Washington State Unemployment Insurance Task Force Meeting September 21, 2005

Presentation by
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Outline of Presentation

- Objectives of unemployment insurance (UI)
- The recession of 2001: national experience
- UI in Washington State
- The Cost of UI in Washington
- Recent UI events in other states
- The UI trust fund balance and trust fund models

Goals of Unemployment Insurance

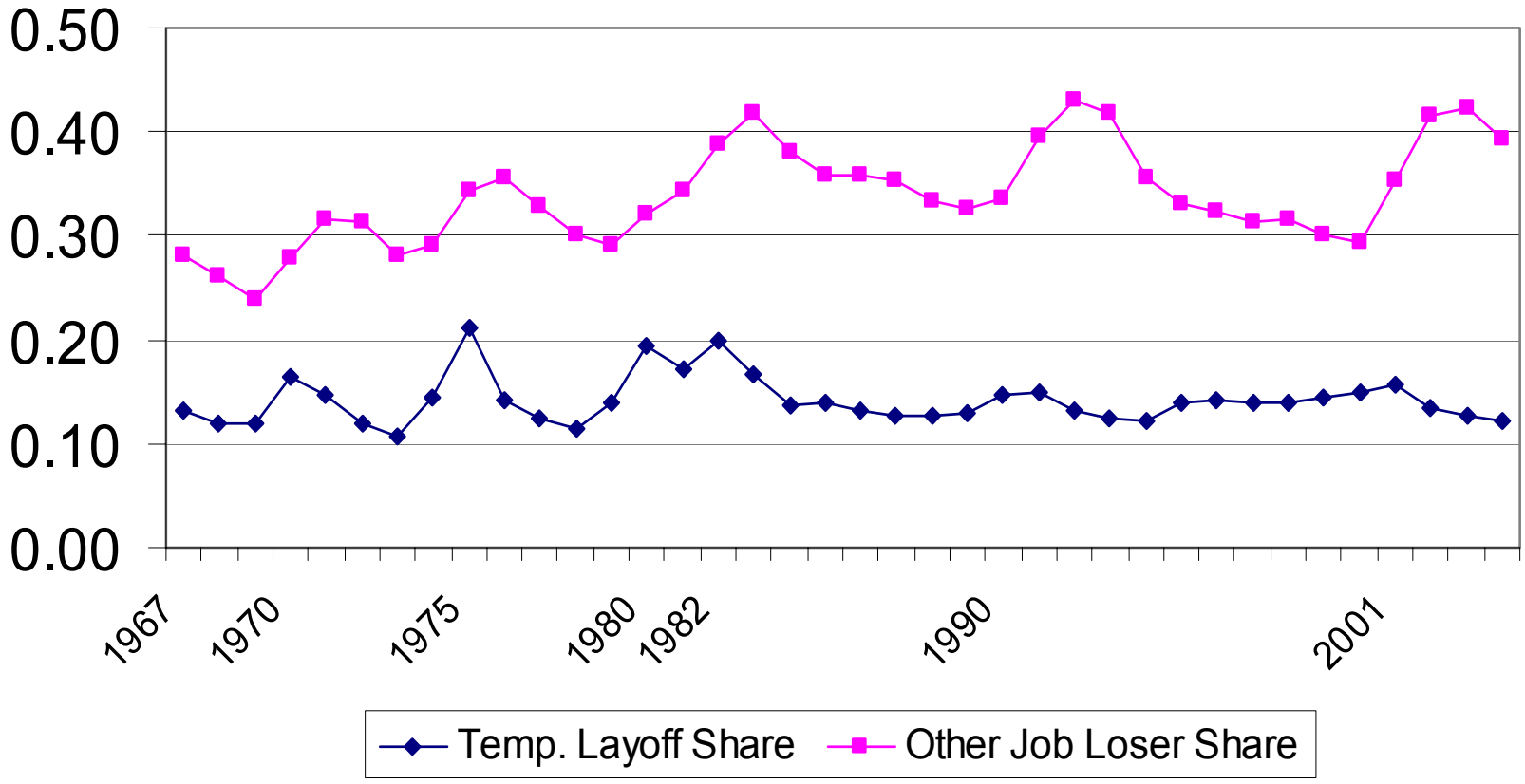
- Stabilize the income of individuals and their families with unemployment
- Provide automatic or "built-in" stability to the macro economy
- Encourage employment stability through experience rating and employer participation in program administration

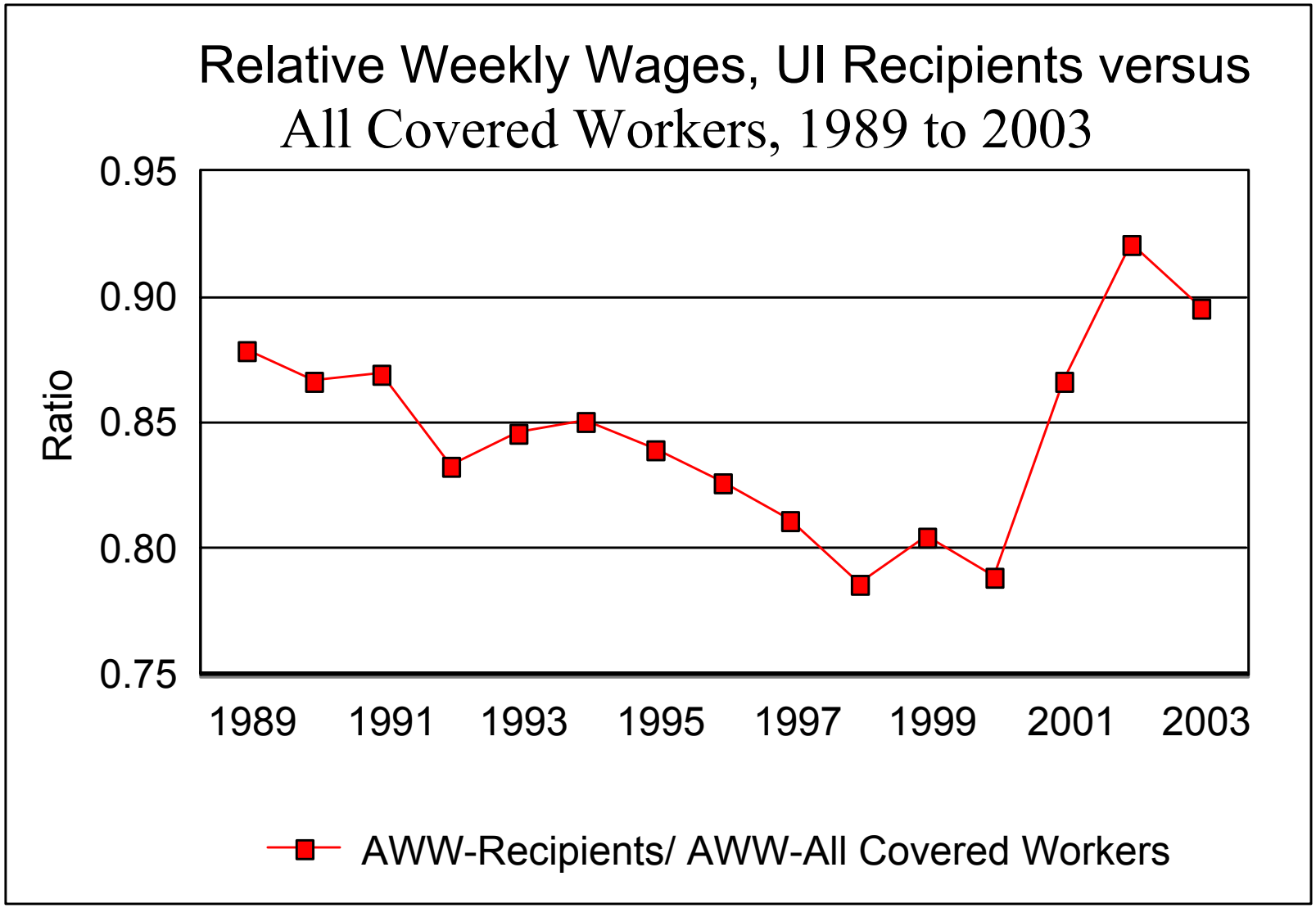
The Recession of 2001: National Experience

The Recession of 2001

1. Real output
   - small decline in output, trough Nov. 2001
   - slow recovery of real output, acceleration in output growth from mid-2003
2. Labor market
   - modest increase in unemployment rate
   - peak unemployment rate 6.3%, June 2003
   - slow recovery of employment to mid 2004
   - slow decrease in unemployment
   - high unemployment duration

Chart 3. Temporary Layoff and Other Job Loser Shares of Unemployment, 1967 to 2004




Relative Weekly Wages, UI Recipients versus All Covered Workers, 1989 to 2003
Ratio
0.95
0.90
0.85
0.80
0.75
1989
1991
1993
1995
1997
1999
2001
2003
AWW-Recipients/ AWW-All Covered Workers

Unemployment and UI Claimants, 2001 to 2005

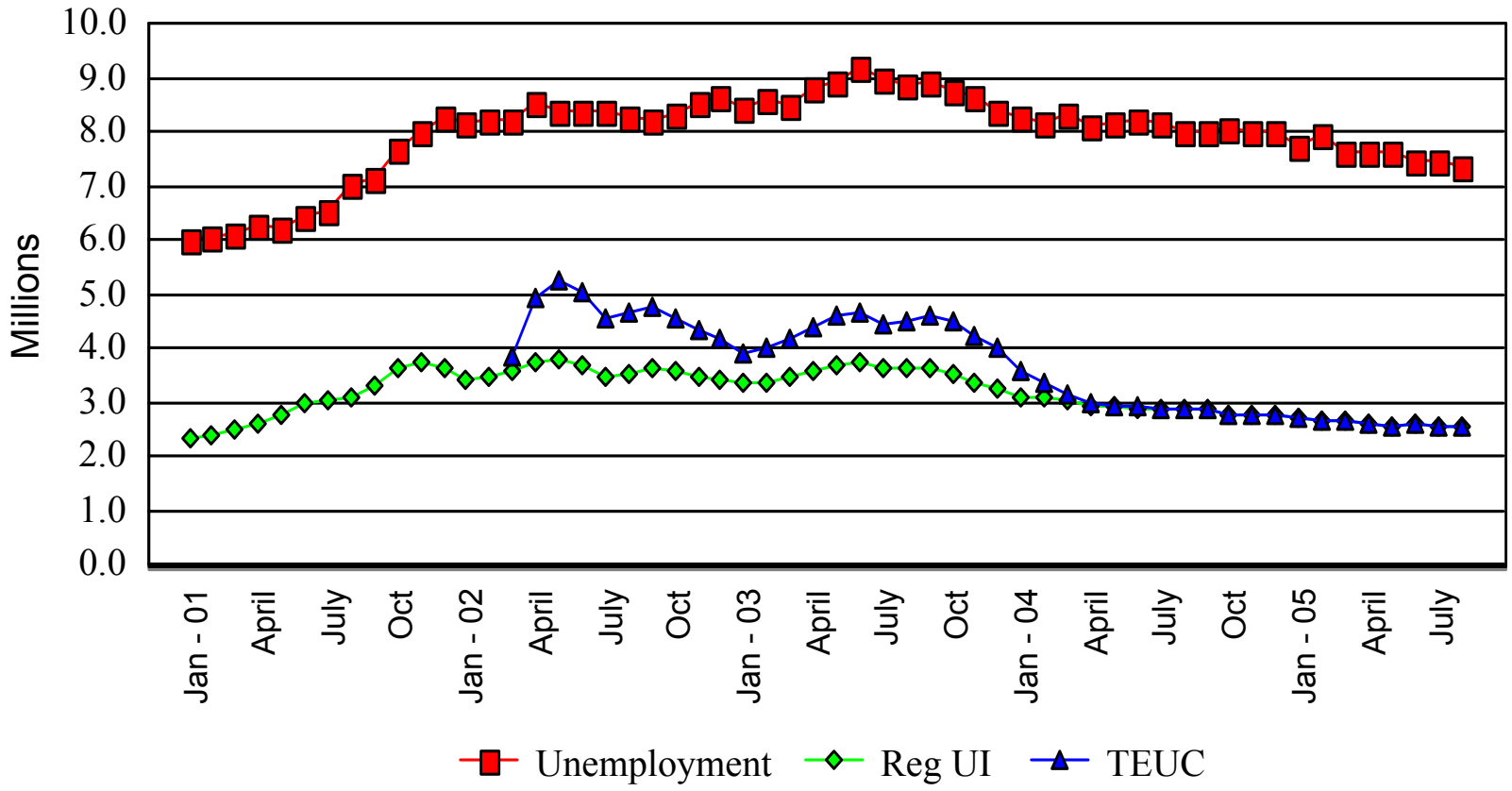
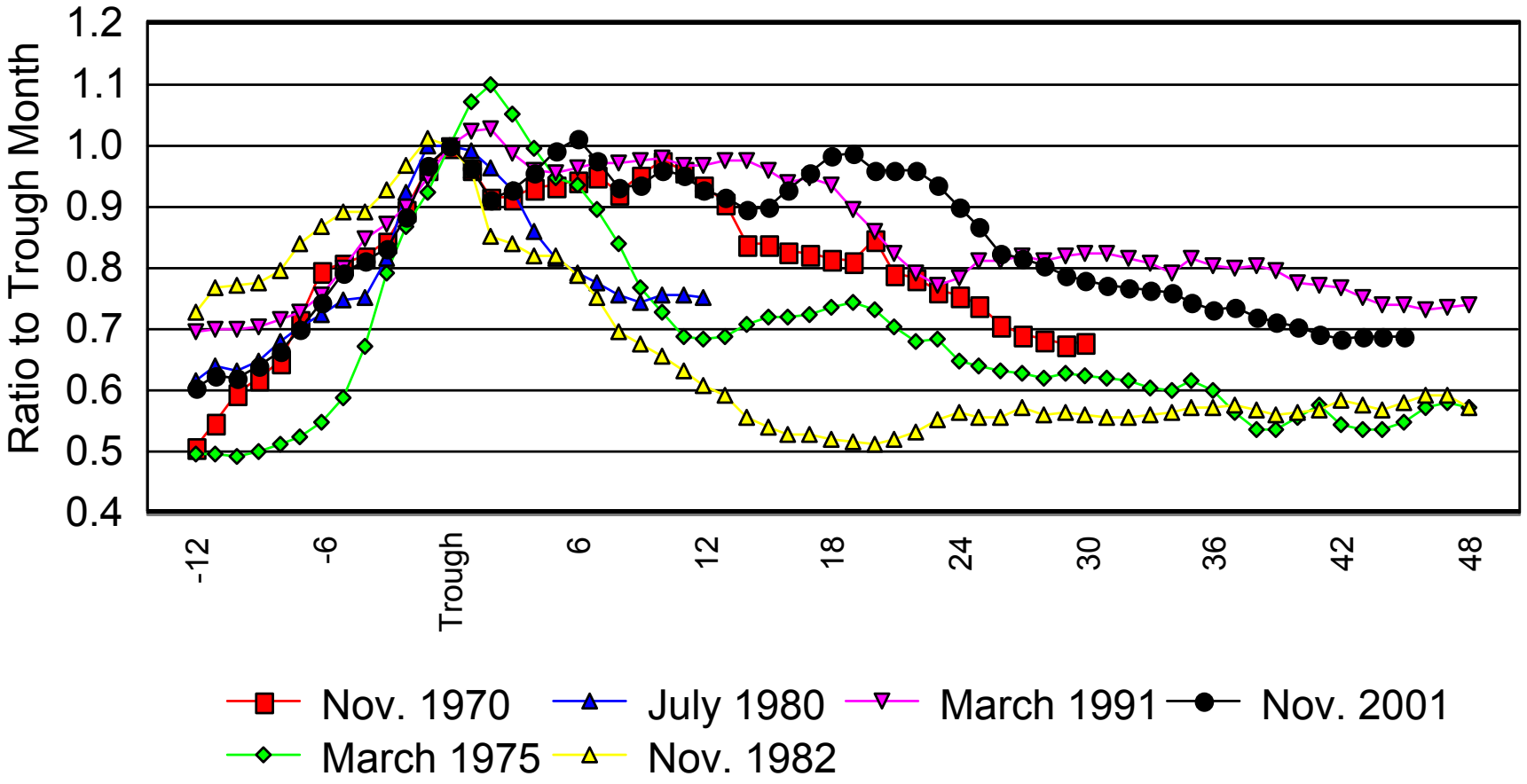


Chart 2. Monthly Claims in Six Recessions



UI Benefit Payments

- Regular UI payouts
  - roughly $20 billion in 1999 and 2000
  - roughly $30 billion in 2001
  - roughly $40 billion in 2002 and 2003
  - roughly $32 billion in 2004
- TEUC
  - roughly $10 billion in 2002 and 2003
  - roughly $1 billion in 2004

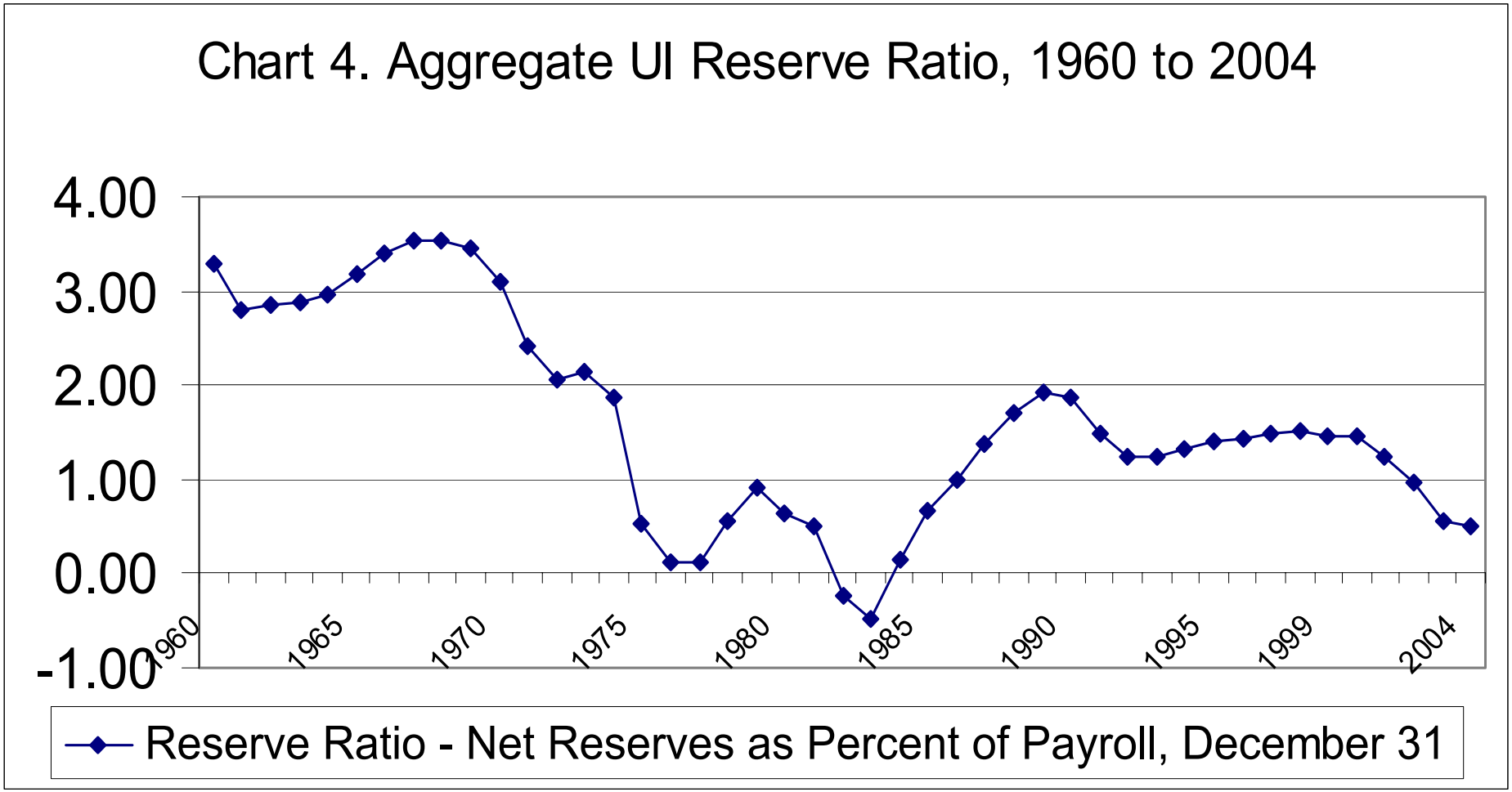
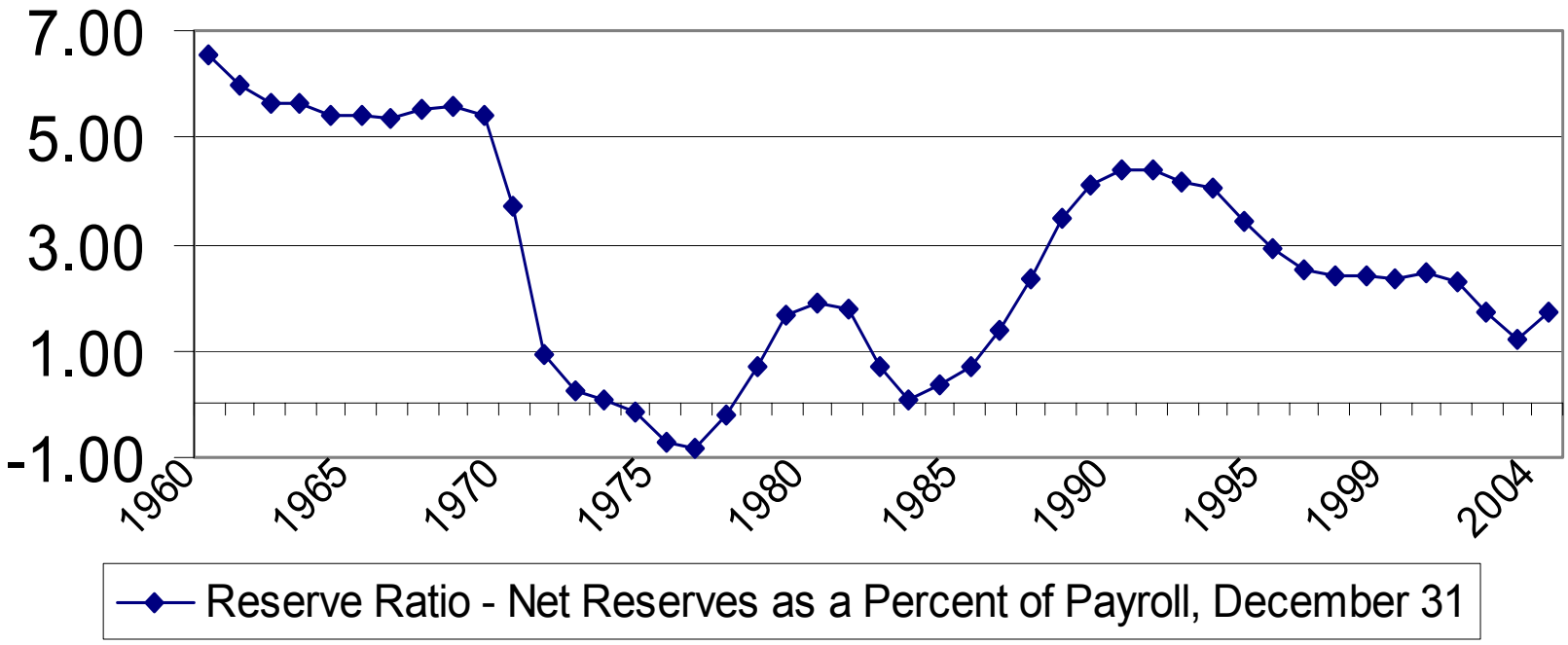


Chart 4. Aggregate UI Reserve Ratio, 1960 to 2004
4.00
3.00
2.00
1.00
0.00
-1.00
1960
1965
1970
1975
1980
1985
1990
1995
1999
2004
Reserve Ratio - Net Reserves as Percent of Payroll, December 31

Unemployment Insurance in Washington State

Chart 5. Washington State Reserve Ratio, 1960 to 2004



Washington's Trust Fund Balance

	Total Reserves	Reserve Ratio %
December 1999	1,753	2.33
December 2000	1,964	2.46
December 2001	1,796	2.28
December 2002	1,320	1.70
December 2003	972	1.24
December 2004	1,377	1.72
June 2005	1,795	2.24

Washington's UI Program: Strong Points: Benefits

- Good access to benefits – a high recipiency rate (beneficiaries/unemployment)
- Eligibility based on hours worked
- Presence of an alternative base period

Washington's UI Program: Weak Points: Benefits

- High benefit costs
- High volume of seasonal claims
- High repeat use of benefits (we believe)

Washington's UI Program: Strong Points: Taxes

- 1. High and indexed tax base
  - Helps to make revenues responsive
  - Lowers tax burdens on low wage employers

2. Responsive to trust fund drawdowns

   - Linked to use of four year benefit ratios

3. Recent improvements in benefit charging

   - reductions in both marginal labor force attachment and voluntary quit noncharges

Washington's UI Program: Weak Points: Taxes

- 1. High turnover of subject employers
  - Suggests there is "gaming" by some employers
  - SUTA dumping legislation will help but more analysis of the problem is needed
- 2. Substantial industry cross-subsidization
- agriculture and construction receive subsidies
- retail, finance, services & most others provide subsidies

The Cost of Unemployment Insurance in Washington

Determinants of the Costs of Unemployment Insurance

- The unemployment rate (or TUR)
- The UI recipiency rate (beneficiaries/unemployment or b/u)
- The replacement rate

  (weekly benefits/weekly wages or wb/ww)

The UI Cost Equation

- B% = (b/u)*(wb/ww)*(TUR/(100-TUR))
- B% = benefit cost rate, benefits as a percent of payroll
- (b/u) = the recipiency rate
- (wb/ww) = the replacement rate
- TUR = the unemployment rate (a percent)
- Double effect of unemployment because it both raises benefit payouts and lowers taxes

Washington and U.S., Costs of Regular UI: 1995-2004 Averages

	United States	Wash-ington	Wash./ U.S.
Taxes/Payroll %	0.66	1.26	1.91
Benefits/Payroll%	0.76	1.40	1.84
(b/u) – recipiency rate	.326	.429	1.32
(wb/ww) - replacement rate	.346	.413	1.20
TUR - unemploy-ment rate	5.07	5.98	1.18

Recent UI Events in Other States

Oregon – Legislation in 2005

- New employer tax rate reduced
- Changed tax rate schedule determination
  - $120 million reduction in employer taxes over 7 years
  - Will slow the rate of trust fund accumulation
- State reserve fund to be eliminated, assets to be transferred to Oregon's account at U.S. Treasury in June 2008 (currently $234 million)
- Indexed tax base changes to be rounded to nearest $100 (formerly to nearest $1,000)
- State emergency benefits (active to August 13, 2005) could pay up to 25% of regular benefits to exhaustees

California

- No important recent legislation
- Tax base remains $7,000
  - Taxable wages/total wages = 0.190 in 2004
- Major increase in weekly benefits since 2001

  Max WBA from $230 to $330 in Jan. 2002 and annual $40 increments to $450 in Jan. 2005
- Trust fund much lower than before recession
  - $5.8 billion - December 2000
  - $0.7 billion - December 2004
  - Small loan and repayment in 2004
  - $1.9 billion – June 2005

Idaho – Legislation in 2005

- Large drawdown of trust fund
  - Balance at U.S. Treasury decreased from $278 million in Dec. 2000 to $107 million in Dec. 2004
- New law prevented large increases in taxes
  - Employer taxes increase in 2005 by $11 million, not $100 million
  - Six year increase of $72 million, not $344 million
- Employee benefits reduced
  - Maximum weekly benefit in July 2005, $323 not $338
  - Benefit reduction of $72 million over six years
  - Future changes in max. WBA linked to changes in taxes
- State reserve fund to be phased out

Massachusetts – Legislation in November 2003

- Trust fund decreased from $2,131 million at end of 2000 to $58 million at end of 2003
- Small modifications of tax rate schedules
- Taxable wage base increased from $10,800 to $14,000 in 2004
- Tax schedule D to be used during 2004-2007 – higher tax rates than during 2003
- Established authority for a tax surcharge, can be operative after the Sept. computation date to prevent borrowing during Oct.Dec. and avoid interest on borrowing during Jan.-Sept.

Minnesota – Legislation in 2003

- Borrowing during 2003, 2004 and 2005
- Shorter computation period: from 5 to 4 yrs
- Changed mechanism for tax surcharges
  - trigger points for surcharges now a percent of wages
  - high surcharge rates to be percentages of taxes due
  - new "falling fund adjustment" surcharge
- 3 year freeze on maximum benefit for high paid (>$17 per hour) seasonal workers

- Considered, but did not adopt, quarterly solvency taxes
- Lower maximum weekly benefit for seasonal workers

Other State Provisions

- Widespread adoption of SUTA dumping laws
- South Dakota – tax rates can change quarterly whenever trust fund decreases
  - higher rates can remain until a "solvency" level is met
- Nebraska – adopted array allocation for UI taxes
- North Carolina – minimizing interest charges on borrowing through use of cash flow loans and issuing short term notes – 2003, 2004 and 2005
- Wyoming – permanently eliminated the waiting week

The UI Trust Fund Balance and Trust Fund Models

Three Models Have Been Used in Washington State

1. Employment Security Department model
2. National OWS model (Mercer model)
3. Model developed by Wayne Vroman
   - The first two have been used recently in Washington
   - Both make quarterly projections
4. When the three were compared in the past (1995-1996) their projections were similar

Main Uses

- Allow one to examine alternative scenarios
- Enforce logical consistency on projections
  - All components (variables) enter a model solution
- Allow one to examine intermediate run,

  e g., ten year developments

  Accuracy greatest for the closest years

Washington ESD Model

- Equations/decision rules for all important variables affecting the trust fund balance
- Forecasts with annual and quarterly detail
- Revenues projected using four factors:
  - 1. Taxable covered employment, 2. Average wages per employee, 3. Taxable wage proportion and 4. Average tax rate
- Benefits – historically less detail than taxes but now more extensive detail related to legislation of 2003-2005

USDOL Actuarial (Mercer) Model

- Quarterly fund projections for ten year periods
- Two main modules: 1) Projection program (PP) and 2) Financial Forecast Program (FFP)
- PP module projects 5 variables: 1) unemployment rate (TUR or IUR), 2. level of wages, 3) labor force, 4) maximum weekly benefit, 5) tax base
- FFP module makes detailed projections of total contributions, applicable future tax rate schedules and distribution of employers by tax rate interval
- Active support from USDOL-OWS actuaries

Vroman Model

- Annual model with five main modules: 1) labor market, 2) benefit payments, 3) tax revenues, 4) interest income and 5) trust fund accounting identity
- Was used in Washington in mid-1990s
- Quarterly detail in Washington was achieved using quarterly seasonal factors
- Model used most recently in Virginia (2002) and Montana (2003)

Models Used in the mid-1990s in Washington

- All three addressed the question of the effects of a major tax cut (roughly $400 million in reductions)
- All three models yielded similar findings
- Conclusion 1. Washington State trust fund would not be jeopardized by the proposed tax cuts
- Conclusion 2. Strength of the Washington UI funding is in the high tax base and the rapid response of taxes to trust fund drawdowns

Variables that are easy to project

- The labor force
- The inflation rate
- Weekly benefits and the replacement rate
  - Maximum weekly benefit is important (70% of lagged wages in Washington)
  - Statutory replacement rate is important(0.0385 of 2High Quarter Avg. in Washington – implies 50 percent replacement of 2HQ wages)
- The taxable wage proportion (TWP)
  - Tax base is most important determinant of TWP
  - Long run trend towards larger earnings inequality reduces TWP

Effects of associated statutes can be reliably estimated

- Raising or lowering the maximum WBA
- Raising or lowering the statutory replacement rate
- Altering the tax base

Variables that are hard to project

- The unemployment rate or TUR
- The UI recipiency rate (beneficiary/unemp.) ratio
  - Among the determinants are composition of unemployment by reason and duration, statutory factors, administrative activities
- Share of taxable wages in fixed benefit ratio intervals
  - Shares change over the cycle
  - Only a few recent cycles to base projections on
  - Washington has limited experience since enacting its 2003 legislation
- More uncertainty in benefit costs than in taxes

Some Questions

1. Do you need quarterly forecasts?
2. Do you need industry detail in forecasts?
3. How much responsiveness does Washington want in its UI revenues?

Big Question: What's the Worst Case (Costwise) to Contemplate?

- Historical experiences in Washington
- Highest costs in any twelve month period – 3.83 pct. Dec. 1971
- Highest 12 month costs in past 20 years – 2.01 pct. – Dec. 2002
- Highest 3 year average costs in past 20 yrs – 1.85 pct. Average of 1994, 2002 and 2003