FINAL REPORT OF THE
JOINT SUBCOMMITTEE STUDYING

The Funding Requirements of the Virginia Unemployment Compensation Act

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

SENATE DOCUMENT NO. 56

COMMONWEALTH OF VIRGINIA
RICHMOND
1994

MEMBERS OF THE JOINT SUBCOMMITTEE

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Delegate W. Tayloe Murphy, Jr., Vice Chairman
Senator Jackson E. Reasor, Jr.
Senator Richard J. Holland
Senator John H. Chichester
Senator Robert E. Russell, Sr.
Delegate Jerrauld C. Jones
Delegate Ward L. Armstrong
Delegate Richard L. Fisher
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DIVISION OF LEGISLATIVE SERVICES - Legal and Research

Arlen K. Bolstad, Senior Attorney
Mark C. Pratt, Research Associate
Cynthia G. Liddy, Executive Secretary

Administrative and Clerical

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Studying the Funding Requirements of the
Virginia Unemployment Compensation Act
To
The Governor and the General Assembly of Virginia
Richmond, Virginia
1994

TO: The Honorable George Allen, Governor,
and
the General Assembly of Virginia

I. INTRODUCTION

The 1993 General Assembly passed Senate Joint Resolution 234 (Appendix 1), continuing a joint subcommittee examining the funding needs of the Virginia unemployment compensation system. The joint subcommittee is composed of members from the Senate Committee on Commerce and Labor and the House Labor and Commerce Committee.

The joint subcommittee convened a meeting in 1993 to receive the Virginia Employment Commission's (VEC) annual briefing on the unemployment insurance trust fund's current and projected adequacy. In addition to its oversight of the trust fund, the joint subcommittee has historically served as a forum for labor and business discussions of unemployment insurance benefits and tax levels. When requested to do so by standing committees of the General Assembly, it has also reviewed pending legislation which would affect Virginia's unemployment compensation laws.

The following General Assembly members were appointed to the joint subcommittee: Senators Schewel from Lynchburg, R.J. Holland from Windsor, Chichester from Fredericksburg, Russell from Bon Air, and Reasor from Bluefield, together with Delegates Murphy from Warsaw, Jones from Norfolk, Armstrong from Martinsville, Fisher from Vienna and Wilkins from Amherst. Senator Schewel and Delegate Murphy served as Chairman and Vice-Chairman, respectively.

The joint subcommittee met in Richmond at the General Assembly Building on October 11, 1993. It received the VEC's briefing, presented by VEC

Commissioner Ralph Cantrell, on the unemployment insurance trust fund's ability to meet current and future unemployment compensation claims. Additionally, the VEC reported its findings concerning the "work sharing" program concept, a study begun in 1992 at the subcommittee's request. The VEC recommended that the concept not be incorporated into Virginia's unemployment compensation program.

The joint subcommittee learned that the unemployment insurance trust fund is currently at 64 percent of adequacy, but that the VEC projects this figure will rise to approximately 92 percent by 1997, assuming no significant changes in tax or benefit levels and a constant statewide unemployment rate of five percent or lower. The subcommittee received no recommendations from the VEC or any members of the labor or business communities for changes in any facet of Virginia's unemployment compensation program, nor did any subcommittee member suggest any. Accordingly, the joint subcommittee concluded its study for the year, recommending that the information it received be transmitted to the Governor and the 1995 Session of the General Assembly.

II. OVERVIEW OF THE UNEMPLOYMENT COMPENSATION PROGRAM

The Federal-State Unemployment Insurance System. The Federal Unemployment Insurance Tax Act (FUTA) was a core component of the federal New Deal legislation passed during the 1930s. FUTA established a federally prescribed, state-administered program providing temporary financial relief to working Americans involuntarily unemployed.

In Virginia, qualifying employees who become unemployed through no fault of their own are entitled to weekly benefits prescribed by state law. To qualify, Virginia employees must have earned at least $ 3,250 in total wages in two of the last four calendar quarters immediately preceding the quarter in which they became unemployed. At this minimum-qualifying level, such employees would receive a weekly benefit amount of $65 for up to 12 weeks of unemployment.

Virginia Program Administration. The Virginia Employment Commission (VEC) administers the Commonwealth's unemployment insurance program. Title 60.2 of the Virginia Code prescribes the VEC's duties, which include (i) collecting taxes to fund the program, (ii) processing and paying benefit claims, (iii) providing administrative adjudication of contested claims, and (iv) ensuring that the unemployment insurance trust fund is adequately funded. The VEC has additional duties which include operating a job service program, providing employment and unemployment statistics, and implementing the federal Job Training Partnership Act.

The VEC's administrative costs are paid from FUTA payroll taxes collected by the Internal Revenue Service. These moneys are deposited in the Employment Security Administrative Account (ESAA) for appropriation by Congress and allocation by the U.S. Department of Labor (DOL). The VEC administrative funding level is based upon DOL's estimate of the VEC's administrative expenses.

Trust fund taxes and benefit payments. Unemployment compensation benefits are paid from a trust fund comprised of taxes collected by the VEC from Virginia employers. It is used solely for paying unemployment compensation benefits to unemployed Virginians. Virginia employers with one or more employees pay trust fund taxes on employee wages up to $8,000. The taxes are "experience rated," i.e., those employers with higher levels of qualifying claims will pay higher tax rates. The minimum tax rate for Virginia's employers is 0.1 percent; the maximum is 6.2 percent. New employers, i.e., those without experience rating, are charged a minimum tax rate of 2.5 percent for the first three years.

Employers are also charged a "pool tax" to cover benefits paid out of the trust fund that cannot be charged to specific employers. Pool costs include (i) benefit payments made to employees of employers no longer in business and (ii) coverage of benefit payment costs that cannot be recovered from maximum-rated employers to whom they are attributable because of the 6.2 percent cap. In recent years, pool costs constituted 20 to 50 percent of total benefits. If the trust fund adequacy level is at 50 percent or more, however, pool taxes are offset by interest earned on the trust fund. The trust fund is also supplemented by a 0.2 percent "fund-building" tax whenever the fund's adequacy level drops below 50 percent.

III. ADEQUACY OF THE UNEMPLOYMENT INSURANCE TRUST FUND

The VEC is required by Virginia Code § 60.2-533 (copy attached as Appendix 2) to make a trust fund adequacy calculation each July 1. The statutory formula attempts to determine how much money the trust fund would need to pay unemployment compensation benefits for an 18-month period if (i) benefit payments were at the highest levels recorded during the past 25 years and (ii) the trust fund received no income during this interval. The statutory formula assumes this worst-case scenario in determining the trust fund's capacity to pay claims during prolonged periods of high unemployment. A detailed explanation of the adequacy calculation (prepared by the VEC) is attached as Appendix 3.

The VEC advised the joint subcommittee that it projected a July 1, 1993, trust fund balance at approximately 64 percent of adequacy. This compares with a 69 percent of adequacy level one year earlier. As stated earlier, VEC Commissioner Ralph Cantrell told the joint subcommittee that the trust fund adequacy level will improve in the near term, culminating in a projected 92 percent adequacy level by 1997. This projected increase assumes (i) a constant unemployment rate of approximately five percent and (ii) no changes in unemployment compensation benefits or taxes. VEC charts summarizing unemployment trends and trust fund data are attached as Appendix 4.

IV. VEC REPORT: WORK SHARING

VEC representatives also reported on its study of work sharing programs, a study requested by this joint subcommittee during its 1992 meeting. The purpose of a work-sharing program is to avoid layoffs during a company's short-term business decline by (i) implementing a reduced work week and (ii) using unemployment insurance benefits to supplement wages of workers affected by the reduced work week. This program has been tried, on a voluntary basis, in 17 states; legislation would be required for its implementation in Virginia.

As presented by the VEC, the program's more visible benefits, including forestalling layoffs and maintaining employees' income levels, are probably off-set by (i) trust fund tax increases resulting from recalculation of employer experience ratings, (ii) a short-term negative impact on the trust fund, and (iii) the increased administrative burden on employers implementing such a program. Accordingly, the VEC recommended that the Commonwealth not implement such a program at this time. A summary of the VEC's study is attached as Appendix 5.

V. SUBCOMMITTEE FINDING AND RECOMMENDATIONS

The joint subcommittee reviewed and discussed the VEC's briefing and report. No proposals to alter the existing unemployment compensation tax and benefit structure were received from the VEC, from any representatives of the business or labor communities, or from any member of the joint subcommittee. Accordingly, the joint subcommittee conducted no further meetings in 1993, directing that information furnished it be incorporated into its final report.

VI. APPENDICES

1. Senate Joint Resolution No. 234
2. § 60.2-533. Fund balance factor
3. Virginia Employment Commission letter, dated October 22, 1993
4. VEC briefing charts
5. Summary of Work Sharing Program Study

SENATE JOINT RESOLUTION NO. 234

Continuing the Joint Subcommittee Studying the Funding Requirements of the Virginia Unemployment Compensation Act.

Agreed to by the Senate, February 2, 1993
Agreed to by the House of Delegates, February 23, 1993

WHEREAS, the reserves in the Unemployment Trust Fund have been declining due to the extended recession and high unemployment in Virginia; and

WHEREAS, the reserves in the Fund continue to be less than the adequate Fund balance amount defined in the Virginia Unemployment Compensation Act; and

WHEREAS, the joint subcommittee, established pursuant to Senate Joint Resolution No. 14 of 1992, the Virginia Employment Commission, and business and labor representatives met in 1992 to review the current status and long-term projections for the Fund; and

WHEREAS, continuing economic uncertainty warrants continuing legislative oversight of the Unemployment Trust Fund to ensure its sustained solvency; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Joint Subcommittee Studying the Funding Requirements of the Virginia Unemployment Compensation Act be hereby continued.

The joint subcommittee's current membership shall continue to serve. Vacancies shall be filled by the Senate Committee on Privileges and Elections and the Speaker of the House, as appropriate.

All state agencies are requested to cooperate by providing any information and assistance that the joint subcommittee may require for the purpose of conducting this study.

The joint subcommittee shall complete its study by December 1, 1993, and shall submit its recommendations to the Governor and the 1994 Session of the General Assembly pursuant to the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

The indirect costs of this study are estimated to be $5,860; the direct costs shall not exceed $3,600.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.

§ 60.2-533. Fund balance factor.

A. As of July 1 of each calendar year, a fund balance factor, rounded to the nearest one-tenth of a percent, shall be determined as follows:

1. The balance which shall stand to the credit of the account of the Commonwealth of Virginia in the Unemployment Trust Fund in the treasury of the United States, including amounts withdrawn therefrom but not expended, shall be compared with the "adequate balance" as determined in subsection B of this section. The resulting percent shall be termed the "fund balance factor," except that if the percent determined is less than fifty percent, the fund balance factor shall be fifty percent.

B. As of July 1 of each calendar year, the Commission shall determine the "adequate balance" for the trust fund as follows:

1. For the twenty-five year period ending July 1 of the year of determination, the highest ratios of benefits divided by total wages of three separate consecutive four-quarter periods shall be averaged and multiplied by 1.5 to determine the fund adequacy multiplier. The fund adequacy multiplier shall be multiplied by the total wages for the year in question to determine the "adequate fund balance" for that year.

C. A fund building rate of two-tenths percent will be added to all experience rating rates established pursuant to § 60.2-531, to all assigned tax rates established pursuant to §§ 60.2-515, 60.2-526, 60.2-527 and 60.2-538 except that such rate shall not be applied if the fund balance factor determined pursuant to subsection B of this section exceeds fifty percent.

(1981, c. 606, § 60.1-85.1; 1986, c. 480; 1993, c. 249.)

OCT 25 1993

COMMONWEALTH of VIRGINIA

Virginia Employment Commission

Ralph G. Cantrell
Commissioner

703 East Main Street

P. O. Box 1358
Richmond, Virginia 2321 1
(804) 371-8050 Voice/TDD

October 22, 1993

MEMORANDUM

TO: Mr. Arlen Bolstad, Senior Attorney
Division of Legislative Services

FROM: Michael P. Maddox, Legislative Analyst

SUBJECT: Report of Committee on Unemployment Compensation

Per your request, I have attached a simple chart defining the methodology for determining the fund balance factor, or trust fund solvency level, under §60.2-533 of the *Code of Virginia*. While I considered the possibility of providing a graphic illustration of how solvency is determined, none that was really effective presented itself. My intent was to break the formula down to it's simplest terms.

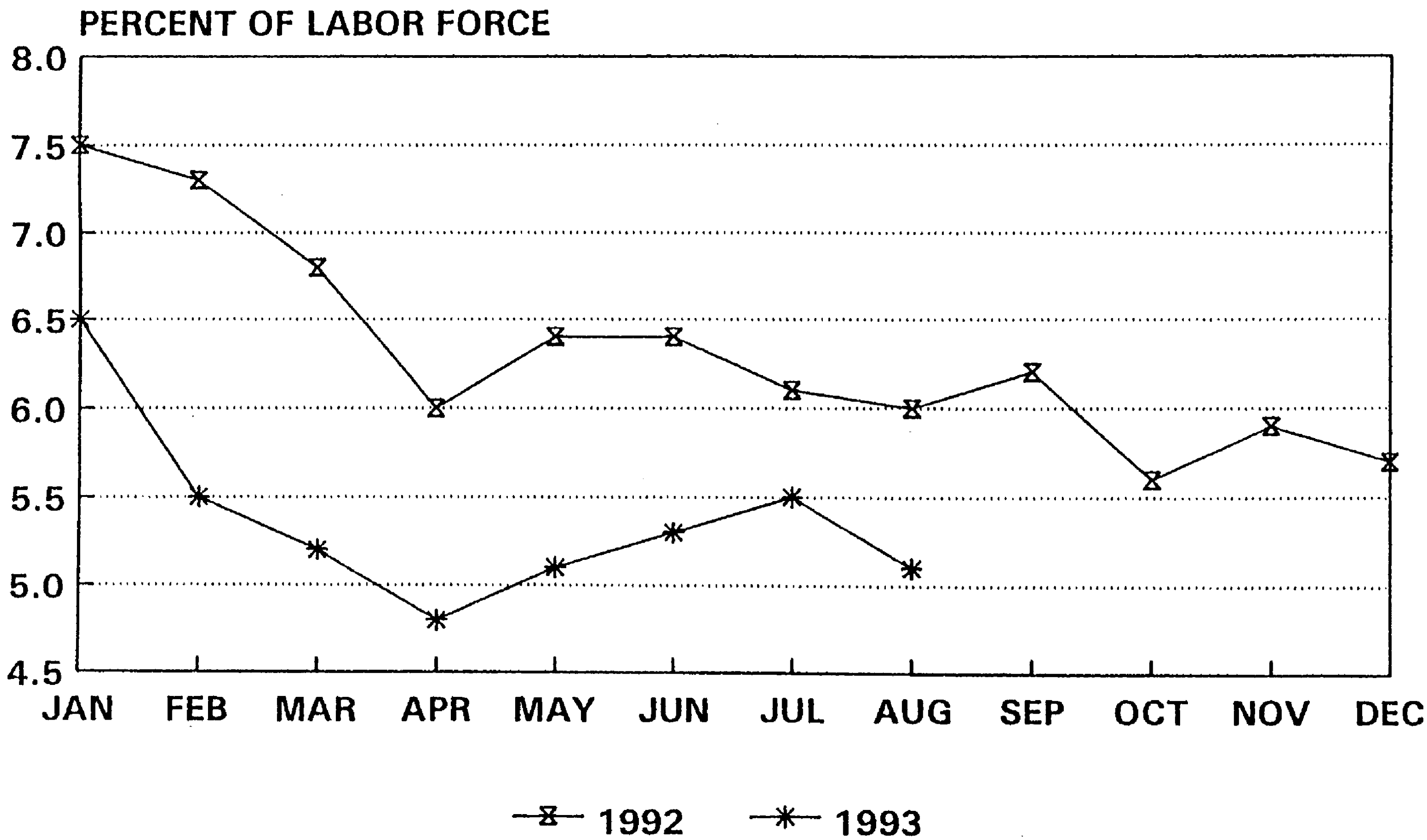
The basic definition of solvency is the average cost rate, multiplied by total wages for the most recent year, multiplied 1.5 times. The purpose of using 1.5 as a multiplier is to achieve a hypothetical 18 months (1.5 years) of benefit payments with no revenue to the trust fund. The cost rate helps to determine what those benefits would be, as a percentage of wages. By using the three highest ratios in the past 25 years as an average, the law hopes to capture a reasonable average for a high benefit period. The "solvency level" to which we refer simply means the percentage of solvency that the current trust fund balance represents (i.e. the actual balance of the trust fund divided by the "adequate balance" determined by the above formula).

I hope this is responsive to your request. Please let me know if this definition is not sufficient, or if you have further questions.

TRUST FUND SOLVENCY

- SOLVENCY = 1.5 X AVERAGE COST RATE X WAGES
- 1.5 - REPRESENTS 18 MONTHS OF BENEFITS WITH NO REVENUE
- AVERAGE COST RATE - AVERAGE OF 3 HIGHEST RATIOS OF BENEFITS TO TOTAL WAGES IN THE PAST 25 YEARS
- WAGES - TOTAL WAGES PAID BY TAXABLE EMPLOYERS FOR THE YEAR ENDING JUNE 30

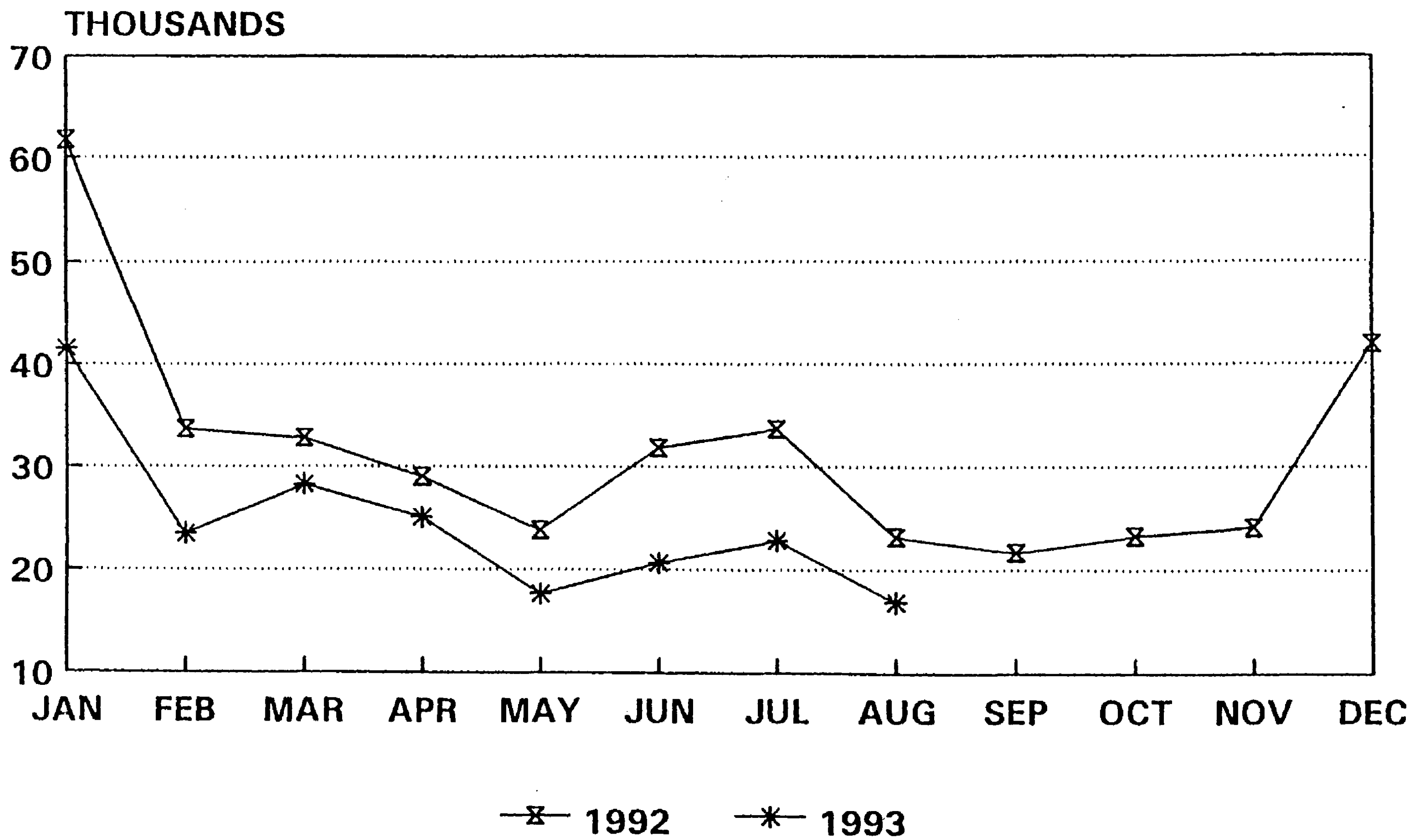
VIRGINIA'S UNEMPLOYMENT RATE
1992 VS. 1993



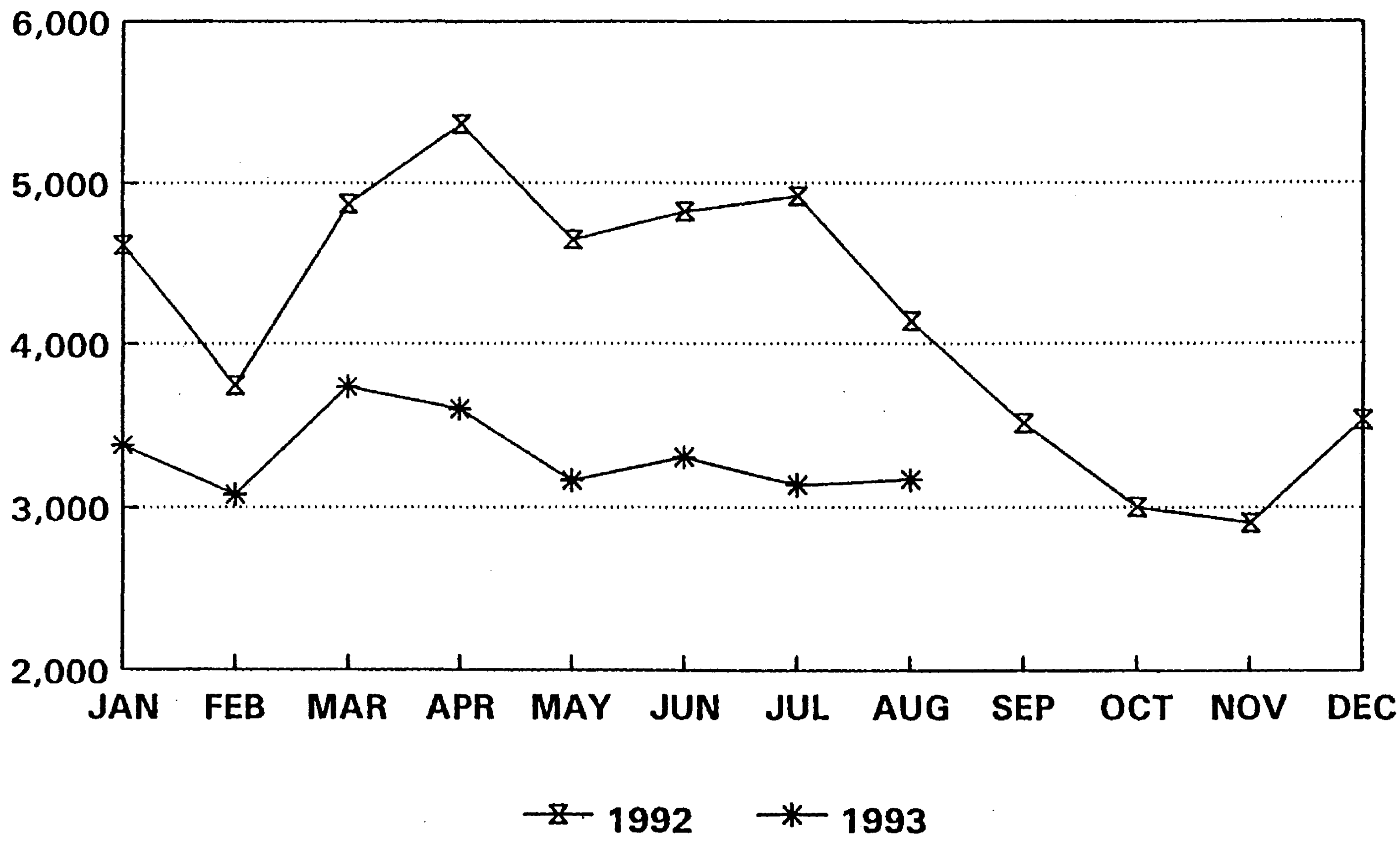
NOT SEASONALLY ADJUSTED

Appendix 4

U.I. INITIAL CLAIMS
1992 VS. 1993



U.I. FINAL PAYMENTS
1992 VS. 1993



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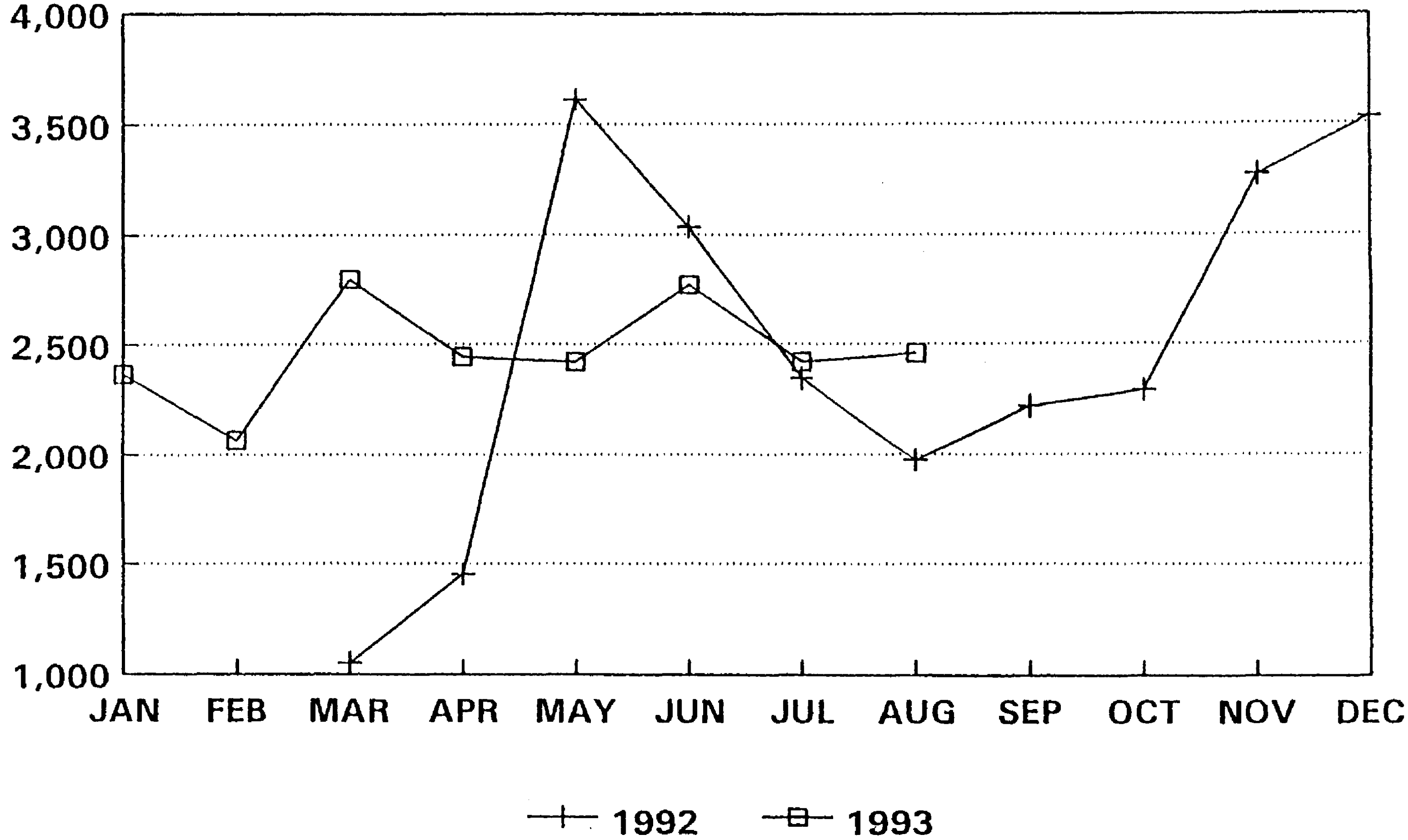
EXTENDED BENEFITS FINAL PAYMENTS

EMERGENCY UNEMPLOYMENT COMPENSATION ACT



100% FEDERAL FUNDING

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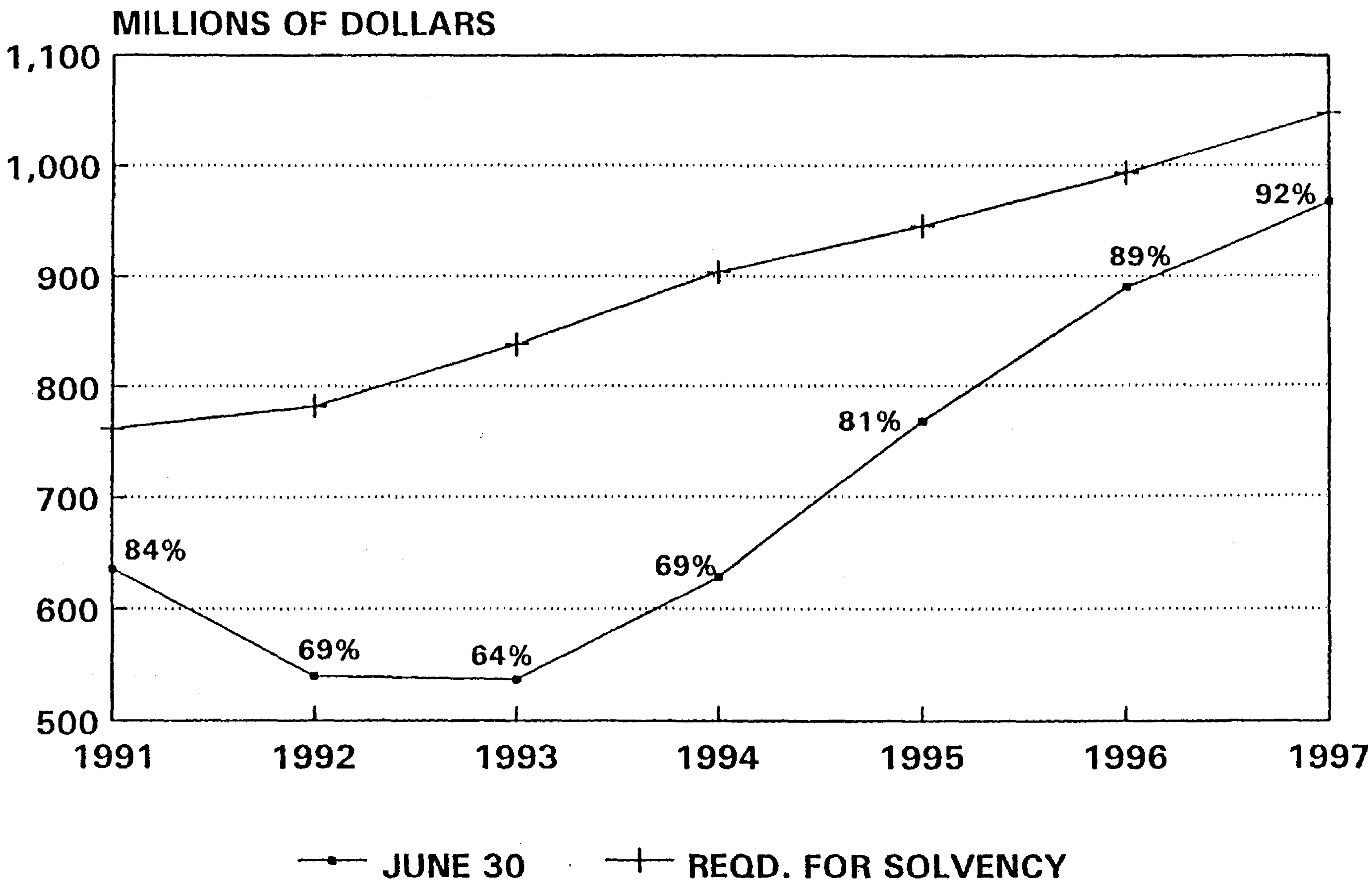
TRUST FUND DATA
(MILLIONS OF DOLLARS)

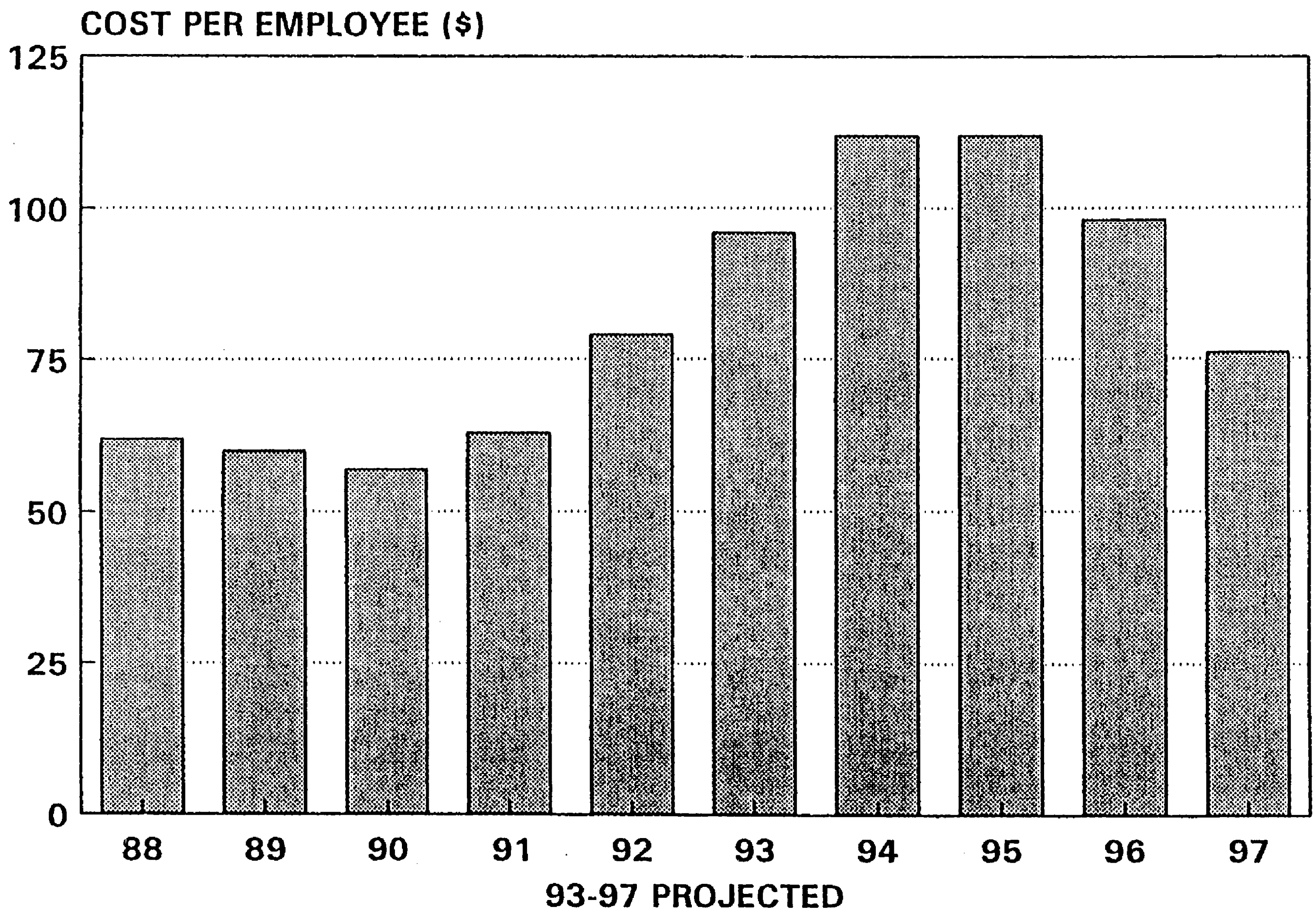
	1992	1993
JANUARY 1 BALANCE	$573.0	$498.2
TAX REVENUE	$177.3	$230.9
INTEREST REVENUE	$44.7	$38.5
BENEFITS	$296.9	$228.3
DECEMBER 31 BALANCE	$498.2	$539.3
SOLVENCY LEVEL (6/30)	69.0%	64.0%
EXTENDED BENEFITS	$150.2	$112.4*

*THROUGH SEPTEMBER

TRUST FUND BALANCES



AVERAGE TAX



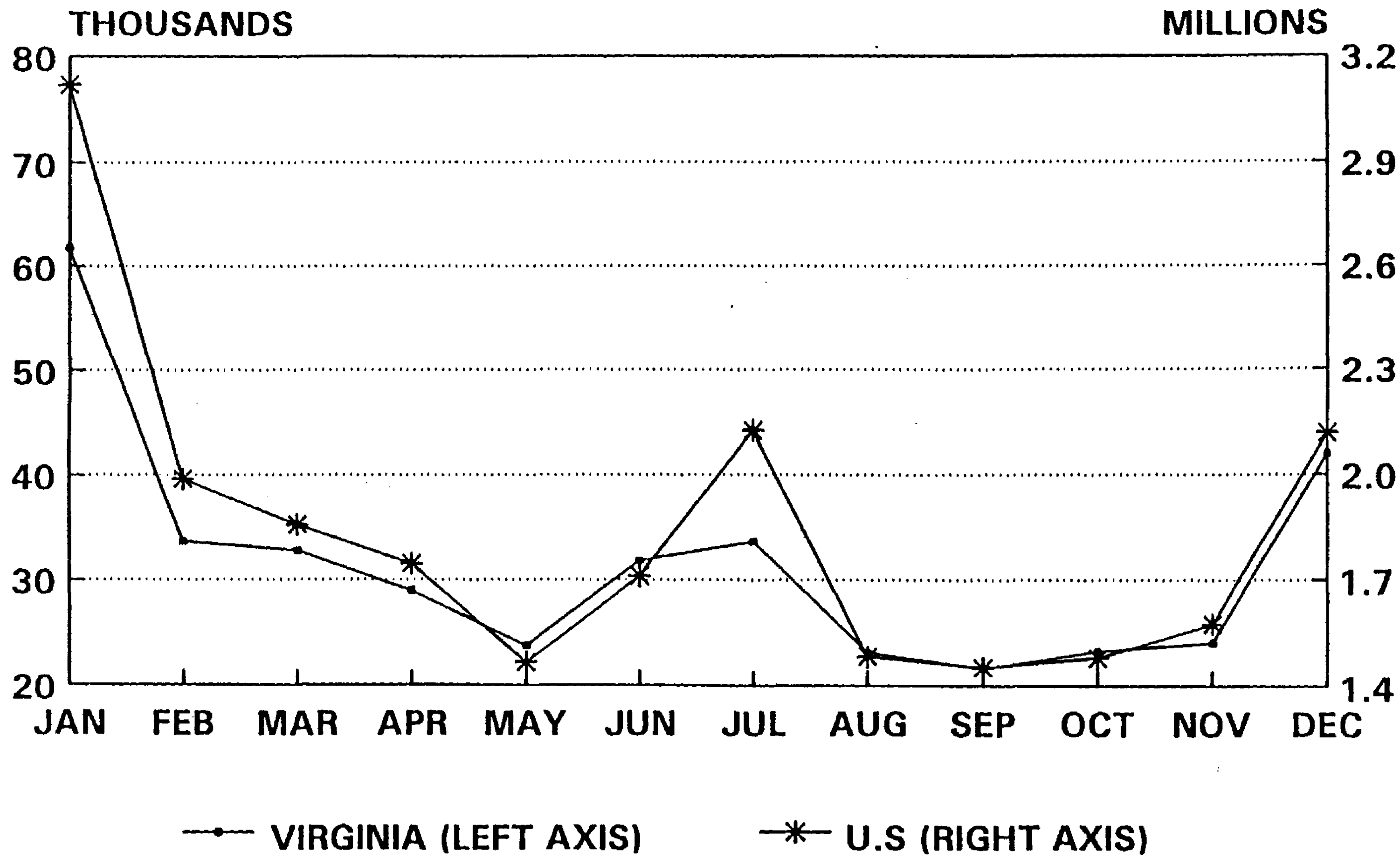
COST PER EMPLOYEE ($)
125
100
75
50
25
0
88
89
90
91
92
93
94
95
96
97
93-97 PROJECTED

AVERAGE TAX RATES BY INDUSTRY
EXPERIENCE-RATED ONLY

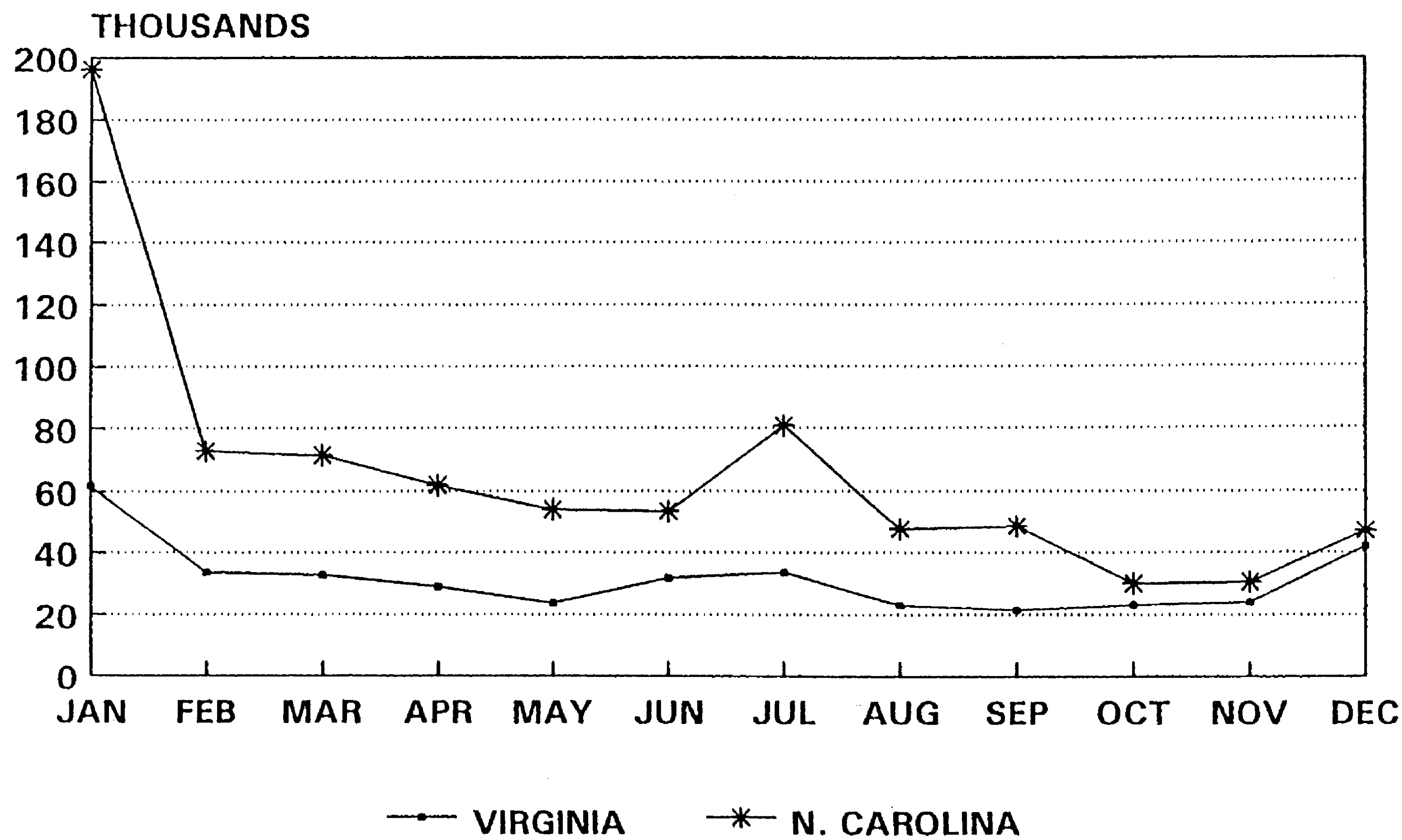
INDUSTRY	1992	1993
AG., FOR., FISH.	0.74%	0.92%
MINING	3.02%	3.26%
CONSTRUCTION	1.39%	1.85%
MANUFACTURING	1.08%	1.42%
TRANS., COMM., UTIL.	0.99%	1.17%
WHOLESALE TRADE	0.68%	0.90%
RETAIL TRADE	0.43%	0.57%
FIN., INS., R.E.	0.49%	0.63%
SERVICES	0.44%	0.57%

AVERAGE BASED ON NUMBER OF EMPLOYERS

1992 U.I. INITIAL CLAIMS
VIRGINIA VS. U.S.



1992 U.I. INITIAL CLAIMS
VIRGINIA VS. NORTH CAROLINA



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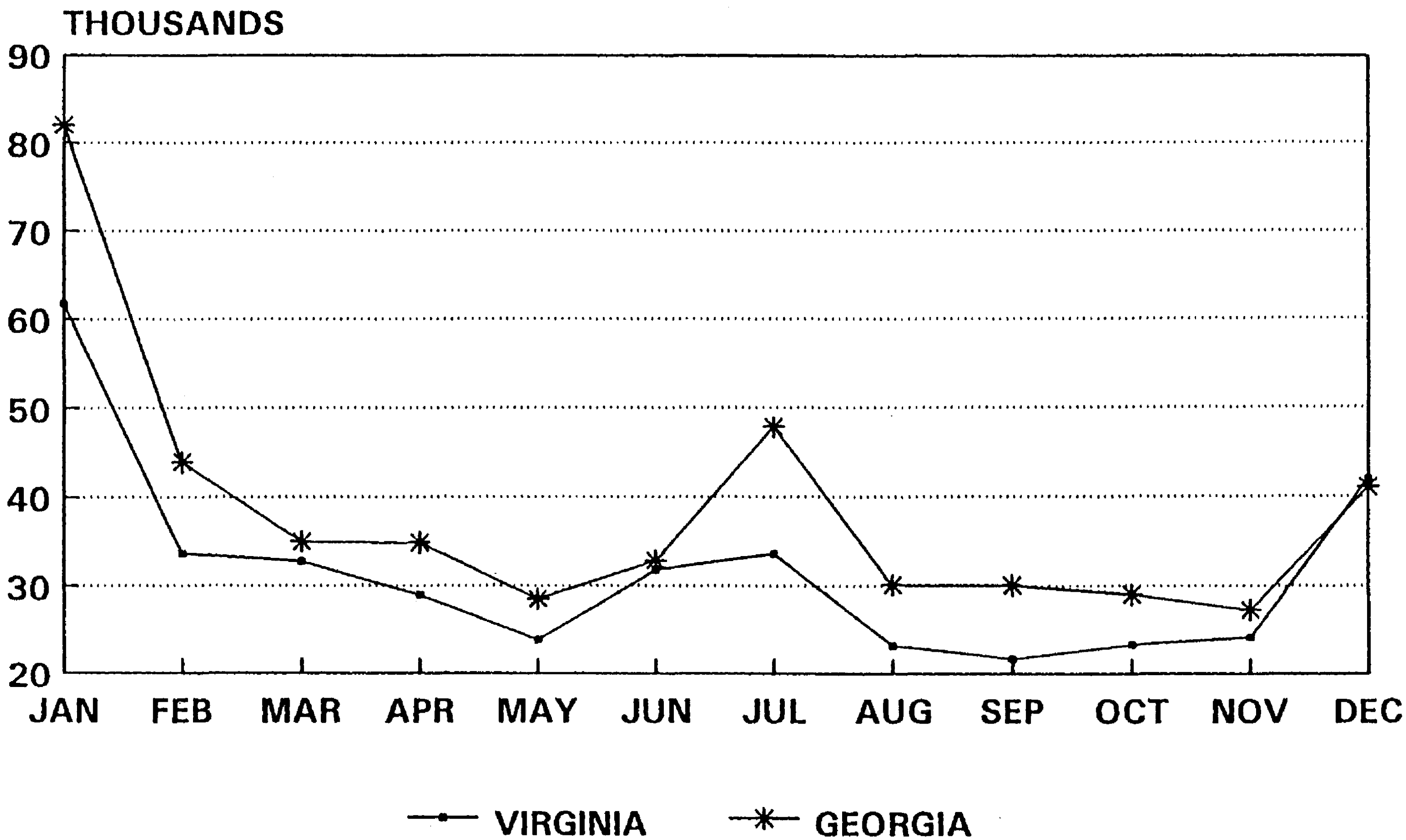
1992 U.I. INITIAL CLAIMS
VIRGINIA VS. GEORGIA



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WORK SHARING PROGRAM STUDY
(SHORT TIME COMPENSATION PROGRAM)

PURPOSE OF PROGRAM: Avoid layoffs when a company suffers a temporary business decline by

. implementing a reduced work week, and

. using Unemployment Insurance (UI) benefits to supplement wages of workers affected by the reduced work week.

PARTICIPATION: Employer participation is voluntary in states with Work Sharing Program.

HOW DOES WORK SHARING PROGRAM WORK:

. State Employment Security Agency (SESA) obtains approval from U. S. Department of Labor for State Work Sharing Plan.

. Employer submits its plan to SESA for approval.

. Employer designates unit(s) having reduced hours and notifies SESA when downturn occurs.

. All employees in designated unit, regardless of seniority, have hours reduced.

. Employer certifies reduced work amount for each employee and submits to SESA.

. Percent of worker's hours reduced equals same percent of weekly benefit amount paid. (Or Waiting Period credit is given if not served).

- If hours reduced 10%, worker paid 10% of weekly benefit amount.

. Work Sharing Benefits are charged to employer's account same as regular benefits.

WORK SHARING PROGRAMS STUDY RESULTS

NUMBER OF STATES CURRENTLY PARTICIPATING - 17

. **Average employer participation rate nationally - .18%.**

- Arkansas has lowest employer participation (9) - .02%.
- Maryland has 29 employers participating - .02%
- California has highest employer participation (3,112) - .36%.

. **Average employee Work Sharing coverage nationwide - .37%.**

- Vermont has lowest employee coverage (282) - .05%.
- Maryland has 3,069 employees covered - .17%.
- Arkansas has highest employee coverage (9,148) - 1.18%.

Note: Not all employees covered by Work Sharing Plan draw benefits.

WORK SHARING PROGRAM STUDY RESULTS

PROJECTED LEVEL OF PARTICIPATION IN VIRGINIA -

. **Using the national averages -**

- .18% X 132,850 employers = 239 employers.
- .37% x 2,659,541 employees = 9,840 employees.

. **Using Maryland averages -**

- .02% X 132,850 employers = 27 employers
- .17% X 2,659,541 employees = 4,521 employees

PROJECTED ADMINISTRATIVE COSTS IF PROGRAM ADOPTED = $338,254

. Implementation costs - $191,717

. Ongoing Administrative Costs (3.3 pos.) - $146,537

WORK SHARING PROGRAM STUDY RESULTS

PROS: . Workers who are ineligible for benefits because of excessive earnings under current regular UI programs are paid under Work Sharing.

. Program preserves employer's work force during decline by sharing available work.

. Program benefits large employers as tax increase is small or negligible.

CONS: . Small employers suffer large tax increases.

. Senior employees not normally affected in seniority based lay offs suffer.

. May negatively affect Trust Fund in short run as payout of benefits is increased.

. Paperwork burden for employers.

. Minimal participation by employers during three year study period.

VEC'S RECOMMENDATION:

. Do not pursue Work Sharing Program at this time because of

- minimal employer participation in all Work Sharing states,

- paperwork burden for employers participating in program (plans, designations, and certifications),

- equity concern that similarly situated individual not covered by plan would be ineligible, and

- questionable cost effectiveness of Virginia's projected implementation costs for so few employers.