HOUSE BILL REPORT
ESB 5925

As Passed House:
March 8, 1995

Title: An act relating to determining unemployment insurance compensation rates.

Brief Description: Modifying the determination of unemployment insurance contribution rates.

Sponsors: Senator Pelz.

Brief History:
Committee Activity:
Commerce & Labor: 3/6/95 [DP].
Floor Activity:
Passed House: 3/8/95, 68-29.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: Do pass. Signed by 6 members: Representatives Lisk, Chairman; Hargrove, Vice Chairman; Thompson, Vice Chairman; Cairnes; Goldsmith and Horn.

Minority Report: Do not pass. Signed by 4 members: Representatives Romero, Ranking Minority Member; Conway, Assistant Ranking Minority Member; Cody and Cole.

Staff: Chris Cordes (786-7117).

Background: Washington's unemployment insurance system requires each covered employer to pay contributions that are a percentage of his or her taxable payroll. These contributions are held in trust to pay benefits to unemployed workers.

An employer's contribution rate is determined by a statutory tax schedule. The statute establishes seven different tax schedules, AA through F. The tax schedule that will be in effect for any given calendar year depends on the amount of funds in the unemployment insurance trust fund on June 30 of the previous year compared to the total payroll in covered employment in the state for the completed calendar year prior to that June 30.

The Employment Security Department makes the calculation, dividing the trust fund balance by the total payroll, and reports the fund balance ratio. When the reported fund balance ratio, expressed as a percentage, is greater than 3.9 percent, the lowest tax schedule, AA, will be in effect. If the fund balance ratio is less than 1.4 percent, the highest tax schedule, F, will be in effect. Tax schedules A through E will be in effect as specified by the following fund balance ratio intervals:

Tax schedule	Fund balance ratio interval
AA	3.9 and above
A	3.89 to 3.4
B	3.39 to 2.9
C	2.89 to 2.4
D	2.39 to 1.9
E	1.89 to 1.4
F	below 1.4

For making the tax schedule determination for calendar year 1995, the department reported a trust fund balance of $1.591 billion and a fund balance ratio of 3.72 percent. Under the statute, the tax schedule in effect for 1995 is schedule A.

During the 1993 and 1994 interims, the Joint Task Force on Unemployment Insurance reviewed the adequacy of the unemployment insurance trust fund, but did not make recommendations relating to the issue.

The task force’s 1995 draft report describes the goal of the tax schedule mechanism as adjusting the trust fund balance toward a targeted amount that is between 2.4 and 2.9 percent of the state’s total wages. When schedule C is in effect because the fund balance ratio interval is between 2.4 and 2.89, the tax rate is expected to provide revenue approximating: (1) the state’s historical average annual benefit costs and (2) a reserve fund capable of meeting recession benefit costs of 2.9 percent of total wages (the benefit costs in recession year 1982, the state’s second highest recession level benefit costs). This amount of reserve equals the cost of 12 months of recession benefit costs, assuming benefit costs equal to 1982 costs.

The draft report notes that as of January 1, 1993, Washington’s trust fund was the third largest state account in the country. A review of Washington’s historic benefit costs shows that the average cost rate over the last 25 year was 1.7 percent of total wages, but that the cost rate during the period from 1983 to 1992 was 1.46 percent. Washington had the seventh highest cost in comparison with other states over this 10-year period.

The Interstate Conference of Employment Security Administrators recommends that states maintain a reserve capable of providing 18 months of recession level benefits, using the state’s highest recession level costs. Washington’s reserve goal of 12 months using the second highest recession level costs has been based on the unlikelihood of recurrence of the worst recession and the responsiveness of the mechanism used to adjust the tax schedules.

Summary of Bill: For calendar year 1995, the unemployment insurance tax schedule in effect will be tax schedule AA.

For future years, the mechanism for determining the effective tax schedule for each calendar year is modified. The fund balance ratio intervals that will determine the tax schedule are changed as follows:

Tax schedule	Fund balance ratio intervals	
	from	to
AA	3.9 and above	2.9 and above
A	3.89 to 3.4	2.89 to 2.5
B	3.39 to 2.9	2.49 to 2.1
C	2.89 to 2.4	2.09 to 1.7
D	2.39 to 1.9	1.69 to 1.3
E	1.89 to 1.4	1.29 to 1.0
F	under 1.4	under 1.0

The Employment Security Department is directed to undertake a study of the unemployment insurance trust fund and the system's financing provisions, including historical costs, estimates of expected future costs, ability of the system to meet expected average costs and future recessionary costs, and advantages and disadvantages of modifying the system. The department may contract with a consulting firm to perform the study. The final report, with any recommendations for change, is due to the Legislature by January 1, 1996.

Technical changes are made to correct a double amendment to the tax schedules and provide for the tax schedule that takes effect in 1998 when the employment and training tax expires.

Appropriation: None.

Fiscal Note: Requested on March 3, 1995.

Effective Date: The bill contains an emergency clause and takes effect immediately, except for section 2, relating to the tax schedule created after expiration of the employment and training tax, which takes effect January 1, 1998.

Testimony For: This is a critical issue to the business community. The trust fund is larger than was ever intended by the Legislature when the financing system was enacted in 1984, yet tax increases are scheduled under that system for the next two years. Washington's average unemployment tax is nearly twice the national average. Even with downturns over the last decade or so, the trust fund continued to grow. The Legislature needs to put the extra money into the economy to generate jobs and reduce the drain on the trust fund. The compromise reached in this bill is to compress the tax triggering mechanism so that the fund will be replenished before it drops as low as in previous versions. However, state economists have reported an opinion that Washington will be able to weather the layoffs that are expected in the coming year. It is important to enact this legislation quickly because the billing cycle for employers will begin by the end of the week and, to avoid confusion, this change must be implemented before that cycle begins. The issues involving the equity in the system must include both benefit equity and tax equity and can be addressed in a separate bill. The bill also includes a study of the financing system so that corrections can be made if needed. This study is important because of some uncertainty about the economy and the need to find a clearly responsible financing mechanism.

Testimony Against: Over the last six months, the unemployment trust fund balance has been falling. Now it appears that an economic downturn may be coming soon because of announced large layoffs in several important sectors of the state's economy. It is not clear that the trust fund is overfunded, considering the future economic uncertainty. The solution in this bill may be more difficult for employers, because the compressed triggers mean quicker jumps to higher tax rates when fund is falling. If the goal of the bill is to provide tax relief, this goal can be better met by more fairly spreading the tax burden among employers in the system. Labor has an important stake in the fund, too, because of the impact of high employer taxes on wage bargaining. The bill rewards those with high layoff rates who pay at the highest rate now. The other employers will pay higher taxes as the fund drops to cover those layoffs. The bill may save taxes now, but will cost more later. This bill could be supported if the changes to the trust fund triggers were terminated in two years.

Testified: (In favor) Clif Finch, Association of Washington Business; Cyrus Kelly, J.C. Penny; Jan Gee, Washington Retail Association; Gary Smith, Independent Business Association; and Dedi Hitchins, National Federation of Independent Business. (Opposed) Jeff Johnson and Robby Stern, Washington State Labor Council; Richard King, International Brotherhood of Electrical Workers; Robert Dilger, Washington State Building and Construction Trades Council; and Dan Sexton, Washington State Association of Plumbers and Pipefitters. (With concerns) Dale Ziegler, Employment Security Department.