



BRIEFLY

SHB 3077 was the first bill signed in the 2000 legislative session. The bill provides short-term tax relief for employers and establishes a program of extended benefits for displaced workers pursuing retraining.

The bill does not confront the root cause of the state's high unemployment insurance costs — generous benefits. Therefore the tax relief afforded employers will be only temporary.

Legislature Passes, Governor Signs Unemployment Insurance Bill

The state's unemployment insurance system is the focus of intense legislative attention early in this session. The resulting legislation, SHB 3077, passed the House on January 28 by a vote of 96 to 1, passed the Senate on February 1 by a vote of 48 to 0, and was signed by Gov. Locke on February 7.

The bill received broad support because it provided both something for business and something for labor. Business avoided an unemployment insurance tax increase for this year, as would have occurred because of the manner in which tax rates are indexed to the growth in employee compensation. Labor won the establishment of a program of extended benefits targeted at unemployed workers from declining industries who enroll in retraining programs.

In addition, the bill took a few small steps to address a long-simmering issue within the business community regarding the distribution of the UI tax burden.

UI basics: Most employers pay UI taxes into the trust fund. Qualified unemployed workers receive weekly benefits from the UI trust fund.

Through an experience rating system, tax rates vary among employers. For each employer there is an experience rating account that tracks benefits paid to former employees. Not all of the benefits paid out are "charged back" to the employer, however. Benefits that are not charged back to an employer are said to be "socialized."

The employer's benefit ratio compares the benefits charged to its experience rating account to the taxes it has paid into the trust fund. Employers are divided into twenty separate rate classes according to their benefit ratios to determine their tax rates.

Tax rates also vary with the trust fund balance. There are 7 possible tax rate schedules, named AA, A, B, C, D, E and F, ranked in order of increasing stringency. Each schedule determines a rate for each of the rate classes. The actual schedule that applies in a particular year depends upon the fund balance ratio, which is calculated by dividing balance of the UI trust by the total wages paid by employers subject to the tax. Tax rates are high when there is relatively little money in the fund and low when the fund is flush.

The maximum and minimum UI benefits and the UI tax base and rates are adjusted annually by the rate of growth in the average wage paid in employment covered by UI.

Tax hike avoided: Unemployment in Washington has been remarkably low in recent years, and as a result the UI trust fund has grown, with a healthy balance of about \$1.7 billion at the end of 1999.



A more complete description of the workings of the UI system can be found in our special report, *Getting Back to Work: Reconsidering Unemployment Insurance in Washington*, November 20, 1998

Without a change in law, however, UI taxes would have risen in 2000. The reason is the extraordinary wage growth for Washington. (For example, total wages in employment covered by UI increased by 11.1 percent from 1997 to 1998.) As a result, in spite of the growing fund balance, the balance ratio fell, requiring a tax increase of about 23 percent for the average employer (from tax schedule “A” in 1999 to “B” in 2000).

The extraordinary growth in wages was due in large part to the prepackaged software industry. Overall, the average annual wage in covered employment was up 7.8 percent in 1998 over 1997. The growth in the prepackaged software sector annual wages was 43 percent. Without software, the growth in state wages was 5.0 percent.

The bill provided relief from the impending increase in UI taxes by reducing the fund balance triggers for the various schedules A to F and by changing the date on which the fund balance is calculated to September 30 from June 30 (the fund balance is typically higher on September 30 than on June 30).

Worker retraining: During the 1990s, the state had several programs that targeted unemployed workers from declining industries (“displaced workers”), providing extended benefits while these individuals pursued retraining. The most recent program ended on June 30th, 1999.

During the 1999 session, labor supported the extension and broadening of the displaced workers training program. Legislation to this effect, supported by Governor Locke, made it out of the Senate but died in the house. (Business has generally opposed funding such a program out of unemployment taxes.)

The bill establishes a program of extended benefits for dislocated workers who attend training programs to prepare for jobs in high labor-demand fields.

The dislocated workers who qualify for the program will be eligible for 52 weeks of unemployment insurance benefits. Unemployed workers from timber, fishing and aerospace industries are special targets of the program and may receive benefits for 74 weeks during its initial phase, which lasts through June 30, 2002.

Program funding is capped at \$60 million during the initial phase and \$20 million per year thereafter.

To partially offset this drain on the trust fund, the bill provides some tightening in the eligibility criteria for UI benefits: Individuals who become unemployed and are denied benefits because job loss was voluntary and not for good cause, or because of their own misconduct, or because they refuse suitable work all will need to wait at least 7 weeks before requalifying for benefits, rather than the current 5 weeks, and will have to earn at least 7 times their average weekly benefit amounts, rather than the current 5 times. The amount that will be saved as a result of these changes is unclear, however. The fiscal note for the bill did not determine a fiscal impact for the tightening.

Tax equity: The business community has for several years been riven by a dispute over the distribution of the burden of UI taxes. Employers in certain sectors (the “more stable” employers) have argued that their taxes are subsidizing the benefits paid to the unemployed workers of other businesses (the “less stable” employers).



Economist Wayne Vroman, of the Urban Institute, prepared a major study of tax equity within the state UI system with the results presented to the legislature during the 1999 session. Dr. Vroman suggested several approaches that the state might follow to improve equity among employers, but the legislature was unable to enact any of these in 1999.

SHB 3077 included several changes to the state UI system that were somewhat responsive to Vroman’s suggestions.

Vroman had recommended raising the tax rate for the top class, class 20, which is 5.4 percent in all 7 schedules, while lowering the rates for intermediate classes. The aim, he explained, was to make the rate schedules “more bowed, or less linear, to more closely match the progression of benefit ratios.” SHB 3077 decreases the rates for classes 4 through 16 in all schedules. The rate for class 20, however, is not increased. These changes have succeeded in making the schedules more bowed, but since they fail to shift more of the cost of UI onto class 20, the effect on equity is limited.

For more on tax equity see Wayne Vroman, *Unemployment Insurance Tax Equity in Washington*, January 1999, www.wa.gov/esd/ui/taxstudy/temain.htm

Vroman also recommended reducing the amount of socialized costs due to voluntary quits. Under the provisions of SHB 3077, a person who quits a job in order to follow a spouse who has taken a job in a different labor market will no longer be eligible for UI benefits unless the change is an employer-initiated mandatory transfer.

Reform still needed: In a number of recent reports, the Research Council argued that an overly generous benefits package leads to excessive unemployment insurance costs in this state. This present bill does nothing, on balance, to address this problem.

Newspaper reports describe the bill as containing a huge tax break for business, but this is not the case. Playing around with the tax rate schedules only affects the timing of the taxes paid by business, not the total over the long run. In the long run, the taxes businesses pay must equal the benefits paid out. The mechanism that sets the tax rate schedule according to the balance of the UI trust fund assures that this will be so.

SHB 3077 does provide some short-term tax relief for employers, but it does not seriously attack the root cause of the high tax burden — the state’s generous package of benefits. The bill does call for a legislative taskforce to study the unemployment insurance system and make recommendations for reform before the 2001 session. Tightening benefits should be a major focus of their efforts.

