

*CB 08-05 September 22, 2008***THE BOTTOM LINE**

Washington's unemployment insurance system remains one of the nation's most generous. The average benefit is fifth highest among the 50 states; the minimum benefit is second highest; the maximum benefit, sixth highest.

MAKE UNEMPLOYMENT INSURANCE WORK

The Washington Competitiveness Council, responding to long standing concern within the business community, called in 2002 for the state to reform its unemployment insurance system. Governor Gary Locke, who had convened the Competitiveness Council to examine Washington's ability to compete in the global economy of the 21st century, made UI reform a legislative priority, and after a false start in 2002, the 2003 Legislature enacted historic reforms of Washington's unemployment insurance system.

A February 2005 WashACE Competitiveness Brief praised the 2003 bill:

Although the term "reform" is often attached to legislative changes that amount to little more than modest statutory refinements, the 2003 UI legislation, SB 6097 fundamentally changed policy. The bill realigned benefits and costs to maintain the safety net for workers who have lost their jobs through no fault of their own and allocate equitably the tax burden among employers.

The legislation improved the balance in a system that had imposed the nation's highest employer UI taxes, combining extraordinary benefits with lax enforcement standards. For decades, our state's employers sought relief without success. And despite the overwhelming evidence that the system placed the state at a competitive disadvantage in the quest to create and sustain jobs and recruit and retain businesses, it's doubtful that lawmakers would have acted had the reform not been coupled with the incentive package designed to win the Boeing [787]. (WashACE 2005)

Since we wrote those words, however, the state has taken several steps backward. In 2005 the Legislature suspended until July 1, 2007 a SB 6097 provision that linked weekly benefits to weekly wages averaged over a full year, linking benefits instead to average wages in the two highest earning quarters of the year; in 2006 the Legislature made this two-quarter averaging permanent. A 2008 state Supreme Court ruling gutted another SB 6097 provision that was intended to tighten the criteria under which individuals who voluntarily quit jobs can qualify to receive UI benefits.

UI appears to be headed back onto the Legislature's agenda. The U.S. Department of Labor recently informed the state Employment Security Department that changes made to Washington's UI system by the 2006 legislation have put the system out of conformity with federal legislation. In crafting a solution to this problem, care should be taken to preserve what remains of the reforms put in place in 2003.

The Washington Alliance for a Competitive Economy is a coalition of business organizations working together to build economic opportunity for all Washingtonians.

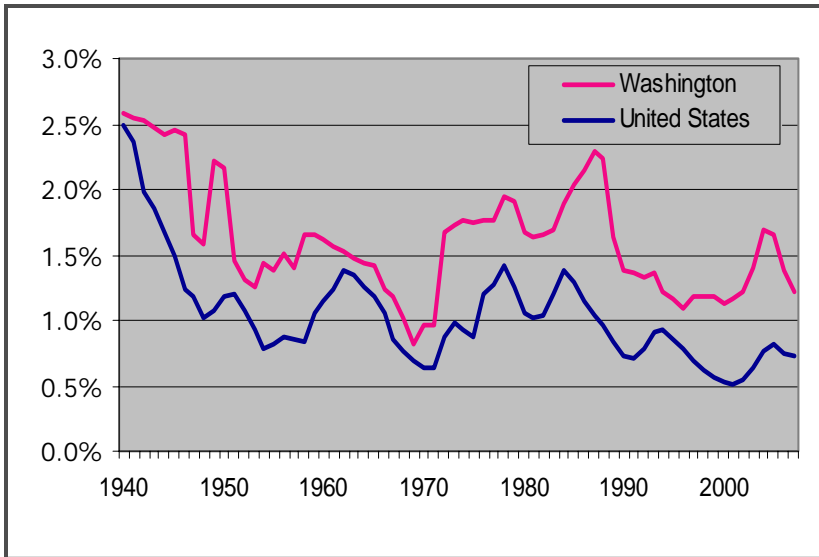
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WASHINGTON'S UI SYSTEM IN CONTEXT

Washington has historically been a high UI tax state.

Chart 1: UI Taxes as a Percent of Wages in Taxable Employment, 1940–2007

Chart 1 shows the average effective UI tax rate (total UI tax payments divided by total wages paid to employees subject to the tax) for Washington state and the U.S. as a whole, for the years 1940 to 2007.



Tax rates follow the business cycle. During periods of high unemployment, UI benefit payouts increase, and tax rates adjust upward automatically to replenish the UI trust fund. As the economy recovers and trust fund balance builds back up, tax rates adjust downward. The result is that UI tax rates vary considerably over time. In every year from 1940 to 2007, through all of these ups and downs, Washington’s average UI tax rate exceeded the national average .

Washington’s UI tax rate reached a cyclical peak of 1.70 percent in 2004, a year in which the national average rate was 0.77 percent. By 2007 the state’s average rate had fallen back to 1.22 percent, which was still considerably higher than the 0.73 percent national average rate. In spite of the reforms put in place in 2003, Washington’s

2007 average tax rate was greater than the rate had been during the period from 1995 to 2002. This is not to say the reforms had been ineffective in reigning in the generous benefits that had made Washington’s system so expensive for employers over the years. Rather, it was that the money saved by controlling benefits was plowed into the trust fund. From the end of 2004 to the end of 2007 the balance in Washington’s UI trust fund grew from \$1.4 billion to \$3.8 billion. At the end of 2007, Washington’s trust fund balance was larger than that of any other state, and represented 10 percent of the total UI reserves of all 50 states. In 2007, 44 cents of each dollar collected in taxes were added to the trust fund balance, while 56 cents were paid out in benefits. The average state put only 10 cents of each dollar into the trust fund.

By the end of June 2008, the trust fund balance exceeded \$4 billion.

BASICS OF UI

Unemployment insurance, like Social Security, is a social welfare program built on an explicit insurance model and funded through a payroll tax. Benefits are not means tested and rise with the amount of the worker’s income that has been subject to the tax. Like many private insurance contracts, UI makes use of both risk sharing and case management to control claims costs. For example, the amount of salary replaced by insurance and the duration of benefits are both capped, shifting a portion of the risk of unemployment onto the recipient. Behavior is regulated by provisions that disqualify workers who have been terminated for cause, who quit voluntarily or who refuse suitable work, and by provisions that require individuals to be actively seeking work.

Regular Benefits

To qualify for unemployment benefits, a claimant must have worked for at least 680 hours in his or her *base year* (the first four of the last five completed calendar quarters before the week in which the claim is filed). The claimant’s weekly benefit amount is equal to 3.85 percent of the average

of quarterly gross wages in the two highest earning quarters of his or her base year, but with minimum and maximum weekly benefit amounts. The minimum and maximum weekly benefits are indexed to the state's average weekly wage. Washington's minimum benefit, currently \$129, ranks second highest among the 50 states. Washington's maximum benefit, \$541, ranks sixth highest. About 4 percent of claimants receive the minimum benefit amount and 20 percent receive the maximum. Under normal conditions, benefits for a single spell of unemployment in Washington are limited both to a maximum of twenty-six weeks and to a maximum of one-third of wages earned in the claimant's base year.

Extended Benefits

During times of high unemployment (as determined state-by-state according to a formula established under federal law), the state/federal extended benefit program automatically increases the maximum duration, typically to 39 weeks. Extended benefits under this permanent program are funded equally from the state UI trust fund and the federal government.

Earlier this summer, Congress and the President approved an "emergency unemployment compensation" bill that will for the next year provide 13 weeks of extended benefits to individuals nationwide who have exhausted their regular benefits. Extended benefits under this temporary program are fully funded by the federal government.

Taxes

For 80 percent of Washington workers covered by unemployment insurance, benefits are funded by a payroll tax levied on their employers. (The other 20 percent of covered employees work for government agencies or non-profit firms who have elected not to pay UI taxes but instead to reimburse the state for any benefits paid to their former employees.) Revenues from the UI tax flow into a federally administered trust fund from which benefits are paid. The trust fund serves as a buffer, in years of high unemployment the state draws down the trust fund balance; then, during years of low unemployment it builds the balance back up.

State UI systems across the U.S. are experience rated: tax rates vary from employer to employer depending upon the past history of claims. Under federal law, states can choose among four broad methods to experience rate unemployment taxes. Washington uses the *benefit ratio* method, basing tax rates for established employers on the four-year ratio between benefits paid and taxable payroll. Tax rates for new employers are based on industry averages.

Experience rating helps to reduce the incidence of unemployment by providing a financial incentive for firms to stabilize employment.

The amount of each employee's wages subject to the UI tax in any year is capped. This maximum amount is called the *taxable wage base*. Washington's taxable wage base is indexed to the average annual wage in covered employment and is currently \$34,000. It is scheduled to increase to \$35,700 next year.

Experience rating doesn't work perfectly. That is, the state fails to capture from some employers all of the costs of benefits paid to their employees. Benefits that are not effectively charged back to claimants' employers are termed *socialized benefits*. Socialized benefits are borne by employers as a group. Socialized benefits fall into three classes. *Noncharged benefits* occur in situations where the state policymakers have decided that employers

should not be held responsible for the benefits paid to former employees. For example, in certain cases an employee who voluntarily quits a job will be allowed to collect unemployment benefits and these benefits will not be charged against the employer. *Ineffectively charged benefits* occur when the benefits charged to an employer exceed the amount that can be collected if that employer is taxed at the maximum rate. Finally, *benefits charged to inactive accounts* occur when claimants' employers suspend or cease operations.

The socialized costs resulting from imperfections in the experience rating system create a degree of cross subsidization between employers, which has been a source of considerable tension within the employer community, particularly between employers whose employment exhibits large seasonal variations and employers whose employment is stable over the year. In the late 1990s, the state commissioned a study by Economist Wayne Vroman of the Urban Institute on what is known as the *tax equity* issue. (Vroman 1999) Several of Vroman's recommendations were included in the 2003 UI reform bill.

In addition to experience rating mechanisms, state UI systems include solvency mechanisms that increase tax rates when trust fund balances are low and lower rates when balances are high.

2002 REFORMS

The issue of Washington's economic competitiveness came to the fore when the state fell into severe recession following the dotcom collapse and the 9/11 terrorist attacks. Responding to the recommendations of the Washington Competitiveness Council Governor Locke made UI reform one of his priorities for the 2002 session. The reform bill that eventually passed the legislature was HB 2901.

The primary emphasis of HB 2901 was the tax equity issue. The bill made a number of changes in the experience rating system with the intent of reducing the amount of cross subsidization. In particular, tax rates were raised for employers in the highest benefit-ratio class and an equity surcharge was introduced that applied to employers for whom benefits charged had exceeded taxes paid in three of the four preceding years. The taxable wage base was increased for employers with the highest benefit ratios and for employers who did not qualify for experience rating.

The bill included one provision that would reduce benefit payments for a period of eight years by holding down the growth in the maximum weekly benefit. Under existing law the maximum weekly benefit amount was adjusted annually to equal 70 percent of the average weekly wage. As a result, the maximum weekly benefit payable in FY 2002 was \$476. The bill froze the maximum weekly benefit at \$476 for FYs 2003 and 2004. For the next six fiscal years, the annual growth of the maximum weekly benefit would be the lesser of either the rate of increase in the average annual wage or 4 percent. After FY 2010 the maximum weekly benefit amount would transition back to 70 percent of the average weekly wage.

The bill included one benefit enhancement. An additional \$34 million in funding was authorized for the training benefit program (which had been introduced in 2000), and the benefit offered specifically to dislocated aerospace workers was extended. The treatment of training benefits with respect to experience rating was changed so that these benefits would be charged to the employers' accounts rather than socialized.

Representatives of employers whose taxes stood to be raised by the

changes in the experience rating system collected 151,239 signatures to force a referendum on that portion of the bill, which then appeared for approval on the November 2002 ballot as Referendum Measure 53. Voters rejected R-53 and so the changes to the experience rating system specified in HB 2901 never went into effect.

2003 REFORMS

With the rejection of R-53, UI reform returned as a legislative priority of Governor Locke in the 2003 session. The issue gained further traction as it became linked with the efforts to attract the Boeing 787 final assembly plant to the state. In 2002 testimony on the state's business climate, Boeing Commercial Airplanes President had told the members of the House Commerce and Labor Committee that Boeing's UI tax rates were higher in Washington than in any other state. The bill that was ultimately enacted, SB 6097, was more comprehensive than the previous year's bill, including a number of provisions affecting benefit payments as well as changes to the experience rating system.

Elements affecting benefit payments

Liberal construction. The bill removed the declaration "that this title shall be liberally construed for the purpose of reducing involuntary unemployment and the suffering caused thereby to the minimum," which gave the "benefit of the doubt" to workers in questions of benefit entitlement, from the introduction to the state's UI statute.

Voluntary quits. In general, workers who quit their jobs are not eligible for unemployment insurance. Existing law made an exception for those who quit for "good cause" and allowed the employment security commissioner a certain amount of discretion in determining what constitutes good cause. The bill rewrote the section dealing with good cause quits, and added a list of ten reasons for quitting which was intended to be an exhaustive list of good causes. (The Legislature subsequently added an 11th good cause: leaving work to attend an approved apprenticeship program.)

Misconduct. Existing law denied benefits to workers who had been discharged from their jobs because of misconduct. The bill clarified and strengthened the definition of misconduct and extended from 7 to 10 the number of weeks an individual who has been discharged for misconduct must work at a new job in order to requalify for benefits.

Stock option income. Income from stock options was excluded from wages used in calculating unemployment insurance benefits and taxes. In particular, this exclusion would lower the minimum and maximum benefit amounts, which are indexed to average weekly wages.

Four-quarter averaging. Under existing law, the weekly benefit amount was equal to one twenty-fifth (4 percent) of average quarterly wages in the highest two quarters of the worker's base year (*two-quarter averaging*), subject to statutory maximums and minimums. The bill changed this. For 2004, the weekly benefit amount would be based on one twenty-fifth of the average weekly wage in the highest three quarters of the worker's base year (*three-quarter averaging*). For 2005 and thereafter, the weekly benefit amount would be based on one one-hundredth (1 percent) of the worker's total wages in the base year. As this is equivalent to basing the weekly benefit amount on 4 percent of the average quarterly wages in the base year, it is generally described as *four-quarter averaging*. This change would reduce the weekly benefit for those claimants whose earnings were not evenly spread across the four quarters of their base years and who were

at neither the maximum nor the minimum.

Maximum weekly benefit. For the last 6 months of 2003, the bill raised the maximum weekly benefit from \$496 to \$510. Beginning in January 2004, the maximum weekly benefit would be the greater of either \$496 or 63 percent of the average weekly wage of all employers for the previous year. This was a bit tighter than the maximum imposed by HB 2901, and it did not revert to 70 percent of the average weekly wage, as the HB 2901 maximum did.

Duration. The bill reduced the maximum duration for regular benefits from 30 weeks to 26 weeks when the state unemployment rate is 6.8 percent or lower. (At the time of SB 6097's enactment, June 2003, the state unemployment rate was 7.6 percent.) In nearly all states the maximum duration is 26 weeks; the exceptions are Massachusetts (30 weeks) and Montana (28 weeks).

Part-time workers. The one benefit enhancement in the bill provided expanded eligibility for part-time workers. Previously, to be eligible for benefits a claimant had to be willing to accept a full time job. Under the new provision, a job-loser who is seeking part-time rather than full-time work may receive unemployment benefits so long as he or she has worked in at least 40 weeks in his or her base year and has worked more than 17 hours per week in no more than three of those weeks.

Elements affecting tax rates

Beginning in the year 2005, the calculation of tax rates was completely revamped. Under the new system, an employer's tax rate would be the sum of three parts: an experience rate, a social cost rate, and a solvency surcharge.

Experience rate. Each employer is placed into one of 40 rate classes, depending upon its benefit ratio (benefits charged to the employer of the previous four years divided by the taxable payrolls of the employer over those four years). Each class is assigned an experience rate, called the *array calculation factor rate*, ranging from 0 for the class with the lowest benefit ratios (class 1) to 5.4 percent for the class with the highest benefit ratios (class 40).

Social cost rate. The *graduated social cost factor rate* is intended to recoup (at least in part) the excess of benefits paid out in the previous year over the experience rate taxes paid in that year (total social cost). The social cost factor rate paid by an employer varies by rate class and with the ratio of total social cost to taxable wages in the previous year. For employers in rate class 1, the minimum social cost factor rate is 0.45 percent, for other employers it is 0.50 percent.

For most employers, the sum of the array calculation factor rate and the social cost factor rate cannot exceed 6.5 percent. The rates for certain seasonal industries are capped at 6.0 percent.

For an employer lacking sufficient history to qualify for experience rating, the array calculation factor would be set equal to 115 percent of the average for firms in its industry; the graduated social cost factor would be equal to 115 percent of the average graduated social cost factor for firms in its industry, but no more than the social cost factor assigned to rate class 40.

Solvency Surcharge. When the balance in the unemployment insurance trust fund is insufficient to provide at least six months of benefits, a sol-

gency surcharge of up to 0.2 percent is added to each employer's tax rate.

MLFA. The bill eliminated a unique feature of Washington's UI system that allowed employers who laid off seasonal workers to avoid being charged for benefits paid to these workers in the off season. Under this provision, known by the acronym MFLA, the benefits charged to an employer in a quarter were capped at the maximum of the amounts that the unemployed worker earned in the corresponding quarters during the preceding two years. As a result, seasonal employers were relieved of charges in the off season for workers who were regularly unemployed in the off season. (These workers were said to have marginal labor force attachment, hence the acronym.)

Job search. SB 6097 included several provisions to strengthen enforcement of the requirement that those collecting UI benefits actively search for work. Monitoring of job search activities was extended to claimants residing outside of the state, through contracts with other state employment security departments. Failure to comply with job search requirements results in loss of all benefits for weeks during which the claimant was out of compliance.

BACKWARD STEPS SINCE 2003

Bills enacted in 2005 and 2006, and a 2008 Washington State Supreme Court decision have rolled back several of the reforms enacted in 2003. In addition, the U.S. Department of Labor has ruled that, because of the 2006 legislation, Washington's UI system does not conform to federal law.

2005—HB 2255

HB 2255, "an act relating to making adjustments to improve benefit equity in the unemployment insurance system," which the legislature passed in 2005, temporarily suspended several of the key reforms contained in SB 6097.

Liberal construction. The directive that the unemployment statutes be liberally construed was reinstated through June 31, 2007.

Two-quarter averaging for benefits. Through June 30, 2007, the weekly benefit amount would be based on 3.85 percent of the claimant's average quarterly wages in the two quarters of the base year in which wages were highest. The new benefit amount calculation thus had the effect of raising the benefits received by claimants whose wages varied greatly from quarter to quarter and reducing benefits paid to claimants whose wages did not vary much by quarter.)

Four-quarter averaging for taxes. To the extent that the two-quarter-averaging caused claimants to receive higher benefits than they would have received if benefits had been calculated as 1 percent of annual wages, the additional benefits would not be charged to the employers' experience rating accounts; that is to say that these benefits would be socialized.

Tax relief for seasonal industries. In addition, the bill set the social cost factor to zero for certain seasonal employers for fiscal years 2006 and 2007.

Studies and reports. The bill established a joint legislative taskforce on unemployment insurance benefit equity, which was to report to the Legislature in January 2006. The bill also provided additional staffing to expand the Employment Security Department's analytic capacities with respect to the UI system.

Table3: Summary of the 2003 Unemployment Insurance Reforms

	<u>Status -Pre 2ESB 6097</u>	<u>Under 2ESB 6097</u>	<u>Current Status</u>
Construction:	Calls for liberal construction of the program.	Provision requiring liberal construction is repealed.	Provision requiring liberal construction is reinstated.
Benefit Calculation:	2% of total earnings in the two highest earning quarters (2 quarter averaging)	1% of the total earnings in the prior year (4 quarter averaging)	1.925% of total earnings in the two highest earning quarters (2 quarter averaging for benefits)
Tax Rates:	Set out in a 20X7 table making the tax rate a function of an employers benefit ratio and the UI trust fund's balance	Employer tax rate sum of three parts: an array factor based on employer's benefit ratio, a social cost factor and a solvency charge.	Employer tax calculated as if benefits were still calculated as specified by 2ESB 6079 (4 quarter averaging for taxes), as a result Washington is out of conformity with federal law.
Maximum Weekly Benefit Amount:	70 percent of average weekly wage of workers in the state; set at \$496 in 2003.	Changed to the greater of \$496 or 63 percent of average weekly wage paid in prior year.	Reform Intact
Duration of Benefit:	30 weeks	26 weeks (unless unemployment rate exceeds 6.8 percent)	Reform Intact
Voluntary Quits:	Provides general guidance regarding the granting of benefits to workers who voluntarily leave employment.	Lists ten specific reasons for granting benefits to a worker who voluntarily quits.	Reform effectively repealed by Supreme Court ruling that statutory list of good causes is not exhaustive.
Part-time Workers:	Not covered	Allows workers earning wages in no more than 17 hours per week to receive benefits.	Reform intact
Marginal Labor Force Attachment:	Employers relieved of responsibility for certain charges involving employees with irregular working patterns	MLFA repealed.	Reform intact
Misconduct:	Requires 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.	Reform intact
Job Search:	Requires claimants to demonstrate contacts with at least three employers per week or in-person search activity at reemployment center.	Expands monitoring to include claimants collecting benefits outside Washington; requires three documented in-person search activities per week at reemployment center; failure to comply results in loss of all benefits for weeks during which claimant was not in compliance and repayment of benefits.	Reform intact

2006—SB 6885

The Legislature revisited UI in 2006, enacting SB 6885. Significant provisions included:

Liberal construction. SB 6885 made permanent HB 2255's provision that unemployment insurance law be liberally construed.

Two-quarter averaging for benefits. The bill made permanent HB 2255's provision that based benefits on 3.85 percent of the average quarterly wage in the highest two quarters of the claimant's base year.

Four-quarter averaging for taxes. The bill also made permanent HB 2255's provision that socialized benefits that exceeded 1 percent of the claimant's annual wages.

Tax relief for seasonal industries. For certain seasonal industries, the bill reduced the cap on the sum of the array calculation factor and the social cost factor to 5.7 percent for years 2008 and later.

Recapture of socialized costs. The bill changed the formulas for calculating the social cost factor to reduce the social cost factor in periods where the trust fund balance is high.

2008—Spain vs. Employment Security Department

In June of this year, the Washington State Supreme Court ruled in the consolidated cases of two women (Sara Spain and Kusum Batley) who had been denied unemployment compensation after quitting their jobs. Both Spain and Batey argued that they had good cause to quit and therefore should receive UI benefits. As the court explained,

Both Spain and Batey tell us they left their jobs because they found their employers unbearable. Spain suffered daily verbal abuse. Batey left her job with a battered women's shelter after sharply disagreeing with management on how their clients should be treated, among other things.

The Employment Security Department determined that the reasons offered for quitting did not fall within the list of 10 good causes enumerated by SB 6097 and therefore denied their claims.

The Supreme Court, however, read the statute to contain both a general statement that a claimant would not be disqualified if she left her job for good cause and a list of specific examples of good causes for quitting. While the court found the State's position that the Legislature intended the list to be exhaustive to be plausible, it stated that "[t]he difficulty with the State's position is that the legislature did not say that 'good cause is' the 10 (now 11) listed categories." In a unanimous decision, the Court remanded "both cases to Employment Security to determine, based upon the individual facts of the case and without regard to [SB 6097] whether these employees had good cause to leave their jobs."

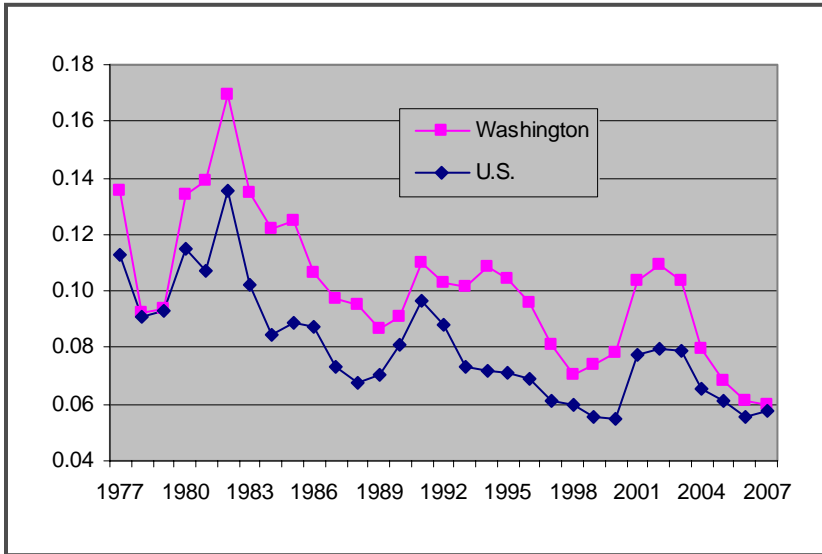
The Court thus returned the situation with respect to voluntary quits to where it had been pre-SB 6079.

The statuses of various SB 6079 provisions are summarized in Table 1 on page 8.

IMPACTS OF THE REFORMS

Three factors determine the cost of providing UI: the number of claims paid, the average length of time recipients receive benefits (the average

Chart 2: Initial Claims Paid, As a Share of Covered Employment



duration) and the benefit level. All three factors are influenced by the design of the UI system, and all three were targets of the 2003 reforms, with the ultimate goal of reducing the UI tax burden on employers.

Washington has historically ranked above the U.S. average on each of these three factors, as the charts on this page demonstrate.

Chart 2 shows the number of initial claims paid, as a share of covered employment for Washington and the United States as a whole for the years 1977 to 2007. Both curves show a cyclical pattern, with initial claims rising in periods of economic contraction and falling in periods of expansion. This cyclic pattern overlays a secular downtrend, corresponding to the downward trend in unemployment rates over the 31-year period.

In every year from 1977 to 2007, covered workers went on to the UI rolls at a greater rate in Washington than the national average. This was true even in 1991, which was a recession year for the nation as a whole but not for Washington. In 2007, however, the gap between the Washington and national initial claims rates was smaller than in any year since 1979. While some of the closing in the gap is certainly due to the relative strength of Washington's economy in 2007, the 2003 UI reforms certainly deserve some of the credit. The narrowing of voluntary quit good causes, the strengthening of the definition of misconduct and improvements to the experience rating system all would be expected to reduce the number of initial claims paid.

Chart 3 shows the average duration for Washington and the U.S. for the 1977–2007 period. Again both the Washington and the national curves show a cyclical pattern, with duration generally lengthening during downturns in the economy and shortening during upturns. (Washington's duration, however, did not decline during the 1990s expansion.)

In every year from 1981 through 2004, Washington's duration exceeded the national average (by an average of 2.2 weeks). Since 2005, Washington's average duration has been less than the national average. For 2007 Washington's average duration was 13.1 weeks compared to a national average of 15.2 weeks. Again, the 2003 reforms certainly deserve some credit for the shrinkage of average duration. The reduction of the maximum from 30 weeks to 26 weeks, the strengthening

Chart 3: Average Duration, in Weeks

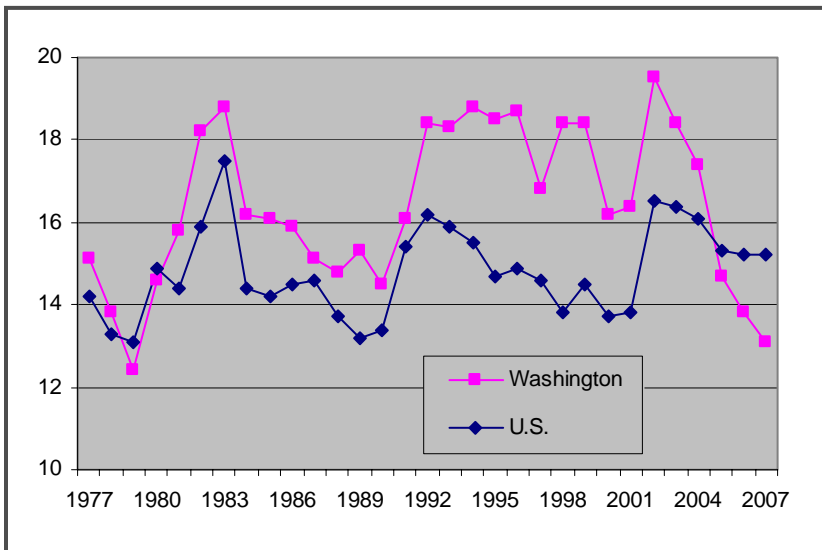
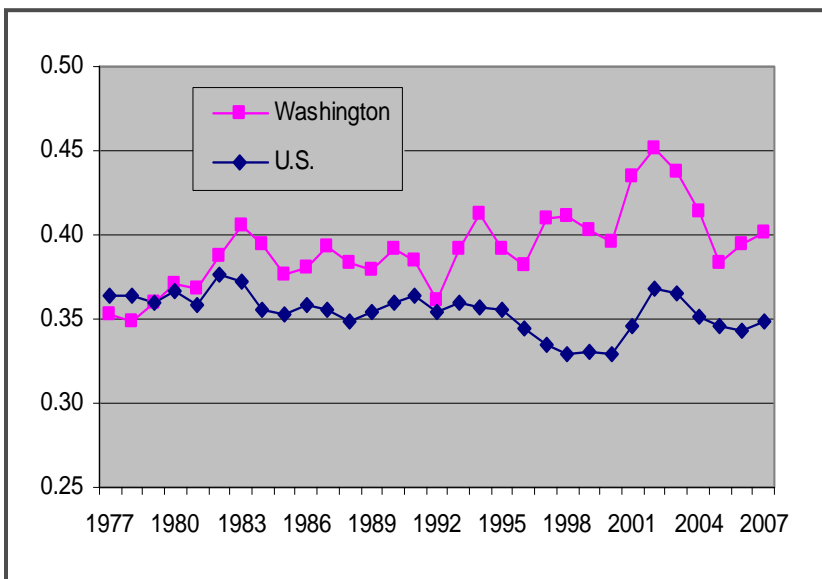


Chart 4: Average Benefit as a Share of Average Wage



of job search requirements and improvements to experience rating all should work to reduce average duration.

Chart 4 shows the average weekly benefit as a share of the average weekly wage. For every year since 1980, Washington's average weekly benefit as a share of the average weekly wage exceeded that of the U.S. as a whole. The spike for Washington in 2001, 2002 and 2003 reflects the unique aspects of Washington's 2001–2003 recession in which a large number of highly paid dotcom and aerospace workers lost their jobs.

While the 2003 reforms reduced the maximum benefit from 70 percent to 63 percent of average weekly wage, the average benefit in Washington remains well above the national average. During the first quarter of 2008, the average weekly benefit in Washington was \$342.99, compared to a U.S. wide average of \$299.14. Among the 50 states, Washington's average weekly benefits ranked 5th highest. Only Hawaii, Massachusetts, Rhode Island, and New Jersey had higher average weekly benefits.

In 2000, the combined impacts of the claim rate, average duration and benefit generosity produced a ratio of benefits paid to wages in taxable employment for Washington that was twice the national average. By 2007 a combination of policy changes and cyclical factors had brought Washington's benefit/wage ratio more closely in line with the national ratio. Washington's first payment rate was then close to the national average. Washington's average weekly benefit exceeded the national average by 16 percent, but this was balanced by a national average duration that was 16 percent greater than Washington's average duration.

While Washington's ratio of benefits to wages in taxable employment has fallen more closely in line with the national average, Washington's average tax rate remains well above the national average. The result is that Washington's trust fund balance has ballooned.

Urban Institute Economist Wayne Vroman prepared a report for the Employment Security Department that examined the growth in the trust fund balance following the 2003 reforms (Vroman 2007). Vroman's report emphasizes the extent to which the 2003 reforms reduced socialized costs:

Compared to past years, a much larger percentage of benefit charges are assigned back to individual employers. The 1990-2003 average of about 60 percent appears to have increased to close to 80 percent.

He suggests that with less socialized cost, UI taxes could be lowered by reducing the social cost factor rate:

An important related point is that Washington can probably anticipate a lower volume of ineffectively assigned benefit charges in future years. If this is the case, it has obvious implications for the setting of the noncharged benefits tax rate. Under the current tax statute, the minimum is 0.5 percent of taxable wages. It seems the minimum should be lower if it is to roughly match the volume of ineffectively assigned benefit charges in periods when total ineffectively charged benefits are low. Otherwise it will add to the trust fund balance year after year.

CONFORMITY WITH FEDERAL LAW

The Social Security Act of 1935 established the federal/state partnership in unemployment insurance. To participate in this partnership, state UI systems must conform to various federal requirements, one of which is that

any variations in employer tax rates must be linked to variations in actual benefit experiences. The U.S. Department of Labor recently informally advised the Employment Security Department that Washington's system is out of conformity as a result of the enactment of ESSB 6885, which mandated two-quarter averaging for calculating benefits and four-quarter averaging for calculating taxes.

The Department of Labor is withholding for the present time a formal declaration of nonconformity, to give lawmakers an opportunity to rectify the situation. With technical assistance from the Employment Security Department, a broad coalition of stakeholders from the business community is discussing changes to state law to bring Washington back into conformity.

A formal determination of nonconformity would be costly to employers. Under federal law a federal payroll tax of 6.2 percent (the FUTA tax) is levied on the first \$7,000 of annual earnings paid to each employee. However, in cases where the employer is making contributions to a conforming state UI plan, the 6.2 percent FUTA is substantially offset by a 5.4 percent credit, so that the net FUTA rate is just 0.8. If the state is formally determined to be out of compliance, Washington employers will lose the credit, which is worth \$378 for an employee at or above the \$7,000 earnings cap.

OBSERVATIONS

Since the end of 2007, the rate of growth of the Washington economy has slowed dramatically. The unemployment rate is rising, although it appears the state will technically avoid a recession. As more workers submit claims for unemployment insurance benefits, the state will begin to draw down reserves in the UI trust fund. With a balance of \$4.0 billion (the nation's highest), the solvency of the trust fund is secure.

Washington workers are well protected. Washington's unemployment insurance system remains one of the nation's most generous. The average benefit is fifth highest among the 50 states; the minimum benefit is second highest; the maximum benefit, sixth highest. The recently enacted federal emergency unemployment compensation bill will provide 13 weeks of benefits beyond the regular 26 weeks. And if unemployment in the state becomes severe, the normal extended benefit program will kick in, providing a further 13 weeks of benefits.

Three issues require the Legislature's attention:

First, steps must be taken to bring the state UI system back into compliance with federal requirements. Members of the business community are working in a broad coalition to develop solutions, with technical assistance from the Employment Security Department.

Second, in accordance with the intent of the 2003 legislation, the Legislature should clarify that the statutory enumeration of 11 good causes for voluntarily quitting is exhaustive.

Third, while the UI tax rate of the average employer has declined significantly over the past several years, the state's rates have remained among the nation's highest. As a result, the state has built up an unnecessarily large balance in the UI trust fund. The Legislature should adjust the tax rate system to reduce the inflow of funds at times when the trust fund balance is high.

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