Commission on Unemployment Compensation
July 27, 2005
Richmond, Virginia

The first meeting of the Commission on Unemployment Compensation this year focused on two issues: unemployment trust fund solvency and cuts in federal funding for the Virginia Employment Commission (VEC).

Status of the Unemployment Trust Fund

The unemployment trust fund (Trust Fund) contains state unemployment taxes paid by employers. State unemployment tax is assessed on the first $8,000 of each employee's wages at a rate that varies depending on the trust fund solvency level and the employer's claims experience over the preceding four years. For 2005 the minimum tax is 0.52 percent ($41.60 per employee) and the maximum is 6.62 percent ($529.60 per employee). In addition, employers are subject to two surtaxes. A "pool tax" is assessed to cover benefits paid out from the Trust Fund that cannot be charged to specific employers, and a 0.2 percent "fund-building" tax is assessed when the Trust Fund's solvency level drops below 50 percent.

James N. Ellenberger, Deputy Commissioner of the VEC, advised the Commission that the solvency level of the Trust Fund is larger than it has been since 2002. The solvency level, which is determined by dividing the balance in the Trust Fund by the statutorily-determined adequate fund balance, is projected to be 49.9 percent as of June 30, 2005; one year ago it was 39.3 percent. The balance in the Trust Fund is projected to be $481.4 million, up from $274.3 million in the previous year. If the Trust Fund's solvency level as of June 30, 2005, is determined to exceed 50 percent, the pool tax will be offset by interest earned on the Trust Fund balance and employers will not be assessed the fund building tax next year.

The average tax per employee was $140 in 2004 and is projected to rise to $162 in 2005 and to $169 in 2006 before declining to $131 in 2007. These levels of average tax per employee exceed the levels charged in 1998 through 2002, when the average tax per employee ranged between $48 and $51. Much of the difference is attributable to the robust condition of the Trust Fund during 1997 and 2001. In each of those five years the solvency rate exceeded 100 percent and the Trust Fund's balance averaged over $1 billion. The increases from 2003 through 2008 are the result of higher benefits schedules and the recession.

Despite Virginia's rising average tax per employee in the past few years, it remains the lowest among the six jurisdictions in the area served by the Fourth Circuit Court of Appeals. The average tax in the other five range from $154 in South Carolina to $275 in North Carolina.

The projected rise in the Trust Fund's solvency rate is due in part to declines in the unemployment rate and shorter periods of benefit payments. Since October 2003, Virginia's unemployment rate in each month has been less than or equal to the rate in the corresponding month of the previous year. The most recent month for which data was available is May 2005, in which the unemployment rate was 3.6 percent. Total initial year-to-date claims for unemployment benefits through May 2005 were down 15.2 percent from the same period in

2004 and down 41.3 percent from 2003. First payments of unemployment insurance benefits the first five months of 2005 were down 11.8 percent from the same period in 2004 and down 36.5 percent from 2003. Final payments of benefits in the first five months of 2005 were down 20.9 percent from the same period in 2004 and down 42 percent from 2003. The average duration for receipt of unemployment benefits was 12.6 weeks in May 2005, down from 14.1 percent in May 2004.

VEC Budget and Strategic Priorities

The VEC is atypical of state agencies in that all of its administrative funding is appropriated by the federal government. The VEC's administrative funding comes from Federal Unemployment Tax Act (FUTA) payments collected from employers. The FUTA tax is imposed at a rate of 0.8 percent of each employee's first $7,000 of wages, for a cost of $56 per employee per year. In addition to paying for the administration of state employment security agencies at the federal and state levels, FUTA revenue finances federal loan funds and provides revenue for extended benefits programs.

Virginia's employers paid $187.5 million in FUTA taxes in 2003. For the same period, the VEC received $66.8 million. Of this sum, $46 million is for administration of the unemployment insurance program, $16 million is for job services, and $4.8 million is for veterans' programs, labor market information, and postage.

While Virginia has been a net "loser" in FUTA revenue allocations for several years, VEC Commissioner Dolores Esser reported that the Commonwealth now ranks 49th among all states in the percentage of FUTA revenue received from the federal Department of Labor compared to the amount paid by its employers. Between fiscal years 2005 and 2006, unemployment insurance funding was cut from $54.3 million to $40 million, and Commissioner Esser reported that a cut of an additional $1.3 million had been announced. Over the same period, program expenditures were reduced from $48.1 million to $42.7 million, producing a projected deficit of $2.7 million. For fiscal year 2007, the unemployment insurance program is projected to face a deficit of $8.5 million and the job services program is projected to face a deficit of $1.6 million.

Several factors contribute to the fiscal woes confronting the VEC. Congress does not appropriate all of the available FUTA tax revenue, in part to help offset the federal budget deficit. The Department of Labor's resource justification model, which determines state administrative funding levels, effectively punishes states such as Virginia that are efficient and have lower employee pay scales. Virginia was one of the first states to automate its systems, which increased efficiency and lowered costs. States with higher unemployment rates receive more money that those like Virginia with comparatively low unemployment levels.

In response to these budget issues, the VEC has closed four offices where its leases are expiring this year. Three of the closing offices are in Hampton Roads and the other is in the Richmond area. The agency plans to lay off approximately 400 staff, most of whom are hourly wage employees, and classified positions are being left open when employees leave or retire. At the same time, the VEC has opened two call centers to handle inquiries and developed the ability to allow claimants to file via the Internet. VEC also faces the need to replace its 20-year-old computer systems at a cost of $45-50 million. Additional fiscal pressures are being exerted on VEC from the VITA and DRES initiatives. While these centralized procurement services are projected to save money in the long run, VITA has added $200,000 in additional information technology costs without any increase in services. Leasing office space in Northern Virginia through DRES is projected to cost VEC $391,000 in 2006.

Members of the Commission expressed interest in locating unused space in local government buildings that can be made available for use as VEC field offices. They also suggested that members of the Congressional delegation be made aware off the inequity in the FUTA allocation formula and its impact on Virginians.

Virginia Legislation in 2005

Coleman Walsh, Chief Administrative Law Judge at the VEC, briefly reviewed legislation passed in the 2005 session. A pair of bills increased the minimum amount of wages an employee must have earned in the two highest earnings quarters of his base period (the first four of the five calendar quarters preceding application for benefits) in order to be eligible for unemployment compensation benefits from $2,500 to $2,700. The bills also increased the maximum weekly benefit from $326 to $330.

The increase places Virginia's maximum weekly benefit level near the middle of the six Fourth Circuit jurisdictions, where the maximum weekly benefit amounts range from $426 in North Carolina to $292 in South Carolina. The national average is $346. Virginia's maximum weekly benefit replacement level is 44 percent of the state's average weekly wage; the national average is 47 percent. Among other Fourth Circuit jurisdictions, the replacement rate ranges from 65 percent (in North Carolina and West Virginia) to 32 percent (in the District of Columbia).

SUTA Dumping

Legislation was also enacted in the 2005 Session to prohibit a person from transferring a business to a related entity for the purpose of obtaining a lower state unemployment tax (SUTA) rate. The unemployment tax rate may vary among firms based on their experience rating, which is determined in part by their history of laying off employees. The practice of artificially reducing a business' rate of unemployment tax by changing ownership is called "SUTA dumping." Virginia's SUTA dumping legislation was drafted to conform to requirements of the federal SUTA Dumping Prevention Act of 2004. The legislation is intended to address the concern that SUTA dumpers shift their unemployment insurance tax costs to other employers. Nancy Broaddus, VEC's Chief of Tax, provided members with an overview of an automated SUTA Dumping Detection System. She reported that wages information for the second quarter of 2005 will be available for download to the SUTA dumping software by October 2005.

In the course of preparing the SUTA dumping legislation for the 2005 Session, the VEC convened a working group that identified a need to examine the broader issue of how business acquisitions should be addressed. The working group is continuing to examine this issue, and will report its recommendations to the Commission. W. Thomas Hudson, a member of the working group, expressed concerns that Congressional enactment of the federal SUTA dumping legislation may have unintended consequences and deter bona fide business acquisitions and mergers.

Pending Federal Legislation

Commissioner Esser reported that Congress may not complete its reauthorization of the Workforce Investment Act this year. The House of Representatives has passed one version, a Senate Committee another, and the Executive Branch is pushing yet a third approach. Mr. Ellenberger apprised the Commission of the proposed Unemployment Compensation Program Integrity Act of 2005, which was submitted to Congress by the Administration in June 2005. The legislation's goal is to reduce improper payments of unemployment benefits. Specific elements would permit states to use a portion of recovered unemployment benefit overpayments for payment control programs; require states to impose a 15 percent penalty on fraudulent overpayments; permit states to compensate debt collection agencies for recoveries of overpayments and delinquent unemployment taxes by keeping a percentage of the amount collected; require states to charge an employer's experience rating account for unemployment benefits improperly paid due to the employer's failure to provide accurate information; and allow the collection of delinquent benefit overpayments through garnishment of tax refunds. The measure would also states to borrow FUTA funds to upgrade their information technology systems.

Other Business

The Commission will hold its next meeting after Thanksgiving, by which date the VEC should have the date required to determine the Trust Fund's solvency level as of June 30, 2005. The Commission also plans to address the provisions of Senate Bill 772 (2005).

The Honorable John C. Watkins, Chairman

For information contact:
Franklin Munyan, Staff Attorney, Division of Legislative Services