Washington Research Council

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Labor Costs in Washington

Briefly

Policy-driven employment costs are a concern for employers. In Washington, unemployment insurance and workers' compensation are costly compared to other states. Washington also has the country's highest minimum wage, a costly prevailing wage law, unusual paid family leave legislation, and a municipal paid sick leave ordinance.

As unemployment remains high in Washington—the unemployment rate in August was 8.6 percent—policy-driven employment costs continue to concern employers. Taxes, regulation and mandated benefits add to labor costs, putting a brake on hiring, particularly at a time of economic uncertainty. In a global economy characterized by highly mobile capital and labor, policies that boost employment costs can put states at a competitive disadvantage.

In this policy brief, we examine policies adopted in Washington that directly affect labor costs.

The Washington legislature has taken steps in the last few years to reform unemployment insurance and workers' compensation—two major components of labor cost—but they remain high compared to other states. In addition, Washington has adopted the nation's highest minimum wage, a costly prevailing wage law, unusual paid family leave legislation, and even a municipal paid sick leave ordinance.

Unemployment Insurance

In 2011, Washington's unemployment insurance (UI) taxes were the fifth highest in the country, at $803 per average full-time employee. Oregon had the highest taxes ($985), and the U.S. average was $451. Washington's average weekly benefit amount was also the fifth highest in the nation, at $374.81. Hawaii was first ($424.61), and the U.S. average was $303.85. The duration of benefits was 17.2 weeks in Washington (19th highest). Delaware had the longest duration (21.7 weeks), and the national average was 17.4 weeks. (WashACE)

Washington's 2012 taxable wage base (the amount on which employers must pay UI taxes for an employee) for UI is $38,200—the second highest in the nation after Hawaii ($38,800). (ETA) The Employment Security Department (ESD) has already announced that the taxable wage base for 2013 will be $39,800. (ESDa) (The federal taxable wage base is $7,000.)

High UI taxes have produced a very healthy UI trust fund in Washington. As of the second quarter of 2012, Washington's trust fund was the most robust in the nation, with $2.626 billion—more than twice the size of the next largest trust fund (Texas, $1.290 billion). (ETA)

In 2011, given the health of the trust fund and the prospect of increased UI taxes, the legislature enacted reforms. The legislature capped the social rate component of the UI tax (costs that can't be attributed to a particular employer are borne by all employers) for 2011 at 2010 levels. For future years, the social rate is capped at a level dependent on the balance of the trust fund, and the multipliers that apportion the social costs amongst rate classes were reduced for some rate classes.

Consequently, for 2012, overall UI tax rates were reduced by 13 percent. This meant a reduction for 88 percent of employers; for those who had no layoffs over four years, the tax rate was reduced by 71 percent. According to ESD, that represents a savings to employers of $207 million (on top of $300 million in

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savings from 2011). ESD said that the lower rates were the result of the reforms enacted in 2011, as well as the continued health of the trust fund. (ESDb)

Workers' Compensation

For workers' compensation coverage, in Washington, employers must participate in the state fund (some large employers may self-insure). Washington is one of four monopoly states; in other states, employers may purchase workers' compensation coverage through the private market. (The other monopoly states are Ohio, North Dakota and Wyoming.)

In 2010 (the most recent data available), Washington paid by far the highest workers' compensation benefits in the country in terms of dollars per covered worker. The amount paid in Washington was $865.67, while it was $740.22 in Alaska and $663.08 in California. Nationally, the average was $443.47. Washington was second in benefits as a percent of covered wages (1.80 percent), behind only Montana (1.95 percent) and followed by Oklahoma (1.66 percent). (WashACE)

Washington's benefits paid (dollars per covered worker) have been the highest in the nation since 2008, rising each year. We use benefits as a proxy for costs because appropriate data hasn't been available. The National Academy of Social Insurance (NASI) only started releasing costs by state this year, but they caution against comparisons because they do not account for differences in the industry mix of each state. The Oregon Department of Consumer and Business Services releases a report every two years that ranks the premium rates of the state, but it is tailored to Oregon's industry mix. Another reason it is difficult to compare costs is that Washington premium data is on an hourly basis, while the rest of the country uses a payroll rate measure. As the 2010 Oregon premium rate ranking report notes, "For Washington, hourly rates had to be converted to payroll rates. The Washington payroll data included overtime for purposes of premium computation, thus understating the effective average payroll rate" (ODCBSa).

That said, as NASI's 2012 annual report on workers' compensation (using 2010 data) articulates, "several studies . . . demonstrate that the level of statutory benefits is a major determinant of the costs of workers' compensation in a state" (NASI).

Premium rates for employers have reflected that. Although annual rate changes have varied, they have cumulatively risen by 21.6 percent since 2001 (that number includes a 2007 rate holiday). By contrast, Oregon's rates decreased cumulatively by 11.2 percent from 2001–12.

One driver of the high costs is the high number of pension awards granted in Washington. The Upjohn Institute has estimated that the incidence of total permanent disability (TPD) awards is two to four times higher in Washington than in other states. (Upjohn) Indeed, in fiscal year 2011, Washington awarded 1,036 TPD pensions (L&Ia), while Oregon awarded only nine (calendar year 2011) (ODCBSb).

Legislation passed in 2011 is already beginning to provide some relief. Adopted reforms included allowing limited structured settlements for workers 55 or older, suspending cost-of-living adjustments for 2012, offsetting pension benefits for prior permanent partial disability awards, creating a Stay-at-Work program in which employers receive wage subsidies for giving injured workers transitional work, and establishing a health care provider network.

While the complete results of the 2011 changes are not entirely clear yet, the Department of Labor and Industries (L&I) has proposed no increase in 2013 average premium rates (a final decision on overall rates will come later in the year). In making its proposal, L&I said, "Savings due to reforms are beating expectations. L&I is now projecting the reforms passed in 2011 will save $1.5 billion over 4 years, $300 million higher than originally estimated" (L&Ib). Further,

> Without savings from the reforms, we would be facing a rate increase.
>
> Without the reforms, the 2013 break-even rate would have been about 4% instead of minus 4.2%. The break-even rate is the amount needed to cover projected costs for the next year. L&I will use the difference between the break-even rate and zero—$82 million—to begin restoring the workers' comp reserves. (L&Ib)

L&I would also like to lower the discount rate it uses in estimating future investment earnings (from 6.5 percent to 4.5 percent over ten years) and shore up the system's contingency reserves. That recent reforms seem to be working is positive, but making the system financially sound will require further reform.

Minimum Wage

The current federal minimum wage is $7.25. It is the same for 23 states, while 18 states and the District of Columbia (DC) have minimum wages that are higher than the federal requirement, four states have minimum wages that are lower than the federal requirement, and five states have no minimum wage at all. (The federal minimum wage prevails unless the state's is higher.)

Washington's minimum wage is the highest in the nation, at $9.04, followed by Oregon ($8.80) and Vermont ($8.46). (WashACE) Cities may enact minimum wages that are higher than their state's. For example, Santa Fe's minimum wage is the highest in the nation at $10.29 (New Mexico's is $7.50) and San Francisco's is $10.24 (California's is $8.00). No city in Washington has its own minimum wage.

Many states and the federal government have a separate minimum cash wage for tipped employees. The federal minimum cash wage is $2.13. Seven states, including Washington, have the same minimum wage for both tipped and non-tipped employees. (WHDa)

Ten states, including Washington, link their minimum wages to the consumer price index. (The others are Arizona, Colorado, Florida, Missouri, Montana, Nevada, Ohio, Oregon and Vermont.) Washington voters indexed the minimum wage to inflation by approving Initiative 688 in 1998. In 1997, the state minimum wage was $5.15. I-688 specified that for 1999, the minimum wage would be $5.70; for 2000, it would be $6.50; and for 2001 and thereafter, the minimum wage would be increased by the rate of inflation. Since 1999, the minimum wage has increased every year except 2010. (L&Ic)

Although most studies have found that a higher minimum wage leads to reduced employment, studies differ on the magnitude of the effect. A study that is frequently referenced by proponents of minimum wage laws is Card and Krueger, which found that employment in fast food restaurants increased in New Jersey following a minimum wage increase, relative to restaurants in Pennsylvania. That 1993 study was based on a telephone survey; in 1995, Neumark and Wascher re-evaluated the results using payroll data. They found that the minimum wage increase actually reduced New Jersey employment by 4.6 percent relative to Pennsylvania restaurants.

A 2003 study by Vedder and Gallaway found that

> the Washington minimum wage law created not eliminated poverty. It did it largely by creating unemployment and reduced hours for workers. While various estimates of job loss were calculated, the true figure likely is not less than 24,000 (0.8 percent of the labor force) and may be as high as 48,000—after correcting for the impact of the business cycle turndown. The job losses were found in virtually every sector of the Washington economy.

A 2006 working paper from Holland and colleagues, also looked at the impact of Washington's minimum wage increases and found that job losses could be in the range described by Vedder and

Gallaway, or much lower (in the 2,000 jobs range), depending on the capital/labor elasticity of substitution. (If it is easy to substitute capital for labor, job losses will be higher when the minimum wage increases.)

When a wage floor is set, workers who would have been willing to work for less could be shut out of the labor market. Employers may also be less likely to hire additional workers if the cost of hiring them increases. As Vedder and Gallaway note,

> the Law of Demand suggests that when the price of something rises, the quantity the people wish to purchase falls. Government mandated higher minimum wages mean the price of labor is being increased, which should induce some reduction in the amount of workers who will be hired. Thus the income-generating effect of higher wages might be offset by the income-destroying impact of falling employment opportunities arising from the higher wages.

Further,

> the longer term ability to increase worker income is closely tied to experience and training, and if the minimum wage hike were to lead to reduced training, and if unemployment lowered opportunities to gain experience, the longer term prospects of lower skilled workers would be reduced.

Prevailing Wage

The prevailing wage essentially increases the minimum wage for public works projects so that it is in line with the going union wage rate. There is a federal prevailing wage law (the Davis-Bacon Act), and 32 states—including Washington—have prevailing wage laws of their own. The Davis-Bacon Act, which was enacted in 1931, requires contractors to pay prevailing wages for public works contracts of more than $2,000 that receive federal funding.

A 2008 study by the Beacon Hill Institute (BHI) found that the methods of the U.S. Department of Labor's (DOL) Wage and Hour Division, which is responsible for setting the prevailing wage under the federal law, inflate wages by 22 percent and construction costs by 9.91 percent (as compared to wages as reported by the Bureau of Labor Statistics). For a local example, the Bureau of Labor Statistics (BLS) average wage of electricians in the Seattle-Bellevue-Everett metro area is $24.47. The prevailing wage for the same electricians is $35.02. (Glassman et al.)

DOL conducts voluntary surveys (each area is supposed to be surveyed every three years). The BHI study identifies the many methodological problems of this system, including that information may be dated in three years and that the administrative burdens on companies filling out the surveys are high, leading to low response rates. This also means that unions have strong incentives to respond, as they have high wages and the administrative capacity to fill out the surveys. (A 2008 study by Roistacher et al. found "anecdotal evidence that the imposition of prevailing wage requirements would significantly hinder minority-owned contracting and subcontracting firms, some of which find compliance with the prevailing wage rules difficult or impossible. Few such firms have the back-office capacity to comply with the complex reporting and oversight requirements of prevailing wages.")

The prevailing wage is the *majority* wage, not the *average* wage (unless there is no single wage rate cited by a majority of respondents). As BHI puts it,

> Since the union wage is set through collective bargaining agreements between contractors and the unions, it is identical to the penny for a specific job across different employers. On the other hand, nonunion wages vary from contractor to contractor in the open market. As long as the current method, the majority rule, is used, the prevailing wage is likely to be set equal to the union wage.

Forty-two states adopted their own prevailing wage laws from the early 1890s to the early 1970s. (Washington's was enacted in 1945.) Ten states have since repealed their prevailing wage laws, mostly during the 1980s (they are Alabama, Arizona, Colorado, Florida, Idaho, Kansas, Louisiana, New Hampshire, Oklahoma and Utah). Georgia, Iowa, Mississippi, North Carolina, North Dakota, South Carolina, South Dakota, and Virginia never enacted such laws. The threshold amounts for contracts to which they apply vary from none to $500,000. The higher the threshold, the fewer projects covered. Washington is one of nine states with no threshold. (State college and university construction must meet a $25,000 threshold, however.) (WHDb)

Washington's prevailing wage is set using a process similar to that of DOL's Wage and Hour Division: L&I surveys trades every three years about their wages and benefits. It sets the prevailing wage for each trade and occupation employed in the performance of public work, by county. State law defines "public work" as "all work, construction, alteration, repair, or improvement other than ordinary maintenance, executed at the cost of the state or of any municipality, or which is by law a lien or charge on any property therein" (RCW 39.04.010).

Paid Family Leave

Since 1993, the U.S. has had a federal Family and Medical Leave Act (FMLA). Under the FMLA, public- and private-sector employees may take up to 12 weeks of unpaid leave in a year for the birth of a child, for placement for adoption or foster care of a child, to care for a family member with a serious health condition, when suffering from a serious health condition themselves, and for exigencies due to a family member's being on active duty. An employee must have worked for his employer for a year and the location must employ at least 50 people in order to qualify for FMLA benefits. Many states also have family leave laws. (NCSL)

Only California and New Jersey currently mandate paid family leave. In California, the weekly paid family leave benefit is 55 percent of a person's wages (the highest quarter of earnings in a 12 month period) for up to six weeks. Enacted in 2002, the law's benefits are financed through a payroll tax paid by employees. For the fiscal year beginning July 1, 2011, $527.1 million were paid in benefits, on 200,246 claims. The average weekly amount was $497. (EDD)

New Jersey's law was enacted in 2008 (effective July 1, 2009); it is also funded with a payroll tax on employees. An employee may receive up to six weeks of Family Leave Insurance benefits. The weekly benefit is two-thirds of the employee's average weekly wage. For 2010, $71.9 million were paid in benefits, on 30,162 claims. The average weekly amount was $479. (DAE)

In 2007, the Washington legislature enacted E2SSB 5659, establishing family leave insurance. E2SSB 5659 requires partial wage replacement for employees who are unable to perform their regular work due to the birth of a child or the placement of a child for adoption with the employee. The amount of the benefit is $250 per week for people working at least 35 hours per week, for a maximum of five weeks per year. (WRC)

The bill was originally set to go into effect on October 1, 2009, but it did not include a funding mechanism. ($18 million was appropriated for initial administration.) A legislative task force considered financing options; in its final report it recommended that "The General Fund--State should be the source used to finance benefits and administrative costs during the first two biennia of the family leave insurance law." As a task force minority report highlighted, this is an entitlement program: "**This is clearly an entitlement benefit.** Even though it's called an insurance program, there are no elements of insurance included" (emphasis in original). (JTF)

In 2009, SB 6158 delayed benefit payments until October 1, 2012, and in 2011, ESSB 5091 delayed benefit payments until October 1, 2015. Although the program has never been funded, it remains on the books. Assuming benefits are actually funded as currently scheduled, a four-year outlook produced by the Office of Financial Management in August 2012 estimates that paid family leave will increase spending by $66 million over 2014–2017. (OFM)

Paid Sick Leave

According to BLS, 61 percent of private sector workers nationally had access to paid sick leave (and 89 percent of state and local government employees did) in March 2012. For full time private sector employees, the number was 75 percent. For part-time private sector employees, it was 23 percent. In establishments with fewer than 50 employees, 50 percent of private sector employees received paid sick leave. (BLS)

As of September 1, 2012, the city of Seattle requires employers to offer employees paid sick leave. Seattle joins a very small number of jurisdictions to do so: San Francisco (effective Feb. 5, 2007), DC (effective Nov. 13, 2008), and Connecticut (effective Jan. 1, 2012). Residents of Milwaukee, Wisconsin also approved a paid sick leave referendum in 2008, but it was challenged legally and never enacted. (Indeed, in 2011, the Wisconsin legislature passed a bill prohibiting local governments from mandating paid sick leave, because "the provision of family and medical leave that is uniform throughout the state is a matter of statewide concern.") (Wisconsin)

Seattle's "paid sick and safe time" (PSST) ordinance (#123698) is applicable to employers with more than four employees, and full-time, part-time, temporary, and occasional-basis (who work more than 240 hours a year in Seattle) employees are all eligible. (This applies to employers based outside of Seattle for employees who perform any work in Seattle.) An employee may use sick time for personal illness or preventative care, or when a family member is ill or needs preventative care. Employees may use safe time if they are survivors of domestic violence, sexual assault or stalking, or when the workplace, child's school, or childcare is closed for health reasons.

Employees of small employers (more than four to 49 employees) may use 40 hours of PSST per year. Employees of medium employers (50–249 employees) may use 56 hours per year. Employees of large employers (250 or more) may use 72 hours per year. (All employees are to be included in these counts—even those that do not work in Seattle.) Unused hours may be carried over. The ordinance is not effective for employers with less than 250 employees until two years after they hire their first employee.

The National Federation of Independent Business (NFIB) has done numerous studies on the estimated impacts of paid sick leave proposals. In a January 2012 study of a Massachusetts proposal, NFIB estimated that it

> would impose new costs on MA employers in the forms of compensation costs associated with paying workers taking paid sick leave, lost production due to more workers taking leave, and new paperwork and recordkeeping costs incurred by complying with the mandate.

NFIB estimated that, under the proposal (in which employees would get at least seven paid sick days a year), "nearly 16,000 MA jobs could be lost by 2016, and MA real output could decrease by more than $8.4 billion." Additionally, "small firms would bear two-thirds of the job losses and more than half of the lost sales." (Chow)

Because paid sick leave mandates are still new, there are few studies on their effectiveness. A study from the Institute for Women's Policy Research looked at San Francisco's law (the Paid Sick Leave Ordinance, PSLO) in 2011. It surveyed employees and employers, and found that "Among employees, 59,000 or 17 percent of San Francisco's workforce, worked in firms that offered no paid sick days in the past, but are now covered, and more than half of all San Francisco employees who now have paid sick days report some benefit due to the law" (Drago and Lovell).

The law hasn't entirely been a boon for employees or employers, however. As a result of the law, 15.2 percent of workers (and 28.4 percent of workers in the bottom wage quartile) reported that employers reduced hours or laid off employees.

While 53.9 percent of employers reported that it was "not too difficult" or "not difficult" to administer the new law, 57.9 percent of employers in the accomodation and food service sector and 53.2 percent of employers in construction said that administering the law was "somewhat difficult" or "very difficult."

Employers also did not find that the law made employee absenses more predictable—only 3.8 percent said it improved predictability, while 75.5 percent said predictability was about the same. Regarding presenteeism (coming to work while ill), 80.4 percent of employers said it was about the same as before the law (3.3 percent of employers said that it got better and 3.4 percent said it got worse). Additionally, "workers who had direct contact with the public were more than half again as likely to go to work when they were sick, even after the PSLO was adopted (24.3 percent), compared to other workers (14.1 percent)."

The study claims that "employer profitability did not suffer." While 70.6 percent of employers said profitability was about the same as before the law, 14.2 percent said it was worse, and only 0.6 percent said it was better. Further,

> The industries where reports of adverse profitability effects occurred most frequently were in accommodation and food service, construction, retail and wholesale trade, and other services. Not surprisingly, these are the same industries where new paid sick days were implemented most frequently in response to the PSLO. (Drago and Lovell)

The Urban Institute also looked at San Francisco's law, in 2009. According to the study,

> For many employers, the fact that their competitors just over the city line were not subject to the city's minimum wage, health insurance, or paid sick leave requirements made the cost of staying competitive difficult. . . . Given these realities, most employers explained that if the government was going to pass paid sick leave mandates, it should be the state or national government. This was true regardless of the employer's personal opinion of the law.

Further,

> Larger employers did not worry as much about competitive disadvantages, since their operations and larger business decisions were not typically driven by policy changes in San Francisco. But, for different reasons, larger employers also said they would prefer a state or national law, if paid sick leave was going to be an increasingly common requirement. These respondents were primarily concerned about administering different policies in different cities and, for national companies, in different states. (Waters Boots et al.)

Comment

Among the states, Washington has been particularly aggressive in regulating labor costs. Minimum wage, unemployment insurance, and workers' compensation benefits have long been among the nation's highest. More recently, paid family leave and sick leave policies extend a pattern of government mandating compensation that other states leave to marketplace competition.

As each is considered on a piecemeal basis, their cumulative effect is easy to overlook. Employers cannot afford to discount these costs, however. The economics—the math—is straightforward. And as employers run the calculations, Washington becomes less competitive.

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