

# **Review of State-Choice Functions**

**September 2007**



**Employment Security Department**  
WASHINGTON STATE

**Contact:** Office of Policy and Legislation, 360-902-9457

**Online:** [www.studies.go2ui.com](http://www.studies.go2ui.com)

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## Summary

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In the 2005-07 budget bill<sup>1</sup>, the Employment Security Department was directed to review “state-choice functions” in the unemployment-insurance system and to recommend whether the legislative mandates that require these functions should be repealed.

The department has done a thorough review of the value of state-choice functions<sup>2</sup> and believes the services add value. Further, the department does not believe that valuable state programs should be sacrificed to make up for unrelated federal funding deficits (described below). As a result, the department will not recommend legislative elimination of any of these functions for the 2008 session.

The Employment Security Department has seen substantial cuts in federal funding for the administration of the unemployment-insurance program over the past several years. Federal funding is no longer adequate to cover the cost of the program in Washington. The department has examined its costs, prioritized services, made cuts and relied on state funding to live within its federal allocation. In the past two years, the agency has significantly reduced staffing, closed a call center and reduced overhead costs. Future efforts focus on further automation and technology updates.

This report provides a general outline of state-choice functions, describes the current funding situation, details the activities the department has taken to reduce unemployment-insurance operating costs, and examines the department’s plans for savings in the upcoming biennium. The appendices include more detailed information.

## State Choice

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State-choice functions are those activities required by state law or administrative decision that are not required nor fully funded by the federal government, and which create additional financial pressure for the agency. Examples in Washington include making sure people look for work while they collect benefits, registering claimants with WorkSource so they find a job faster, and helping employers maintain their workforce during tough times.

## The Funding Situation

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The unemployment-insurance program is federally-funded. However, administration of the system has been under-funded by the federal government for several years.<sup>3</sup>

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<sup>1</sup> The department shall submit recommendations by September 1, 2007, to the office of financial management and the legislative fiscal committees for options reducing the costs of the state choice administrative functions for the 2007-2009 biennium. If these options require any statutory changes, the department shall submit agency request legislation to the appropriate legislative policy committees and fiscal committees by December 15, 2007. Senate Bill 6090, Chapter 518, Laws of 2005.

<sup>2</sup> See Appendix A.

<sup>3</sup> It is important to note that funding issues are not unique to Washington; most states are under-funded. Under the federal model, each function of the system is allotted a certain dollar amount and that amount is split among all states. Only the ten states with the lowest costs in a specific category receive full funding for that function. Others receive a percentage share. For each function, the total amount allotted is lower than actual state costs. See Appendix C for details.

Meanwhile, growing surpluses in the federal unemployment trust fund have been used, in part, to make the federal deficit appear smaller.<sup>4</sup>

In 2002, the federal Department of Labor introduced a new model<sup>5</sup> to allocate funds to states. Two aspects of the model directly affected Washington state:

1. Under this model, states see only short-term benefits for reducing costs. The model limits long-term benefits to states because those states that reduce costs and spend less, receive less funding in succeeding years.
2. The ranking process used in the model is designed to reward efficiency and discourage waste. However, it inadvertently promotes a “one-size-fits-all” approach and punishes states (including Washington) that have tailored programs to meet the needs of their workers and employers.

The long-term funding outlook for the unemployment-insurance program is tenuous at best. It does not appear that the federal government will change its allocation model or provide a sustainable level of funding.

Given the pressures on the federal deficit, and the discretionary classification of the unemployment-insurance program within the federal budget, the department does not expect a dramatic increase in federal administrative funding. If the state were to modify its program to match the award of funds, the unemployment-insurance program would look much different than it does today.

In 2005, the state legislature appropriated Reed Act funds to the department to cover shortfalls in administrative funding that were due to state-choice functions. The appropriation language also directed the department to examine those functions for possible cost reductions.<sup>6</sup>

### **Current Efforts to Reduce Operating Costs**

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The Employment Security Department has taken a number of steps to reduce its costs for administering the unemployment-insurance program. In an effort to preserve customer service, the department has elected to maintain front-line staff and focus on reducing overhead costs and maximizing efficiency through automation.

Over the last two years, the department has reduced operating costs by:

- Closing one of its three TeleCenters<sup>7</sup>.

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<sup>4</sup> See Appendix B.

<sup>5</sup> Resource Justification Model (RJM). See Appendix C.

<sup>6</sup> Engrossed Substitute Senate Bill 6090, Chapter 518, Laws of 2005.

<sup>7</sup> A TeleCenter is a call center that processes unemployment claims. TeleCenters take initial claims information, process continuing claims and adjudicate disputed claims. While the majority of services are provided over the phone and Internet, in-person services may be provided in cases of mass layoffs, plant closure, etc.

- Consolidating its district tax operation from 12 offices to 10 offices.
- Automating intake of basic information from people who call the TeleCenter.
- Increasing the proportion of claims filed over the Internet<sup>8</sup>.

These reductions are in addition to cuts made in 2003-2005, which include:

- Reduction of permanent and nonpermanent staff in the TeleCenters based on drops in workload.<sup>9</sup>
- Closure of four adjudication centers. Adjudication staff make decisions about eligibility for unemployment benefits.
- Change in the ratio of supervisor to staff in the TeleCenters (requiring a greater number of staff to be supervised by fewer managers).
- An agency-wide hiring freeze.
- Reduced funding for divisions within the agency that provide support for the unemployment-insurance program, but not direct services (e.g., communications support and human-resource services).
- Active marketing of electronic tax filing.
- Stricter guidelines around equipment replacements (limited to cases in which equipment ceased to function).

It is important to note that these collective actions have helped to limit the total use of Reed Act funds in the 05-07 biennium. Out of a Reed Act authorization of more than \$19 million, including \$12.6 million in state-choice funding, the department has only used \$6.8 million. The remaining funds have not been spent because of the savings generated by the department and because the department first spends money that was not spent previously and can be carried over into the next funding cycle.

However, these savings have been partially offset by mandatory ongoing cost increases for which the department did not receive additional funding, including:

- Salary increases for staff in 2006<sup>10</sup> cost an additional \$3.8 million the following year.
- Requirements to cover a greater share of retirement and other benefit costs as a result of legislative action in the 2005-07 biennium.<sup>11</sup>

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<sup>8</sup> As of May 2007, 40 percent of benefit applications and 44 percent of weekly claims were filed online.

<sup>9</sup> This was a "right-sizing" effort to ensure that the TeleCenters did not have more permanent staff than could be justified by the workload.

<sup>10</sup> Substitute House Bill 1128 (Chapter 522, 2007 Laws PV), 2007-09 operating budget: The Legislature did provide funding for the 2007-09 biennium for the department to cover the increased salary and benefit costs associated with the collective bargaining agreement, which significantly reduced the additional costs the department will be required to cover.

- Higher costs for services provided by other state agencies, such as the Department of Personnel's Human Resource Management System (HRMS) used for time reporting, and increased use of fee-for-service funding for the departments of General Administration and Information Services.

### **Future Efforts to Reduce Operating Costs**

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The department is committed to further reduce costs and will take the following actions during the current biennium:

- Offer direct deposit of benefits. This allows benefits to be electronically deposited in a claimant's bank account, eliminating the need to print and mail a check each week.
- Evaluate the feasibility of using cash cards to completely eliminate paper checks.
- Reduce or eliminate multiple mailings to one address.
- Stabilize telephone technologies in the TeleCenters to maximize staff efficiency.
- Acquire a call-monitoring system for the TeleCenters to improve customer service, use supervisor time more efficiently, improve complaint resolution, and assist in agent training.
- Increase the use of automated reports to reduce redundancy and increase individual efficiency and enhance performance.

### **Conclusion**

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To address the continuous decline in federal funding for the administration of the unemployment-insurance program, the Employment Security Department will work with stakeholders and legislators to identify solutions. Options include seeking additional Reed Act funding in the 09-11 biennium and/or seeking an alternate funding source.

At the same time, the department will continue to do everything it can to reduce costs and seek additional federal funding. Despite ongoing funding issues, the department does not recommend eliminating any state-choice functions at this time.

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<sup>11</sup> Most other state agencies receive higher legislative appropriations to cover such cost increases. Because the Employment Security Department is primarily federally funded, it usually does not and must cover the increased costs out of federal funding grants.

## Appendix A - State Choice Functions

### State-mandated functions

Washington maintains one of the most complex unemployment-insurance systems in the country.<sup>12</sup> The

legislature has made a conscious decision to create a system that offers more services than required under federal law and to ensure fairness throughout the system.

The federal government does not fully cover the costs of state-mandated programs or services. As a result, the legislature has appropriated funding for several functions at a cost of more than \$12.3 million each biennium.<sup>13</sup>

Function	Administrative cost per biennium
Monitoring job search	\$2,950,000
Relief of benefit charges	\$659,000
Alternate base year	\$1,477,000
Cancel wage credits for gross misconduct	\$1,148,000
Shared work program	\$1,055,000
Eligibility based on hours worked	\$524,000
Tax reports filed on paper forms	\$1,169,000
Registering all claimants with WorkSource	\$703,000
Benefits for temporarily, totally disabled (TTD) workers	\$317,000
Toll-free calls for claimants	\$2,346,000
<b>Total</b>	<b>\$12,348,000</b>

### Monitoring Job Search

State law (RCW 50.20.240) requires the department to verify that people look for work while they collect unemployment benefits. To accomplish this:

- Claimants are called into WorkSource, where staff review their job-search logs for a given week.
- Unemployment-insurance staff follow-up with a smaller sample of employers to verify the claimant applied for a job with that employer.
- Claimants must provide job search logs for each week they claimed if they miss their review appointment or staff find they did not look for work during the initial review.

If the claimant did not look for work as required or did not apply with an employer listed on the job-search log, he or she is denied benefits for that week(s) and must repay the money received.

From July 2005 to June 2006, 55,000 job-search reviews were conducted statewide. As a result, \$8.6 million in overpayments were identified. The department consistently collects 64 percent of new overpayments and would expect to recover \$5.5 million for the year. Neither job search nor job-search monitoring are federally required, and their

<sup>12</sup> Example: In most states, a person who quits his or her job cannot collect unemployment benefits and all quits are treated the same. In Washington, each claim is considered on a case-by-case basis. This requires staff to explore the details of every claim, including asking additional questions of the claimant and contacting the employer.

<sup>13</sup> Not included in the department's base funding.

costs are not fully covered by federal funds. However, studies show that closely monitoring eligibility has several positive results.

- It saves employers money because they are not paying for benefits for people who do not follow the rules.
- It provides an incentive for claimants to become re-employed.
- It ensures that claimants are not receiving benefits to which they are not entitled.

During the job-search review, claimants also receive job referrals and learn about other services offered through WorkSource, increasing their chances of finding a new job.

**Cost:** \$1,475,000 per year; \$2,950,000 for the biennium.

### **Relief of Benefit Charges**

Under federal law, states must have an experience-based system to calculate tax rates for employers. Employers either pay taxes to support the unemployment-insurance program or they reimburse the trust fund for benefits paid out. The rates for taxable employers depend on their experience with unemployment claims. This is determined by calculating the ratio of benefit charges to taxable wages.

Under Washington law (RCW 50.29.021), employers may request relief from benefit charges under certain circumstances (e.g., the claimant didn't look for work while collecting benefits, the claimant was a victim of a crime or domestic violence, the business closed because of a natural disaster). If granted, those charges will not be used to calculate the employer's tax rate.

In fiscal year 2005, Washington employers were relieved of \$174.5 million in benefit charges (45,686 claims). This serves to keep tax rates low for those employers and ensures that employers are not unfairly charged for unemployment-insurance costs.

Eliminating this provision would have the greatest effect on employers that work to control their costs by actively monitoring and requesting relief of charges. It would have little effect on employers that do not work to control their costs, do not have good personnel practices, or are in seasonal industries, and often already have the highest tax rates.

The federal government does not require states to grant relief of benefit charges, and does not fully reimburse the costs incurred in administering the service.

**Cost:** \$329,500 per year; \$659,000 for the biennium.

### **Alternate Base Year**

In Washington, a person must work at least 680 hours in the base year<sup>14</sup> to qualify for unemployment benefits. If the person worked less than 680 hours in the regular base

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<sup>14</sup> Benefits are calculated based on wages from the previous base year, not the calendar year. The base year is the first four of the last five calendar quarters. For example, if you applied for unemployment benefits on January 5, 2007, your base year would include wages earned from October 1, 2005 through September 30, 2006.

year, Washington law (RCW 50.04.020) offers an alternate base year that includes the last four quarters. This option allows workers an additional option to qualify for benefits.

If this provision were eliminated, unemployed people without a long work history or with interruptions in their work history would have to wait up to three months to establish a claim or may not be eligible at all. About 9 percent of all claimants (approximately 31,000 people) use the alternate base year to qualify for benefits each year.

Federal law does not require states to offer alternate-base-year claims. The cost to administer this option is not fully covered by federal funds.

**Cost:** \$738,500 per year; \$1,477,000 for the biennium.

### **Disqualification from Benefits**

If a person voluntarily quits a job<sup>15</sup> or is fired because he or she did something wrong<sup>16</sup>, he or she cannot collect unemployment benefits right away. Instead, the person must:

- Wait seven weeks and earn seven times the weekly benefit amount if he or she **quit without good cause**.<sup>17</sup>
- Wait ten weeks and earn ten times the weekly benefit amount if he or she **was fired for misconduct**.<sup>18</sup> If the act was classified as **gross misconduct**, the wages from that employer are not used to calculate benefits or the person loses 680 hours of wage credits.<sup>19</sup>

Because the disqualifications are different under different circumstance, the federal government requires the department to make a reasonable effort to contact each employer directly. If the employer does not reply to the standard notice sent to employers to verify why someone is no longer working, the department calls the employer to get the information. As a result, the department must make more than 80,000 calls to employers each year, the cost of which is not fully covered by federal funds.

**Cost:** \$574,000 per year; \$1,148,000 for the biennium.

### **Shared Work**

The Shared Work Program was established in state law (RCW 50.60) to help employers retain a skilled work force during tough economic times by providing partial unemployment benefits to workers whose hours have been reduced. The program also helps workers avoid full unemployment and retain their purchasing power through economic downturns.

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<sup>15</sup> There are some instances in which there is no disqualification period and people can collect benefits if they quit their job. For example, a person may quit because his or her spouse is in the military and is relocated; if work hours are reduced; or if a child becomes very sick or disabled and requires care.

<sup>16</sup> Includes insubordination, chronic tardiness, poor attendance, engaging in illegal activities, etc.

<sup>17</sup> RCW 50.20.050.

<sup>18</sup> RCW 50.20.066 (1).

<sup>19</sup> RCW 50.20.066 (2).

In 2003, the department conducted a study of the Shared Work Program. The study found that employers that participated in Shared Work from 2001 through October 2003:

- Retained employees at a higher percentage rate than employers as a whole.
- Had a higher survival rates than employers as a whole.
- Did not have a negative impact on the unemployment trust fund because benefit payments were recaptured through higher tax payments in later years.

Shared Work is a labor-intensive program. It is more expensive to administer than traditional unemployment-insurance because employers must provide a range of information, the department must review and approve employer plans, and must often make ongoing adjustments.

The Shared Work Program is not federally required and is not fully covered by federal funds.

**Cost:** \$527,500 per year; \$1,055,000 for the biennium.

### **Eligibility Based on Hours Worked**

Washington is one of two states (the other is Oregon) that uses the number of hours a person works to determine whether he or she is eligible for unemployment benefits. Other states base eligibility on wages. Basing eligibility on hours worked often requires staff-intensive processes.

State law (RCW 50.04.030) requires employers to report both hours worked and wages earned. Figuring hours worked is often complicated because of the various types of wages paid by employers (e.g., salary, hourly, severance, bonus, vacation). As a result, employers frequently misreport hours and their workers are deemed ineligible for benefits. When this happens, the department's intake staff must correct hours. This involves asking the claimant additional questions, calculating actual hours worked and reading additional material to the claimant.

When the claimant worked in another state, the process is even more staff-intensive because other states only report wages. In this case, the department calculates hours by dividing the wages reported by the federal minimum wage. Because many workers earn more than the federal minimum wage, this often results in the worker getting credit for more hours than he or she actually worked and more phone time because the process must be explained to each claimant. It also results in more calls to the TeleCenter because the claimant disagrees with the calculation.

Federal law does not require states to consider hours when determining eligibility, so does not fully cover the additional costs for staff time. However, when eligibility is determined solely on wages, workers with very low wages are at risk because they are less likely to qualify for benefits if they lose their jobs.

**Cost:** \$262,000 per year; \$524,000 for the biennium.

## **Tax Reports Filed on Paper Forms**

Employers in Washington currently have the option to file quarterly tax and wage reports electronically or on paper forms. Of the approximately 200,000 employers that report each quarter (representing 2.5 million employees), more than half (56.5 percent) elect to file electronically (representing 88.9 percent of all employees). This share continues to grow as electronic options become more user-friendly and more employers have access to the Internet.

Processing electronic tax reports is much less staff-intensive than processing reports on paper forms. Electronic data go directly into the department's tax computer system and require little or no manual processing. Paper forms, on the other hand, must be reviewed, edited and scanned through an optical character-recognition process. The data are then verified or corrected manually. It is sometimes necessary to hand-key the entire report, including hour and wage details for each employee.

In an effort to reduce the number of employers who continue to file reports on paper forms, the department actively encourages them to file electronically both through central outreach efforts and through customer contact by tax staff throughout the state. The department also is developing an enhanced online system that will allow users to securely access previously submitted data and other account information, providing additional incentive to file electronically. The new system will be available in early 2008.

Despite the benefits, there also are drawbacks to requiring employers to file electronically. It could present a hardship for small businesses and would likely result in staff-intensive technical support for businesses that make the switch. Realistically, it also would require a transition plan and additional funding to implement. Further analysis indicates that requiring mid-and large-size employers (those with 20 or more employees) to file electronically would reduce the department's burden by about 18,000 reports each year, while affecting only about 4,500 employers.

There is no federal law regarding unemployment tax reporting, so the extra costs associated with processing paper reports are not fully covered by federal funds.

**Cost:** \$584,500 per year; \$1,169,000 for the biennium.

## **Registering all Claimants with WorkSource**

Washington law (50.20.230) requires the department to register most claimants<sup>20</sup> for work in its electronic WorkSource system. To do so, the intake agent must ask each person who applies for unemployment benefits a series of question to help match him or her with job openings:

- What is your highest level of education?
- Do you consider yourself disabled according to the Americans with Disabilities Act of 1990?
- Do you have a disability that is service connected?

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<sup>20</sup> Some claimants are not required to look for work while they collect benefits, such as people in approved training programs and people who belong to a referral union.

- Are you a veteran of the U.S. military?
- What was your primary occupation while working at (employer that paid the most wages)?

The first four questions require the agent to access a help screen and select and input the appropriate code. The last question requires the agent to look up and input a nine-digit occupation code. That information is then transferred to the agency's WorkSource system.

In many cases, this service helps people return to work more quickly. In some cases, claimants would register with WorkSource on their own; many would not. Most would suffer some delay in being called for job openings.

The federal Department of Labor requires only a two-digit occupation code, which is much less time consuming to find than the nine-digit code used in Washington. Therefore, the additional staff time is not fully covered by federal dollars

**Cost:** \$351,500 per year; \$703,000 for the biennium.

### **Benefits for Temporarily, Totally, Disabled Workers**

State law (RCW 50.06) provides unemployment benefits to people who have suffered a job-related injury, have been the victim of a crime or have been temporarily totally disabled due to a non-work-related injury or illness. These benefits do not take the place of industrial insurance or other benefits, but allow people who no longer collect industrial insurance to collect unemployment while they look for work.

In many cases, people have been out of work for several years, so do not qualify for benefits based on wages from the current base year. Instead, their unemployment claims are based on wages from the base year that was in effect at the time of injury or when time loss began.

Because these claims are not standard, the process is more staff-intensive. The intake agent must see if a claimant is eligible for the program, gather additional information, explore options with the claimant and then input the information. The claimant must complete several forms, which the department must process. Because this type of claim is more complicated, a single claim often takes several weeks to complete.

Federal law does not require states to provide these benefits, so does not fully cover the cost of administering them. However, if the provision were eliminated in Washington, each year roughly 3,500 injured workers or crime victims would not be able to collect unemployment benefits.

**Cost:** \$158,500 per year; \$317,000 for the biennium.

### **Toll-free Calls for Claimants**

In 1998, state law (RCW 50.20.140) was changed to allow people to claim unemployment benefits over the telephone. While the law does not specify that people be allowed to call toll-free, the department committed to providing this service when it moved claims out of local offices and into call centers.

When the TeleCenters first opened, the department maintained both local and toll-free phone lines. In July 2005, the department consolidated all phone lines into a single toll-free number. This simplified things for claimants and allowed the department to better manage workload and reduce wait times in areas of the state with higher call volumes.

The move to a single toll-free line did increase toll charges, but the majority of the cost is offset by the reduction in the number of phone lines. The department also continues to encourage claimants to claim on the Internet to reduce costs.

Federal law does not require states to provide toll-free services to unemployment claimants, so does not cover the cost. Currently, nine other states operate call centers. None of them offer toll-free service to claimants.

**Cost:** \$1,173,000 per year (no FTEs); \$2,346,000 for the biennium.

## **Additional State-Choice Function**

### **Second Level of Appeals**

The department continues to review its programs and services to identify function that are not fully funded by federal dollars, but add significant costs to unemployment-insurance operations. In addition to the functions covered by legislative Reed Act appropriations, the department has identified one other area: second-level appeals.

In Washington, claimants and employers have two levels to which they can appeal if they disagree with the department's decision regarding unemployment benefits or unemployment taxes. The Office of Administrative Hearings (OAH) handles all initial appeals. If the person disagrees with OAH's decision, he or she can appeal to the Commissioner Review Office (an independent review function in the department). Only then is the case elevated to the courts.

Federal law requires only one level of appeal, The higher costs of a second level of appeal are not fully funded. However, many cases are settled in the second level of appeal in Washington, thereby avoiding costly litigation. Many states only provide a single level of appeal prior to court action.

**Cost:** \$1.2 million per year; \$2.4 million for the biennium.

## Appendix B - Federal Funding Context

### The Federal Trust Fund

Employers across the country pay a federal unemployment tax (FUTA) to pay for administration of the unemployment-insurance system. The money is held in the federal unemployment trust fund to cover administrative costs, to provide loans to states that run out of money in their own trust funds and to help pay for extended benefits.

In the 1950s, Congress passed legislation (the Reed Act) that provided that when the federal trust fund reached a certain level, excess funds would be distributed to the states. This has rarely been the case. Instead, Congress and succeeding administrations have opted to increase the level at which funds would be distributed to the states, resulting in significant reserves.

### Allocation of Resources

For many years, the federal government used time-motion studies to benchmark the allocation of administrative funds to states. In the mid-1980s, the Department of Labor suspended time-motion studies. States, such as Washington, that automated functions and increased efficiency were able to establish modest reserves that could be carried forward from year to year. They also could use the savings to finance additional automation and quality improvements. As a result, states with more complex and costly systems were able to maintain fiscal stability through automation, despite the problems with the federal funding system.

In the 1990s, the Department of Labor and the states sought to justify increased funding (from built-up reserves in the federal trust fund) by accurately documenting state expenditures. For this purpose, the department developed a resource justification model<sup>21</sup> to demonstrate the states' actual fiscal conditions.

Rather than resulting in funding of actual costs, the model was implemented in 2002 with no increase in the administration allocation. The result was a redistribution of inadequate funding among the states.

Washington was particularly hard hit (a loss of \$4.8 million out of a then \$69 million base). Despite operating with significant automation, our state's administrative costs are higher than other states because of extensive state mandates<sup>22</sup>, undertaken to increase the quality of services provided.

It is important to note that administrative funding problems are not caused directly by the model itself, but by ongoing and significant federal under-funding of unemployment-insurance administration. A key reason for the shortfall is that actual costs are recalculated based on 1995 wages (ignoring inflation) before they are input into the model. The result is an allocation that was \$271 million less than actual costs in 2007 and is projected to be \$208 million less than documented costs in 2008.

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<sup>21</sup> The allocation process is detailed in Appendix C.

<sup>22</sup> See Appendix A.

### **Looking forward**

By the end of 2008, the federal trust fund is projected to contain a total of \$38 billion - many times more than would be required to meet all statutory requirements for all states.

However, it is unlikely that any of this money will be allocated back to the states because under the unified federal budget, this surplus offsets the federal budget deficit. As a result, there is ongoing congressional and administration interest in limiting expenditures from these accounts.

Another reason the allocation is unlikely to increase is that administration of the unemployment-insurance system is appropriated in the same budget bill as the highly visible issues of health and education programs. Under current "pay-go" rules, increases in one program must be paid for with reductions in another. As a result, any increase in unemployment-insurance funding would involve cuts in health, welfare or education programs, making an increase both difficult to achieve and unlikely.

## Appendix C - Federal Allocation Process

The federal funding system for state administration of the unemployment-insurance system operates in the following way:

- States use the resource justification model (RJM) to document actual costs. These costs<sup>23</sup> are used to calculate funding for the state not for the following year, but for two years later (i.e., 2007 costs dictates 2009 allocations).
- For a given year, Congress appropriates a lump-sum amount to be spread across all states.<sup>24</sup>
- Each year the appropriation has fallen short of actual costs. This results in a shortfall amount, which is distributed among the states and among the diverse unemployment-insurance functions that states operate.
- Non-personal services account for 20 percent of total administration costs nationally. These costs must bear 20 percent of the funding deficit. In this case, an across-the-board reduction is calculated and each state receives that percentage less in funding, below its documented costs for non-personal services.
- Staff-operated services are divided into major categories, such as initial claims or non-monetary determinations. In each category, states are compared. The 10 states with the lowest costs receive full funding.<sup>25</sup> Other states receive less than full funding, with the highest cost states in each category receiving significantly less than full funding. This system is used to increase system efficiency. It also is used to allocate to the states the share of the deficit linked to each function.

As a result of this process, most states receive less than their full costs for administration.

Under this system, low-cost states in each category receive a higher percentage of funding compared to their costs, than do high-cost states. Washington's unemployment-insurance system is relatively high-cost due to administrative functions required under state law that are not reimbursed by the federal government.<sup>26</sup> The allocation system works to increase state efficiency, but has no provision for quality. Currently, the system is used to allocate budget shortfalls.

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<sup>23</sup> The actual cost does not determine funding levels, instead staff costs are entered based on 1995 salaries (ignoring inflation) and other costs are adjusted by adding inflation for the two-year lag.

<sup>24</sup> Based in part on the Department of Labor's budget request, which is based on the RJM.

<sup>25</sup> Ranking the states and awarding full funding to lower-cost states is not unique to RJM. It was used with previous funding models. The key difference is that the level of under-funding has increased, so deficits have increased.

<sup>26</sup> See Appendix A.

Under this system, a state that makes reductions only benefits from the savings for two years because the system makes allocations on the basis of two-year old expenditure data. At the end of the two years, the RJM data-collection process identifies actual costs and removes any allocation advantage those savings previously provided. Under the model, expenses not incurred are expenses not justified for reimbursement.

Personnel cost areas, such as initial claims, involve a ranking of the states from lowest to highest costs based on the minutes per unit (MPU) comparison between them. Only the ten lowest cost states in each functional area receive their actual costs, with other states receiving a lower share of their actual costs, with the percentage declining toward the high-cost end of the ranking. In each area, the total amount allocated to the states is set to cover a share of that year's deficit related to how large the function is of total administration costs.

## **Appendix D - Efforts to Secure Additional Federal Funds**

The Employment Security Department has been active in appealing for additional funding at the federal level. The department:

- Appealed to the Office of Management and Budget before the new resource justification model was implemented (2001) and to the Department of Labor to increase funding (2002, 2003 and 2004).
- Appealed both with other states through the National Association of State Workforce Agencies (NASWA) and directly to the Administration and to Congress for additional administrative funding.
- Served on a national workgroup to eliminate inequities in the funding model. The workgroup was disbanded before all of the flaws in the model were corrected.

Despite these efforts, federal funding has not increased. At this time, we do not project increased funding in the foreseeable future, though the department is continuing to pursue such increases.