

## THE BOTTOM LINE

The 2003 Washington State unemployment insurance legislation restored balance to a system suffering from lax enforcement and excessive costs. However, before SB 6097 was able to take full effect, legislators overturned key UI reforms through HB 2255.

## HB 2255 Repeals Needed UI Reforms

Washington State's unemployment insurance (UI) tax burden per employee has exceeded the national average every year since 1967, making it one of the most expensive UI systems in the country. While this translates into generous benefits for unemployed workers, the high costs hurt local businesses, discourage business relocation to Washington and indirectly impact workers through higher rates of unemployment and lowered wages.

In an attempt to bring Washington State's UI more in line with the national average, legislators passed SB 6097 in 2003. However, in this last session the (2005) Legislature reversed two of the key unemployment insurance reforms – reinstating both two-quarter averaging and “liberal construction” through HB 2255.

### 2005 UI CHANGES

Just as the last of the 2003 UI reforms were being implemented, Gov. Christine Gregoire signed labor-supported HB 2255 on April 22, 2005 restoring some of the unemployment benefits that were repealed during the 2003 legislative session. Under the 2005 legislation, two-quarter averaging was reinstated to raise benefits for seasonal and cyclical workers. To offset the costs this reversal incurs, HB 2255 reduced unemployment benefits across the board by approximately four percent and made available funds from the Reed Act.

Under 2003's SB 6097, the weekly benefit amount (WBA) was calculated at one percent of annual wages (or four percent of the average quarterly wage). However, under HB 2255, the WBA is calculated at 3.85 percent of the average wage for the two quarters of highest earnings. This translates into a net gain for seasonal workers with large salary fluctuations between quarters and a loss for workers with stable employment.

The Reed Act Funds are part of the 2002 federal Temporary Extended Unemployment Compensation Act that Congress authorized to be used by states for their unemployment insurance programs. Washington received approximately \$167 million in funds - of which an estimated \$130 million remained at the conclusion of this last legislative session. While the Reed Act Funds can be used to help with a wide range of UI related issues, legislators have chosen to use this money to mitigate the effects of returning to two-quarter averaging. Specifically, for the next two years, any additional cost incurred as a result of moving to the new

WBA will not be charged to employers (Washington State Legislature “Final Bill Report EHB 2255” 3).

Since Reed Act money given to the states reflects an overpayment of federal UI taxes, many employers believe that the money should be used on tax reduction and not on sustaining high benefit levels. Using Reed Act money only temporarily mitigates the cost of two-quarter averaging while creating an expectation of future benefit levels that cannot be sustained once the fund has been drained. In fact, the Employment Security Department (ESD) estimates that by Calendar Year 2009, the UI Ending Fund Balance in Washington will be reduced by approximately \$192 million as a result of HB 2255.

HB 2255 also reinstated the “liberal construction” requirement, shifting the burden of proof back on to employers in contested benefit claims.

To review the UI system, the bill created a Joint Legislative Task Force. In addition, the Employment Security Department is required to report to the Legislature on the impact of the bill’s provisions.

Currently, HB 2255 only temporarily restores these UI benefits. If legislators do not pass a bill by 2007, the system will revert back to the 2003 reforms.

### **2003 UI REFORMS**

The changes put in place by the 2005 bill were, in large part, a distinct change in direction from the job-creating reforms passed in 2003.

SB 6097 encompassed several reforms designed to curb the rising unemployment insurance costs. By moving to four-quarter averaging, the UI system was anticipated to save an estimated \$164 million annually (WashACE, “Preserve” 4). Similarly, repealing the “liberal construction” provision allowed workers and employers to contend on an equal basis over disputed benefit claims. See Table 1.

The adjustments made to the UI system in 2003 were vital due to the combination of disproportionately high benefits and lax enforcement, which resulted in a system that imposed one of the nation’s highest employer UI taxes.

Even with the 2003 changes, Washington continued to offer one of the most generous and expensive UI systems in the country. In the third quarter of 2004, Washington employers paid an average tax of \$755 per employee –more than two and a half times the US average (WashACE, “Preserve” 2).

### **OPPONENTS OF THE 2003 REFORMS**

While business leaders considered SB 6097 to be a major win for competitiveness, organized labor groups argued that the reforms “guttled” the UI System (WSLC, “Washington”). The Washington State Labor Council reported that “The cost to working families was enormous” and that some workers receiving unemployment insurance saw their benefit checks reduced by \$50 to \$200 a week (“Washington”).

**Table 1: Summary of Unemployment Insurance Legislation**

	<b>Before 2003</b>	<b>2003 SB 6097</b>	<b>Effect of SB 6097</b>	<b>2005 HB 2255</b>	<b>Effect of HB 2255</b>
<b>Construction:</b>	Called for liberal construction of the program.	Provision requiring liberal construction repealed.	Eliminated presumption favoring workers.	Reinstates liberal construction language favoring workers.	Shifts the burden of proof to employers in contested claim.
<b>Tax Rates:</b>	Set out in table with 20 rate classes and levels ranging from AA to F.	The tax table consists of 40 fixed array classes from 0.0 percent to 5.4 percent.	Taxes more accurately reflect employer experience; redistributes "socialized costs."	2003 Reforms remain intact.	No effect.
<b>Benefit Calculation:</b>	1/50 of total earnings in the two highest quarters (i.e. 4% of 2 quarter average).	1/100 of total earnings in the prior year (i.e. 4% of 4 quarter average).	Benefits more directly reflected claimants' work experience; \$164 million annual savings estimated.	Reinstates 2 quarter averaging of benefits. Change from paying 4% of a worker's average earnings to 3.85%.	To pay for increase in benefits to seasonal workers, small across the board benefit reduction. Also, Reed Act funds used to cover additional costs.
<b>Maximum Weekly Benefit:</b>	70 percent of average weekly wage; set at \$496 in 2003.	Changed to the greater of \$496 or 63 percent of average weekly wage.	Expected to save more than \$17 million per year for the time the benefit level is frozen.	2003 Reforms remain intact.	No effect.
<b>Duration of Benefits:</b>	30 weeks.	26 weeks (unless unemployment rate exceeds 6.8 percent).	Puts Washington in line with other states. Estimated to produce \$57 million annual savings.	2003 Reforms remain intact.	No effect.
<b>Voluntary Quits:</b>	Provided general guidance regarding the granting of benefits to workers who voluntarily left employment.	Identifies ten specific reasons for granting benefits to a worker who voluntarily quits.	Removes ambiguity by placing criteria in statute.	2003 Reforms remain intact.	No effect.
<b>Part-Time Workers:</b>	Not covered.	Provides benefits for workers earning wages in no more than 17 hours per week.	New benefit, expected to cost less than \$10 million annually.	2003 Reforms remain intact.	No effect.
<b>Marginal Labor Force Attachment:</b>	Employers relieved of responsibility for certain charges involving employees with irregular work patterns.	MLFA repealed.	Shrinks "non-charges," assigns costs appropriately, and reduces socialized costs.	2003 Reforms remain intact. However, by using Reed Act funds, effectively subsidizing certain sectors.	No effect.
<b>Misconduct:</b>	Required proof of "harm to the employer's business."	No longer requires proof of harm to employer, new definition of gross misconduct, specifies acts that constitute misconduct.	Reduces standard of proof, provides for clarity.	2003 Reforms remain intact.	No effect.
<b>Job Search:</b>	Required claimants to demonstrate contacts with at least three employers per week or in-person search activity at reemployment center.	Expands monitoring; requires three documented in-person search activities per week at reemployment center; failure to comply results in some loss in benefits.	Strengthens job search requirements.	2003 Reforms remain intact.	No effect.

Opponents also argued that SB 6097 hurt the economy as a whole since unemployment insurance provides economic stability for communities. Citing a report by the U.S. Department of Labor estimating that every \$1 of unemployment benefits leads to \$2.15 in purchasing power, the WSLC claimed that the UI benefits were essential for countering the recession and keeping small businesses afloat (Chimerine; WSLC, “Unemployment”).

According to this logic, reducing benefits to seasonal workers slowed Washington’s economic recovery and actually hurt businesses. However, when citing these statistics, opponents of SB 6097 fail to address the economic benefits that resulted from lowered UI costs – including securing the Boeing 787, improving the state’s competitive position and boosting job creation.

While studies have shown that UI benefits can lessen the impact of recessions by smoothing out consumption spending, Gruber found that “each dollar of UI is translated to much less than one dollar of increased consumption, suggesting that UI is to some extent crowding out other forms of insurance” (“Consumption” 203). From his analysis he also concluded that, despite consumption smoothing, the distortions created by UI are so large that the optimal benefit level (i.e. the level that would minimize damage to the economy while providing adequate protection to unemployed workers) is fairly low (202).

Furthermore, the purchasing power multiplier is really a macroeconomic stabilization argument that applies most appropriately to the national economy. The economic effect of UI benefit increases in Washington is much smaller since spending is not restricted to the state economy, resulting in substantial leakages (Conerly “Unemployment”).

The UI system props up consumer spending during recessions when it is paying out more in benefits than it is bringing in through taxes. Conversely, it retards the economy during business expansions when it takes more in taxes than it pays out in benefits. The general observation, however, has little relevance to the specific case of seasonal workers, whose employment patterns tend to be consistent throughout the economic cycle. The recipients whose benefits were cut as a result of the switch to four-quarter averaging are people who are regularly unemployed each year because they work in seasonal industries. Such bouts of unemployment are nearly as likely in expansions as in contractions. Increasing benefits for these workers, regardless of any other merits, cannot be said to have any countercyclical economic effect.

Many of the arguments against benefit reform also fail to take into account additional sources of supplemental income available to workers (Gruber, “Wealth” 80). Individuals may have a variety of “private mechanisms upon which they can draw to finance their consumption” including family labor (i.e. spouse going to work), private supplemental insurance, additional government transfer programs, transfers from family members and personal savings (80). High UI benefit levels can actually “crowd out” these sources of support by lowering household savings rates - making unemployed workers more reliant upon future UI benefits (Engen and Gruber 569-570).

## PROPONENTS OF HB 2255

Largely to restore benefit levels of seasonal workers, legislators reversed key UI reforms in 2005. Labor groups hailed HB 2255 a compromise since many of the 2003 changes were left in tact - including the new tax structure, the 26-week cap on benefits and tougher eligibility restrictions. The Washington State Labor Council reported that HB 2255 “returned Washington to the national mainstream of UI benefits” (“Just”).

## 2005 REFORM IMPACT

Regardless of the temporary relief given to seasonal workers, HB 2255 threatens Washington’s competitiveness by removing needed reforms and keeping the system in limbo for at least two more years. Reversing the 2003 changes also sends a dangerous signal to businesses. Other states (and countries) are actively courting Washington companies and we must work to mitigate the damage done by extremely high UI costs. Of particular concern should be the increasing competitiveness of border states. While Washington had the highest UI taxes per employee in the first quarter of 2004, Oregon and Idaho ranked third and tenth respectively (WashACE, “Across”).

Although HB 2255 kept the 2003 tax reforms aimed at minimizing cross-subsidy flows, the bill restored some of the subsidies to seasonal workers and seasonal industries. For example, for fiscal years 2006 and 2007, the social cost factor has been set at zero for employers in agricultural crops, agricultural services, livestock, food and seafood processing, and cold storage. These industries have largely been identified as less stable and more able to shift “social” costs onto other employers and as a result of HB 2255, these industries are further insulated from the cost associated with higher rates of layoffs.

Seasonal subsidies are also increased by returning to two-quarter averaging. According to a five-state UI study by Meyer and Rosenbaum, nearly 40 percent of benefit claims went to workers with at least three UI receipts over the 5-year period studied. Of the repeat benefit receivers, the majority were concentrated in seasonal industries and were laid off and re-hired repeatedly by the same employer (Meyer and Rosenbaum). Therefore, by basing benefit levels off of the two quarters of highest earnings, UI expenditures designed to insure Washington workers against unforeseen events are further being diverted to seasonal industries.

HB 2255 hurts the majority of workers, both directly and indirectly. In order to pay for the cost of two-quarter averaging, benefits were decreased for workers with seasonally consistent employment. In addition, high UI taxes are often passed on to employees in the form of lowered wages and increased unemployment levels. The existing UI system also has a negative impact on employment by increasing the average duration of unemployment and increasing temporary layoffs (Conerly, “Getting” 1).

## CONCLUSION

SB 6097 was passed to bring Washington’s UI system more in line with other states and to provide a better competitive environment for businesses. Had all of the reforms been fully implemented, Washington would still have one of the nation’s most generous plans.

In 2005, HB 2255 reversed much of the progress made in bringing Washington more in line with competitor states. Legislators need to be reminded that successful reemployment, not seasonal subsidies, is the goal of UI. Government, business and labor must work together to meet the dual goal of creating an attractive and competitive business environment while protecting workers from fluctuation in employment.

The Joint Legislative Task Force must remain focused on achieving the goals embraced by the 2003 legislature, even if they choose to modify the means by which the goals are achieved. Washington's high cost UI system costs the state jobs.

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