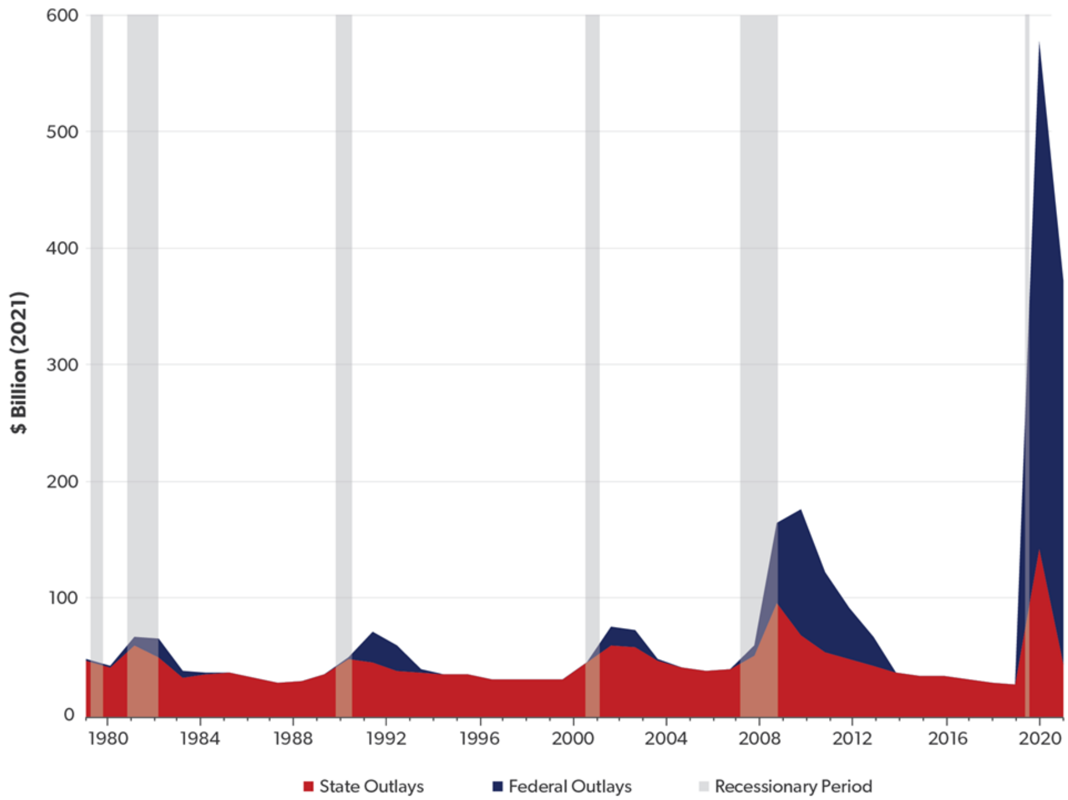
For an individual consistently collecting the national average weekly unemployment benefit between April 1, 2020, and September 6, 2021, state and federal benefits could reach $46,000.[6] That figure highlights both the record support made available to unemployed Americans, as well as the scale of the lucrative target for those seeking to defraud this system.

The cost to taxpayers of these extraordinary benefits was equally unprecedented, as Figure 2 displays. Overall, approximately $900 billion in unemployment benefits was distributed between March 2020 and September 2021, including over $700 billion in extraordinary federal benefits.[7]

Figure 2. State and Federal Unemployment Benefit Spending since 1980

[6] The average weekly state UI benefit during this period was about $325; $46,000 is the product of $325 in state UI and subsequent federal extended benefits over 74 weeks, plus $600-per-week federal supplements over an initial 17 weeks followed by $300-per-week federal supplements across another 41 weeks.

[7] GAO reported in June 2022 that "The Department of Labor (DOL) has reported about $658 billion in compensation paid under the CARES Act UI programs as of April 30, 2022." The Lost Wages Assistance program, which provided $300-per-week federal supplements during generally August and September 2020, added $41 billion, while other significant federal costs are attributable to the EB program.



Source: [US Department of Labor](#).

The scale and design of federal benefits increased the potential for fraud

Starting in March 2020, state unemployment benefit agencies were faced with two crises at once: responding to the unprecedented surge in demand for state UI benefits due to the pandemic, while at the same time standing up and administering several massive new federal benefit programs.

The new federal Pandemic Unemployment Assistance (PUA) program proved especially problematic, starting with the fact that it offered benefits for the first time to millions of independent contractors, self-employed individuals, and others not previously eligible for UI program benefits, or known to state UI systems.

Features explicitly legislated into the design of the program also made it highly vulnerable to abuse. PUA allowed claimants to self-certify their eligibility for benefits and initially did not require proof of prior work or adequate identity verification. Those features meant PUA had none of the third-party or employer verification that state UI programs regularly depend on to ensure benefits are properly targeted. Maryland's Labor Secretary in July 2020 described how this practice left PUA open to fraudulent claims: "The PUA Program, in particular, allows individuals to self-certify that they are unemployed due to the coronavirus, eliminating the regular check-and-balance that exists under the regular state UI program, increasing the potential for fraud." The Department of Labor's Inspector General later summarized that PUA's "reliance solely on claimant self-certifications without evidence of eligibility and wages during the program's first 9 months rendered the PUA program extremely susceptible to improper payments and fraud."

In contrast with many state UI recipients, self-employed individuals and independent contractors also could remain on PUA without being subject to recall by employers. As a September 2020 report reviewing benefits in California described, "claimants of regular UI have been almost five times more likely to exit UI in any given week than those receiving PUA benefits." The same report suggested that literally every self-employed person in California had applied for PUA benefits: "Since the start of the crisis, there have been 2.2 million PUA claims by individuals indicating previous self-employment. According to available estimates, there were only approximately 2.2 million self-employed individuals in CA prior to the start of the pandemic." The reality is more likely that many saw an assertion of self-employment as an easy route to getting on and staying on PUA benefits for lengthy periods.

Other federal and state policies opened the door wider for misspending and fraud. For example, by offering federal subsidies to states that eliminated the longstanding waiting week before collecting benefits, federal policy prioritized rushing benefits out the door over ensuring the correct recipients qualified. Federal law also allowed states to waive the longstanding requirement that benefit recipients search for work as a condition of eligibility, eliminating a longstanding check on improper extended benefit collection. While that may have made sense early in the pandemic, as businesses and the economy reopened, the requirement should have been promptly restored.

States also made mistakes that contributed to fraud and misspending. One glaring example was when California and 14 other states suspended the matching of unemployment benefit caseloads against prisoner databases – which was predictably followed by prisoners fraudulently claiming large amounts of benefits.

The result was record misspending and fraud

The result was a massive—and still only partially understood—increase in fraud and misspending, in both percentage and dollar terms.

As the White House described in December 2021, "the improper payment rate in the Federal-State Unemployment Insurance (UI) program…totaled 18.71% from July 2020 to June 2021—roughly 5-8 percentage points higher than during a normal, non-pandemic 12-month period."[8] That elevated rate is likely understated, perhaps significantly, for at least two reasons. First, it misses the massive spike in claims early in the pandemic, which coincided with the bulk of the weeks when $600-per-week federal supplements provided an especially inviting target for criminals. As the White House admits, "Data was not collected during the middle of 2020 as a result of the chaotic challenges state-run UI systems faced." Second, as the Department of Labor's (DOL) Inspector General (IG) noted in March 2022 testimony, the 18.71 percent error

[8] The White House quote conflates the state Unemployment Insurance program with various federal temporary unemployment benefit programs, which were responsible for most spending, and misspending, during the pandemic.

rate "does not include the PUA program" which "had control weaknesses that may have facilitated comparable or greater improper payments." We may never know the true extent of PUA misspending. A June 2022 audit found half of PUA benefits in Illinois were stolen. Last month, another audit found the Illinois unemployment benefits agency failed to maintain accurate data for the program, meaning auditors "were unable to conduct detailed testing to determine whether the PUA claimants were entitled to benefits."

During PUA's operation from April 2020 through early September 2021, repeated waves of fraud swept through states administering it. Colorado officials reported in September 2020 that more than 75 percent of recent PUA claims "were determined to be fraudulent." Driven by massive fraudulent PUA claims, in August 2020 an implausible 80 percent of all 3.4 million workers in Arizona appeared to have applied for unemployment benefits. California PUA cases doubled from 3.1 million to almost 7.0 million in just two weeks in August 2020, forcing state officials to admit that "a big part of the unusual recent rise in PUA claims is linked to fraud." In January 2021, California officials reported that, of all state and federal claims paid since the start of the pandemic, 10 percent had been confirmed as fraudulent and an additional 17 percent had been identified as "potentially fraudulent." California separately reported that 95 percent of confirmed fraud involved the PUA program.

Applied against the record benefit spending during the pandemic, such error rates translate into staggering losses for taxpayers. As the DOL IG noted in his March 2022 testimony, based on the 18.71 percent error rate, during the pandemic at least $163 billion "could have been paid improperly, with a significant portion attributable to fraud." Other experts estimate losses could reach $400 billion. Senior Republicans on the House and Senate committees with jurisdiction over unemployment benefits asserted in an August 2021 letter to the head of the Government Accountability Office that "fraud in COVID unemployment programs appears to be the greatest theft of American tax dollars in our nation's history."

For a sense of the scale of just the known losses, the DOL IG's conservative estimate of at least $163 billion in misspending is the equivalent of all UI program spending nationwide in six non-recessionary years.[9] It also is twice all federal unemployment benefit spending during the months of the Great Recession, which lasted from December 2007 to June 2009. During fiscal years 2008 and 2009, which spanned the Great Recession plus an additional six months, extraordinary federal unemployment benefits totaled $82 billion (adjusted for inflation to 2021 dollars).[10]

Congress was slow to react, but changes eventually helped

The warnings of massive fraud began almost immediately after federal pandemic benefits were authorized—and indeed before they began being paid out in some states. An April 2020 DOL IG report found that, under the Disaster Unemployment Assistance (DUA) program on which the PUA program was modeled, improper payments went to over 71 percent of sampled recipients in

[9] State UI benefits totaled $27 billion in CY 2019.

[10] Significant federal benefits are often paid after a recession officially ends. For example, federal extended benefits after the Great Recession continued to be paid through December 2013. The entire federal unemployment benefits response, covering fiscal years 2008 through 2014, cost $341 billion (adjusted for inflation to 2021 dollars).

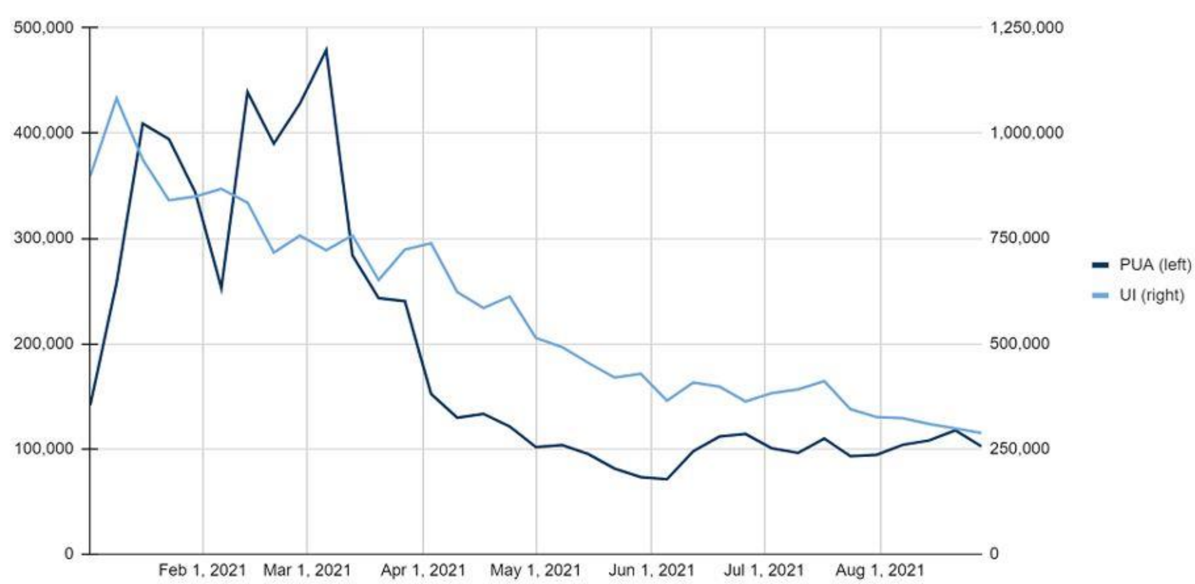
one state. Anticipating what was to come for the PUA program, the report noted that "identity thieves and organized criminal groups have found ways to exploit program weaknesses. Thus, improper payments stemming from fraudulent activity continue to pose a significant threat to the integrity of the UI program."

States soon reported widespread criminal attacks. In May 2020, Washington state officials reported that "a Nigerian fraud ring, dubbed 'Scattered Canary' by security researchers….had made off with 'hundreds of millions of dollars.'" Maine subsequently joined Washington in freezing new applications for benefits to investigate surging fraudulent claims. Seeking to reduce huge backlogs and prevent identity fraud, California suspended new benefit applications for two weeks in September 2020. Rappers crooned about ripping off state unemployment agencies, as criminals claimed benefits on behalf of at least one US senator and multiple governors.

Yet despite such early and prominent warning signs, for months Congress failed to act. Senate Republicans proposed legislation in July 2020 closing some of the loopholes that left the PUA program open to abuse. But it took until December 2020, as part of bipartisan legislation extending PUA and other federal benefits, for only some of those changes to be enacted. Importantly, the new law required that, starting in February 2021, new PUA claimants must provide proof of prior employment within 21 days of starting benefits or lose eligibility. States also were required to have procedures for verifying the identity of claimants.

As displayed in Figure 3, those changes were followed by rapid declines in initial claims for PUA benefits nationwide— which fell at a faster pace than first-time claims for state UI benefits over the same period.

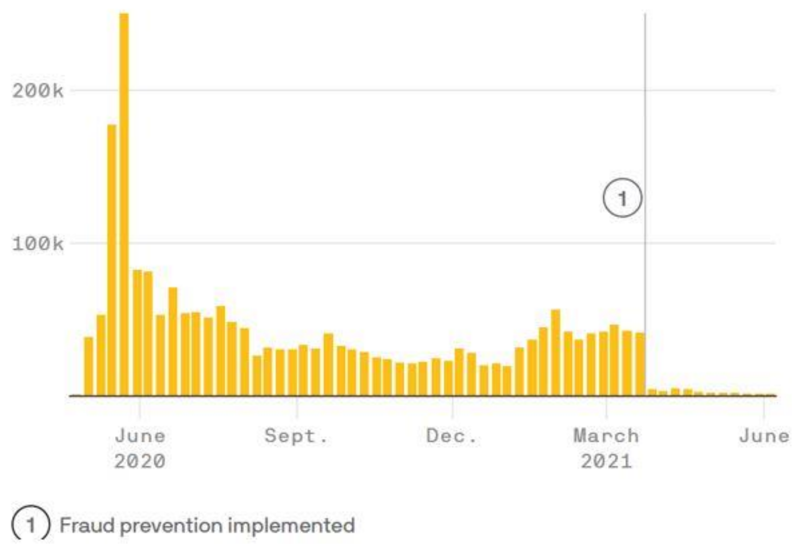
Figure 3. Initial claims for PUA and State UI benefits, January-August 2021



Source: Department of Labor, PUA, and UI claims data. Data are not seasonally adjusted.

In some states, the effects were even sharper. As displayed in Figure 4, in New York State, initial claims for PUA dropped by a stunning 92 percent when anti-fraud initiatives were implemented.

Figure 4. New York Weekly PUA Initial Claims, April 25, 2020 to June 12, 2021



Source: Data from the Department of Labor, Chart from Axios Visuals.

Additional measures are needed

Temporary federal unemployment benefit programs expired in early September 2021, and about half of the states opted out of paying most federal benefits in June and July 2021. But despite the programs' expiration, their continuing effects make it clear that additional measures are needed.

In the near term, Congress and the Biden administration should work together with states to recover as much of the past misspending as possible. There is plenty to be done. The Washington Post reported in May that only $4 billion had been recovered as of March 2022—or six months after temporary federal programs expired. That's roughly 2 percent of the DOL Inspector General's admittedly conservative estimate of $163 billion in benefit misspending. Meanwhile, DOL in February 2022 offered states guidance allowing additional "blanket waivers" against recovery, which some congressional Republicans described as "allowing states to waive large numbers of suspicious claims and forgo restitution for taxpayers." As federal programs continue to recede into the past, it will become increasingly difficult to recover remaining misspent funds. Given that international criminal groups intentionally targeted the largely undefended federal benefits, some significant share of fraudulent spending is likely unrecoverable.[11]

[11] The Department of Justice and U.S. Secret Service have found that significant fraud stemmed from organized criminal networks, including those with origins in China, Ghana, Nigeria, Romania, and Russia.

Policymakers should recognize that states that administer both state and federal benefits currently have little incentive to recover what has been mostly misspent federal funds. Such recoveries require state effort and additional administrative expense, only to have any recovered funds revert to the federal government in the end. To overcome that financial disincentive, leading House and Senate Republicans proposed the Chase COVID Unemployment Fraud Act, which seeks to promote both better state systems and more recovery of misspent federal funds. The legislation would allow states to retain 25 percent of any future recoveries of misspent federal pandemic funds, which states could use to modernize their systems as well as improve program integrity to prevent future abuse. That approach offers potential gains for taxpayers and rightful recipients alike.

The Biden administration included a $2 billion modernization fund in the March 2021 American Rescue Plan, which reinforces that funding for the administration of unemployment benefits is a federal responsibility. There should be serious questions about whether $2 billion in one-time funds will be adequate to address the administrative challenges of this system, especially given the massive fraud it just experienced. The history of large one-time infusions of federal funds suggests those expecting enduring process improvements or structural changes are likely to be disappointed. Congress should conduct appropriate oversight on this $2 billion fund, including requiring evidence of concrete results in terms of improved service delivery and fraud prevention.

Beyond these one-time funds, more fundamental questions must be asked, including what are the long-term administrative financing needs of this system, how can those best be met, and at what price? In the end, it is the federal government's responsibility to work with states to ensure the system's administrative needs are met, including in the event of an inevitable future crisis.

Further, some Democratic lawmakers have proposed designing future benefit increases to replace a specific share of each recipient's prior wages, which state information technology systems at the start of the pandemic were incapable of doing. That, in significant part, led lawmakers to provide flat $600-per-week supplements, which resulted in many recipients collecting more in benefits than they earned from working. Will a reformed system be able to accommodate those policy goals? If so when and at what cost? Unless Congress holds the short-term and long-term administrative funding it provides accountable for answering such questions, policymakers in a future crisis may once again be forced to provide poorly targeted benefits in the name of rushing benefits out the door, with too many deserving recipients once again waiting in line behind those bent on defrauding the system. Benefit recipients and taxpayers deserve far better.

As it considers such administrative funding questions, Congress should apply the lessons learned during the pandemic to prevent a repeat of massive losses to fraud – and just as importantly deliver appropriate customer service to deserving recipients. Those lessons include:

- *Don't allow individuals to self-certify their eligibility for benefits.* Unemployment benefit programs should require proof of prior employment *before* benefits start to flow, not just within 21 days of their onset, and certainly not without that information. That may result in minor delays in the onset of benefits for some claimants — who would likely receive several weeks of back benefits in an initial lump sum. But that delay would be well worth it if it helps prevent a repeat of the massive losses to fraud taxpayers experienced during the pandemic.

- *Ensure claimant identities are established before benefits are paid.* Especially since mandated to implement identity verification in 2021, many states worked with third parties to both screen out blatant fraudsters on the front end and to verify identities before and while benefits were paid. This should be standard program practice in the future, and states should be required to report on their fraud detection and prevention measures to DOL.

- *Prevent benefits from exceeding prior wages.* As mentioned above, if policymakers wish to revive weekly supplements in a future recession or emergency, they should ensure the system can tailor such benefits to each individual as a share of prior wages, instead of offering flat supplements to all that result in benefits often exceeding earnings.

- *Restore work search requirements.* States were allowed to waive normal work search requirements to limit contacts in the pandemic. In the future, benefits should once again be paid only to those who perform expected work search, to assist in transitions back to work.

- *Ensure benefits are tied to past and future tax payments.* If Congress chooses to revive extraordinary benefits like PUA, it should ensure potential recipients pay experience-rated taxes into the system beforehand—as is the case under the state UI program. That would resolve many of the identity verification issues that plagued PUA, in addition to addressing some (but not all) of the return-to-work disincentives inherent in its benefits.

- *Consider additional methods to measure the proper functioning of the system.* State UI performance is effectively graded on two elements: timeliness and accuracy. Most states opt for the former over the latter. The pandemic demonstrated there are additional elements that merit consideration as evidence of a properly functioning UI system, including appropriate, scalable fraud deterrence and prevention strategies, customer-centric processes or interfaces for claimants and employers, and an ability to continuously provide adequate data reporting.

- *Fix flaws in the counting of benefit recipients.* Data reporting issues (including fraud and the counting of back weeks of benefits) confounded efforts to understand the number of people collecting key unemployment benefits early in the pandemic. As GAO concluded in November 2020, "Without an accurate accounting of the number of individuals who are relying on UI and PUA benefits in as close to real-time as possible, policy makers may be challenged to respond to the crisis at hand."

The DOL Inspector General has also recommended a series of common-sense data matching requirements, which should be standard practice for states. These include cross-matching UI claims against prisoner databases, the National Directory of New Hires, and other states' caseloads to better ensure benefits are paid correctly. The Inspector General also proposes allowing state agencies to retain 5 percent of UI overpayment recoveries for program integrity purposes.

Concluding thoughts

The coronavirus pandemic presented extraordinary economic and health challenges for all Americans. Congress' unemployment benefits response sought to alleviate financial hardship for tens of millions who found themselves suddenly unemployed. An extraordinary number collected benefits, which unfortunately included record numbers who defrauded these important benefits. Overwhelmed systems and key program design flaws contributed to that unprecedented abuse, which Congress must address before it crafts any future response to recession. If Congress successfully incorporates these lessons, it should significantly reduce the potential for future abuse—and better ensure that rightful recipients have timely access to benefits they deserve.