

# Unemployment Insurance Taxes Will Be a Headwind for the State Economy

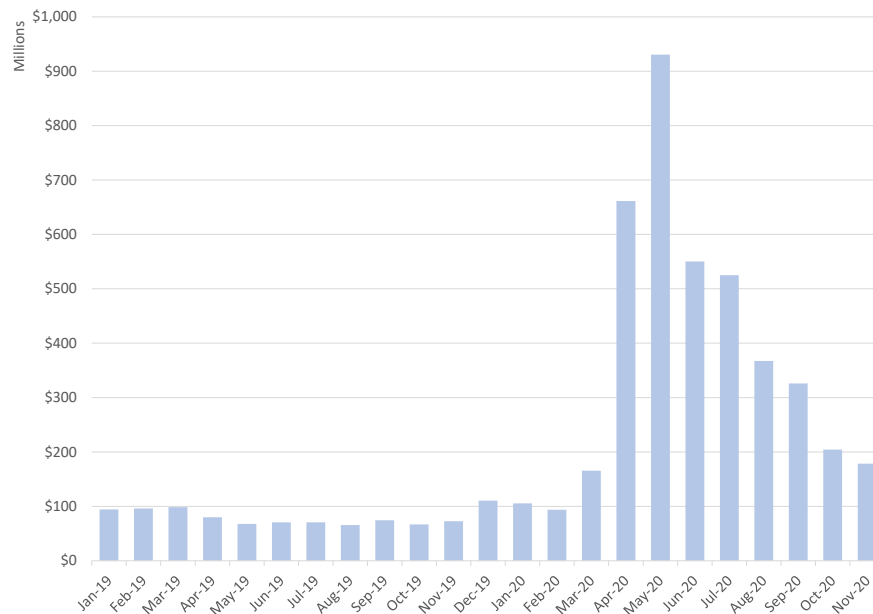
## Briefly

*Unemployment insurance tax rates are adjusted annually and will be much higher this year due to the COVID-19 pandemic. The amount of unemployment insurance tax paid by Washington businesses is expected to increase dramatically, from \$1.12 billion in 2020 to \$2.11 billion in 2021 and then to \$2.99 billion in 2022. This rising UI tax burden will be a significant headwind to the recovery of the state economy.*

Unemployment insurance (UI) tax rates are adjusted annually and under current law will be much higher this year due to the COVID-19 pandemic. According to the U.S. Department of Labor, for Washington state, regular benefits paid under the regular state UI program totaled \$3.36 billion from April to September 2020, a dramatic increase from the \$429 million paid out in the corresponding months of 2019 (DOL, see Chart 1). The state UI trust fund began 2020 with a balance of \$4.99 billion. It was forecasted to end 2020 with a balance of just \$1.37 billion. The forecasted balance at the end of 2021 under current law is \$566 million (ESD 2021).

Because of the automatic adjustment of UI payroll tax rates, the amount of UI tax paid by Washington businesses is expected to increase dramatically, from \$1.12 billion in 2020, to \$2.11 billion in 2021, and then to \$2.99 billion in 2022. This rising UI tax burden will be a significant headwind to the recovery of the state economy.

Chart 1: Payouts From the State UI Trust Fund



Source: U.S. Department of Labor

## The UI Tax System

Unemployment insurance benefits are funded by a payroll tax. The tax applies to wages up to a statutory cap (known as the taxable wage base), which is \$56,500 for the year 2021. The cap is adjusted annually based on the growth in the average wage in the state.

Table 1: Forty Rate Classes

	Benefit Ratio		Experience Tax	Maximum	
	At least	Less than		Social Tax	Solvency Tax
Rate Class 1		0.0001%	0.00%	0.49%	0.20%
Rate Class 2	0.0001%	0.125%	0.11%	0.54%	0.20%
Rate Class 3	0.125%	0.250%	0.22%	0.59%	0.20%
Rate Class 4	0.250%	0.375%	0.33%	0.63%	0.20%
Rate Class 5	0.375%	0.500%	0.43%	0.68%	0.20%
Rate Class 6	0.500%	0.625%	0.54%	0.73%	0.20%
Rate Class 7	0.625%	0.750%	0.65%	0.78%	0.20%
Rate Class 8	0.750%	0.875%	0.76%	0.83%	0.20%
Rate Class 9	0.875%	1.000%	0.88%	0.88%	0.20%
Rate Class 10	1.000%	1.125%	1.01%	0.93%	0.20%
Rate Class 11	1.125%	1.250%	1.14%	0.98%	0.20%
Rate Class 12	1.250%	1.375%	1.28%	1.02%	0.20%
Rate Class 13	1.375%	1.500%	1.41%	1.07%	0.20%
Rate Class 14	1.500%	1.625%	1.54%	1.12%	0.20%
Rate Class 15	1.625%	1.750%	1.67%	1.17%	0.20%
Rate Class 16	1.750%	1.875%	1.80%	1.22%	0.20%
Rate Class 17	1.875%	2.000%	1.94%	1.27%	0.20%
Rate Class 18	2.000%	2.125%	2.07%	1.32%	0.20%
Rate Class 19	2.125%	2.250%	2.20%	1.37%	0.20%
Rate Class 20	2.250%	2.375%	2.38%	1.42%	0.20%
Rate Class 21	2.375%	2.500%	2.50%	1.46%	0.20%
Rate Class 22	2.500%	2.625%	2.63%	1.46%	0.20%
Rate Class 23	2.625%	2.750%	2.75%	1.46%	0.20%
Rate Class 24	2.750%	2.875%	2.88%	1.46%	0.20%
Rate Class 25	2.875%	3.000%	3.00%	1.46%	0.20%
Rate Class 26	3.000%	3.125%	3.13%	1.46%	0.20%
Rate Class 27	3.125%	3.250%	3.25%	1.46%	0.20%
Rate Class 28	3.250%	3.375%	3.38%	1.46%	0.20%
Rate Class 29	3.375%	3.500%	3.50%	1.46%	0.20%
Rate Class 30	3.500%	3.625%	3.63%	1.46%	0.20%
Rate Class 31	3.625%	3.750%	3.75%	1.46%	0.20%
Rate Class 32	3.750%	4.000%	4.00%	1.46%	0.20%
Rate Class 33	4.000%	4.250%	4.25%	1.46%	0.20%
Rate Class 34	4.250%	4.500%	4.50%	1.46%	0.20%
Rate Class 35	4.500%	4.750%	4.75%	1.46%	0.20%
Rate Class 36	4.750%	5.000%	5.00%	1.46%	0.20%
Rate Class 37	5.000%	5.250%	5.15%	1.46%	0.20%
Rate Class 38	5.250%	5.500%	5.25%	1.46%	0.20%
Rate Class 39	5.500%	5.750%	5.30%	1.46%	0.20%
Rate Class 40	5.750%		5.40%	1.46%	0.20%

The tax rate applicable to a particular employer varies from calendar year to calendar year, as we explain below. In early December the state Employment Security Department (ESD) notifies each employer of its rate for the upcoming year.

Most private employers qualify to participate in the experience rating system. Under this system each employer is assigned to one of forty rate classes, based upon its benefit ratio, which is calculated by dividing total benefits charged to the employer's account by the employer's taxable wages over a 48-month period. (For taxes on wages paid in 2021, the benefit-ratio period is July 1, 2016 to June 30, 2020.) A statutory formula that depends upon the balance in the trust fund and other factors determines a tax rate for each rate class.

Taxes are levied quarterly and are due on the last day of the month following the quarter. For example, taxes on employment during the last three months of 2020 are due on January 31, 2021.

### Three Taxes

A business's unemployment insurance tax rate is the sum of three separate taxes: the experience tax, the social tax and the solvency tax.

*Experience tax.* A statutory table specifies the experience tax rate for each rate class, ranging from 0% for rate class 1 to 5.4% for rate class 40.

*Social tax.* The calculation of the social

tax begins with the amount by which systemwide benefits paid exceeded systemwide revenue received from the experience tax over a 12-month period. (For taxes on wages paid in 2021, this period is July 1, 2019 to June 30, 2020.) This amount is referred to as total social costs. A formula determines rates for each experience rate class that together would have roughly covered these costs over that period. Social tax rates are graduated (i.e., class 40’s rate is greater than class 1’s rate) but not as highly graduated as experience tax rates are. The amount of costs to be recovered is capped at 1.22 percent of taxable wages.

*Solvency tax.* The solvency tax kicks in when the balance of the UI trust fund is insufficient to cover seven months of benefits. This rate is the same for all rate classes and is capped at 0.2 percent. Table 1 (on page 2) shows the benefit ratio boundaries for each rate class, its experience tax rate, its highest possible social tax rate and its highest possible solvency tax rate.

Table 2 (on page 7) shows the overall 2020 tax rate for each rate class and our estimates for what the overall rates will be under current law for years 2021 through 2025 based on the Unemployment Insurance Trust Fund forecast prepared by ESD in November (ESD 2021). Social tax rates are projected to be at their maximum possible values in 2021 and 2022, and to decline thereafter. Solvency tax rates are projected to be at their maximum possible values in 2022 and 2023, and to be zero in all other years. For each rate class, the combined rate peaks in 2022 and declines each year thereafter.

Year-to-year changes in rates for a specific business will be the product of both changes in the rate schedule (the combination of social tax and solvency tax changes) and changes in the rate class to which the business is assigned based on its ratio of benefits paid to taxable wages.

Chart 2 shows forecasted UI tax collections in calendar years 2020–2025 if no changes to the current law are made. The numbers come from ESD’s November trust fund forecast. Employers’ UI tax payments are projected to rise steeply over the next two years, from \$1.12 billion in 2020 to \$2.11 billion in 2021 and

Chart 2: UI Tax Collections 2020–2025 – Current Law



then to a peak of \$2.99 billion in 2022. From that point, the amount of taxes paid gradually declines. The amount paid in 2025 is still projected to be twice that paid in 2020. For reference, businesses are expected to pay \$4.79 billion in business and occupation taxes in state fiscal year (FY) 2021, \$5.08 billion in FY 2022 and \$5.38 billion in FY 2023.

## Dynamics

Social tax revenues react more quickly to the coronavirus shock to unemployment than do experience tax revenues.

The experience ratio used to assign employers to rate classes is calculated over a four-year period. March 2020 was the first month with a discernible number of COVID-related UI payments. Thus, only four months of the 48-month period used to calculate 2021 rates could have claims directly or indirectly related to COVID. For 2022 rates, 16 out of 48 months are potentially affected. Employers' movements to higher rate classes will extend over several years as COVID benefits paid roll into the calculation. This slows the reaction of experience tax revenues to the COVID recession.

Social tax rates, on the other hand, are based on the difference between total benefits paid out and total experience tax collections over a one-year period. All else equal, higher experience tax receipts in a particular year lead to lower social tax rates in the next year. For this reason, social tax receipts decline as experience tax receipts ramp up and social tax receipts peak two years before experience tax receipts do.

Under the November 2020 forecast, the solvency tax will only be assessed on employment occurring in 2021, 2022 and 2023. On Chart 2, the small amount of solvency tax revenue received in 2024, \$30 million, reflects taxes on employment in the final quarter of 2022, which will be paid in January 2024. The solvency tax is a small portion of the overall UI tax burden on businesses. However, it hits in the years in which the burden is highest.

Looking at the projection of individual taxes over time:

- Between 2020 and 2021 the increase in revenue from the experience tax (+\$146 million) is much less than that from the social tax (+\$651 million).
- Between 2021 and 2022 the increase in revenue from the experience tax (+\$658 million) is much greater than that from the social tax (+\$183 million).
- Between 2022 and 2023 revenue from the experience tax continues to rise (+\$303 million) while that from the social tax falls sharply (-\$415 million).
- Between 2023 and 2024 revenue from the experience tax rises modestly (+\$84 million) while that from the social tax falls modestly (-\$57 million).
- Between 2024 and 2025 revenue from both the experience tax (-\$263 million) and the social tax (-\$234 million) decline.

A successful strategy to reduce the near-term impact of UI taxes on businesses must address all three taxes.

## Gov. Inslee’s Proposal

Governor Inslee has proposed legislation (HB 1098, SB 5061) that would reduce the near-term impact of UI taxes on businesses. Key features that would affect UI taxes include:

*Experience tax.* Benefits paid between March 22 and May 2, 2020 (the period of Gov. Inslee’s Stay Home, Stay Healthy order) would be excluded from the calculation of firms’ benefit ratios. Beginning next year, employer benefit ratios would be calculated by dividing total benefits charged to the employer’s account by the employer’s taxable wages over a 60-month period instead of the current 48-month period. (For taxes on wages paid in 2022, the benefit-ratio period would be July 1, 2016 to June 30, 2021.)

*Social tax.* The cap on costs to be recovered by the social tax would be reduced from 1.22% of taxable wages to 0.50% of taxable wages in 2021, 0.75% of taxable wages in 2022, 0.80% of taxable wage in 2023, 0.85% percent of taxable wages in 2024 and 0.90% of taxable wages in 2025.

*Solvency tax.* The solvency tax would be suspended for five years (2021–2025).

*Minimum weekly benefit amount.* Under current law, the minimum weekly benefit amount is 15% of the average weekly wage. As a result, Washington’s current minimum is the highest in the nation (ESD 2020b). Gov. Inslee proposes raising the minimum to 20% of the average weekly wage beginning on July 1, 2021. This would raise the projected minimum benefit in July from \$201 to \$270. Over time, higher benefit payouts would push some businesses into higher rate classes, increasing the amount of tax they pay.

Chart 3 shows UI tax collections in calendar years 2020–2025 under Gov. Inslee’s proposal. The numbers come from a presentation made by ESD staff on January 6 to the Unemployment Insurance Advisory Committee. UI tax payments are forecasted to be lower in each year from 2021 to 2024 under the governor’s proposal than they would be under current law. The tax savings in 2021 would be \$790 million;

Chart 3: UI Tax Collections 2020–2025 – Gov. Inslee Proposal



over the four years the savings would total \$2.50 billion. However, under the governor's proposal, 2025 tax payments would be \$537 million higher than under current law and \$1.297 billion higher than the amount paid in 2020.

The forecasted December 31, 2025 ending balance for the UI trust fund is \$2.834 billion under the governor's proposal, compared to \$5.848 billion under current law. The reduction in trust fund balance is the sum of three parts: Under the governor's proposal, tax revenues received would be \$1.963 billion lower, benefits paid would be \$804 million higher and interest earned on reserves would be \$257 million lower than would be the case under current law.

ESD's forecasting model does not presently extend beyond 2025. It is certain, however, that taxes in 2026 and later years would remain higher under the governor's bill than under current law until the trust fund is replenished.

## Comment

Under current law, businesses' UI tax burden will increase dramatically over the next two years. This will be a headwind to the recovery of the state economy. Increasing rates on other existing business taxes or adding a new business tax would only compound the problem.

Under current projections, the balance in the UI trust fund at the end of 2025 will be \$859 million more than the balance at the beginning of this year. It should be possible to provide some relief to businesses by restraining the near-term increase in UI rates.

Gov. Inslee's proposal to increase the minimum weekly benefit is ill-timed. The state currently has the nation's highest minimum weekly benefit. Right now the focus should be on restraining the UI tax burden and supporting economic recovery.

## References

Washington State Employment Security Department (ESD). 2020a. [Unemployment Insurance Trust Fund Forecast](#). November 2020.

———. 2020b. [Unemployment Insurance Advisory Committee Meeting Slide Deck](#). December 18.

———. 2021. [Comparison of the UI trust fund - Governor's proposal versus current law \(November Trust Fund Forecast\)](#). January 6.

U.S. Department of Labor (DOL). n.d. [Monthly Program and Financial Data](#).

Table 2: Projected UI Tax Rates 2020–2025

	Rates										
	Actual 2020	Projected, November Forecast					Projected, Gov. Inslee Proposal				
		2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
Rate Class 1	0.13%	0.69%	0.69%	0.44%	0.24%	0.16%	0.20%	0.30%	0.32%	0.34%	0.36%
Rate Class 2	0.25%	0.85%	0.85%	0.57%	0.37%	0.29%	0.33%	0.44%	0.46%	0.48%	0.51%
Rate Class 3	0.37%	1.01%	1.01%	0.71%	0.51%	0.41%	0.46%	0.58%	0.60%	0.63%	0.65%
Rate Class 4	0.49%	1.16%	1.16%	0.84%	0.64%	0.54%	0.59%	0.72%	0.75%	0.77%	0.80%
Rate Class 5	0.60%	1.31%	1.31%	0.97%	0.77%	0.65%	0.71%	0.85%	0.88%	0.91%	0.93%
Rate Class 6	0.72%	1.47%	1.47%	1.10%	0.90%	0.78%	0.84%	0.99%	1.02%	1.05%	1.08%
Rate Class 7	0.84%	1.63%	1.63%	1.23%	1.03%	0.91%	0.97%	1.13%	1.16%	1.19%	1.23%
Rate Class 8	0.96%	1.79%	1.79%	1.37%	1.17%	1.03%	1.10%	1.27%	1.30%	1.34%	1.37%
Rate Class 9	1.09%	1.96%	1.96%	1.51%	1.31%	1.17%	1.24%	1.42%	1.46%	1.49%	1.53%
Rate Class 10	1.23%	2.14%	2.14%	1.67%	1.47%	1.31%	1.39%	1.58%	1.62%	1.66%	1.69%
Rate Class 11	1.37%	2.32%	2.32%	1.82%	1.62%	1.46%	1.54%	1.74%	1.78%	1.82%	1.86%
Rate Class 12	1.52%	2.50%	2.50%	1.98%	1.78%	1.62%	1.70%	1.91%	1.95%	1.99%	2.04%
Rate Class 13	1.66%	2.68%	2.68%	2.14%	1.94%	1.76%	1.85%	2.07%	2.11%	2.16%	2.20%
Rate Class 14	1.80%	2.86%	2.86%	2.29%	2.09%	1.91%	2.00%	2.23%	2.28%	2.32%	2.37%
Rate Class 15	1.94%	3.04%	3.04%	2.45%	2.25%	2.05%	2.15%	2.39%	2.44%	2.49%	2.53%
Rate Class 16	2.08%	3.22%	3.22%	2.60%	2.40%	2.20%	2.30%	2.55%	2.60%	2.65%	2.70%
Rate Class 17	2.23%	3.21%	3.41%	2.76%	2.56%	2.36%	2.46%	2.72%	2.77%	2.82%	2.88%
Rate Class 18	2.37%	3.59%	3.59%	2.92%	2.72%	2.50%	2.61%	2.88%	2.93%	2.99%	3.04%
Rate Class 19	2.51%	3.77%	3.77%	3.07%	2.87%	2.65%	2.76%	3.04%	3.10%	3.15%	3.21%
Rate Class 20	2.69%	4.00%	4.00%	3.28%	3.08%	2.84%	2.96%	3.25%	3.31%	3.37%	3.42%
Rate Class 21	2.83%	4.16%	4.16%	3.42%	3.22%	2.98%	3.10%	3.40%	3.46%	3.52%	3.58%
Rate Class 22	2.96%	4.29%	4.29%	3.55%	3.35%	3.11%	3.23%	3.53%	3.59%	3.65%	3.71%
Rate Class 23	3.08%	4.41%	4.41%	3.67%	3.47%	3.23%	3.35%	3.65%	3.71%	3.77%	3.83%
Rate Class 24	3.21%	4.54%	4.54%	3.80%	3.60%	3.36%	3.48%	3.78%	3.84%	3.90%	3.96%
Rate Class 25	3.33%	4.66%	4.66%	3.92%	3.72%	3.48%	3.60%	3.90%	3.96%	4.02%	4.08%
Rate Class 26	3.46%	4.79%	4.79%	4.05%	3.85%	3.61%	3.73%	4.03%	4.09%	4.15%	4.21%
Rate Class 27	3.58%	4.91%	4.91%	4.17%	3.97%	3.73%	3.85%	4.15%	4.21%	4.27%	4.33%
Rate Class 28	3.71%	5.04%	5.04%	4.30%	4.10%	3.86%	3.98%	4.28%	4.34%	4.40%	4.46%
Rate Class 29	3.83%	5.16%	5.16%	4.42%	4.22%	3.98%	4.10%	4.40%	4.46%	4.52%	4.58%
Rate Class 30	3.96%	5.29%	5.29%	4.55%	4.35%	4.11%	4.23%	4.53%	4.59%	4.65%	4.71%
Rate Class 31	4.08%	5.41%	5.41%	4.67%	4.47%	4.23%	4.35%	4.65%	4.71%	4.77%	4.83%
Rate Class 32	4.33%	5.66%	5.66%	4.92%	4.72%	4.48%	4.60%	4.90%	4.96%	5.02%	5.08%
Rate Class 33	4.58%	5.91%	5.91%	5.17%	4.97%	4.73%	4.85%	5.15%	5.21%	5.27%	5.33%
Rate Class 34	4.83%	6.16%	6.16%	5.42%	5.22%	4.98%	5.10%	5.40%	5.46%	5.52%	5.58%
Rate Class 35	5.08%	6.20%	6.20%	5.67%	5.47%	5.23%	5.35%	5.65%	5.71%	5.77%	5.83%
Rate Class 36	5.33%	6.20%	6.20%	5.92%	5.72%	5.48%	5.60%	5.90%	5.96%	6.00%	6.00%
Rate Class 37	5.48%	6.20%	6.20%	6.07%	5.87%	5.63%	5.75%	6.00%	6.00%	6.00%	6.00%
Rate Class 38	5.58%	6.20%	6.20%	6.17%	5.97%	5.73%	5.85%	6.00%	6.00%	6.00%	6.00%
Rate Class 39	5.63%	6.20%	6.20%	6.20%	6.00%	5.78%	5.90%	6.00%	6.00%	6.00%	6.00%
Rate Class 40	5.72%	6.20%	6.20%	6.20%	6.00%	5.88%	6.00%	6.00%	6.00%	6.00%	6.00%