**South Dakota Department of Labor**
**Unemployment Insurance Advisory Council**
**2004 Annual Report**

This document serves as the report of meetings, discussions and recommendations of the Unemployment Insurance Advisory Council, pursuant to SDCL 61-2-7.1. Council members appointed by Governor Rounds include Secretary of Labor Pam Roberts (chair), Carol Hinderaker, Robert Anderson, David Owen, Paul Aylward, Jason Dilges, Jerry Wheeler and Homer Harding. The report is available to any interested person or groups and can be found on the Department of Labor web site.

South Dakota uses a “reserve ratio” unemployment tax system which compares the balance in the account of each employer to their payroll. A table of reserve ratios and associated tax rates (SDCL 61-5-18.14) determines the annual tax rate for each employer. The tax is paid on a $7,000 wage base which has been fixed at that level since 1983. The minimum rate is “0” percent and the maximum is seven percent, with special low rates for new employers in their first three years of business. (Attachment A)

The South Dakota unemployment insurance trust fund was relatively stable in the decade prior to 2001, with benefit payments to unemployed workers being about equal to revenue from employer taxes and trust fund interest. In the past four years, however, benefits paid have exceeded normal revenue by $43 million. The trust fund balance was $51 million at the end of 2000, but decreased to $27.3 million by December 31, 2004. If no changes are made, the fund is projected to continue a gradual decline and become insolvent in 2008. (Attachment B)

The unemployment insurance system was designed with the understanding that adjustments would need to be made periodically. Benefit levels are tied to wage inflation, while income to the trust fund and other triggers do not have inflation factors. Prior to 2001, benefits were about $15 million a year, tax receipts about $12 million and interest income about $3 million. The economic decline pushed benefits up to $30 million, tax revenue increased only slightly and interest income dropped with the declines in assets and interest rates. Benefit payments are decreasing due to the current economic recovery, but they will remain higher than income levels and continue to inflate in the future. Preventing insolvency of the trust fund will require legislation to address systematic problems and reverse the downward trend in trust fund assets.

On November 24, 2004, the Council held an organizational meeting during which the members learned about the Unemployment Insurance (UI) program in South Dakota. Information was presented on benefit amounts for unemployed workers, the conditions under which they are paid or not paid, the system for assigning tax rates to employers, historical data on the amount of taxes received and benefits paid and projections of the trust fund balance through 2007. The Council was also briefed on legislative proposals from the Department for 2005.

At their December 9, 2004, meeting the Council received public testimony on all items under consideration. It also took action on the following legislative proposals for the 2005 legislative session:

**Senate Bill 13: An Act to create certain provisions regarding transfers of experience rating accounts and assignment of unemployment insurance tax rates**

Summary: This bill was submitted by the Department of Labor to address a problem referred to as "SUTA dumping", with "SUTA" meaning state unemployment tax act. In the simplest form, an employer with a high unemployment cost history will create a new legal entity and transfer assets to that new entity. Without preventive legislation, the new entity would be entitled to the low tax rate for the new employer, thus "dumping" their former high tax rate and leaving other employers in the state to cover their higher costs. South Dakota law already prohibits this, but SB 13 adopts mandatory federal legislation which makes state law more comprehensive and eliminates some loopholes in current law.

Public Testimony: None.

Council Action: Homer Harding MOVED the Council support SB 13. Robert Anderson SECONDED. Motion carried.

**Governor's Bill, Senate Bill 85: An Act to modify provisions related to the payment of unemployment insurance benefits**

Summary: Current law requires that employers be charged for claims unless the worker is fired for misconduct or quits without good cause or unless other special circumstances exist. This would mean an employer would be liable for a claim if they had to terminate a worker to create a position to reinstate a former employee who is returning from active military service. Section 1 of this bill would allow the benefit to be paid in this circumstance, but would charge the claim to the general state trust fund and not to the former employer.

Public Testimony: None.

Council Action: Paul Aylward MOVED the Council support the Governor's bill. Carol Hinderaker SECONDED. Motion carried.

**Senate Bill 14: An Act to modify provisions related to the payment of unemployment insurance benefits**

Summary: This bill was submitted by the Department of Labor to address two issues. The first clarifies that wages earned in a calendar quarter can be used only one time on a claim. The second concerns the one non-paid waiting week required on each claim. Current law allows waiting week credit for a week even though the applicant does not meet all the conditions that are required by actual benefit payment for a week. The worker currently does not have to seek new employment, be available to take a job or be able to work during this week. This legislation would make the requirements for the waiting week the same as for all other weeks of benefits claimed.

Public Testimony: None.

Council Action: David Owen MOVED that the Council support SB 14. Robert Anderson SECONDED. Motion carried on a roll call vote. 5 Yea, 1 Nay (Aylward).

The January 4, 2005, meeting of the Council began with a general discussion of financial trends in the South Dakota program. The difficulty in accurately projecting future benefits was noted with factors such as unemployment rates, industry trends, worker incomes, claim duration, weather conditions and other factors affecting total payments.

The Council considered options for projecting future payment levels and trust fund reserves. The first projection used national estimates of benefit payments provided by the US Department of Labor. Under this assumption, the fund would be nearly insolvent by December 31, 2007. The Council established this assumption as the "worst case" scenario. A second set of assumptions was that the 8.4 percent rate of decline in benefit payments from 2003 to 2004 would continue through 2007. This scenario would result in a $15.8 million fund balance at the end 2007. The Council established this assumption as the "best case" scenario. The consensus of the Council was to project future activity using a third set of assumptions, that 2004 benefit payment levels would continue at the same rate through 2007, leaving a $3 million trust fund balance at the end of 2007. It should be noted that these projections could be significantly affected by changes in economic conditions. (Attachment C)

The Council concluded that two sets of solutions were the best approach to the problem of declining reserves in the state Unemployment Insurance trust fund.

The first set contains short-term strategies to address specific issues during the coming months; the second were longer-term strategies to resolve major system issues during the coming years. These latter solutions require additional discussion and input from groups directly affected.

Using this framework, the Council took action on pending issues. A summary of testimony, discussion and Council action on each item follows.

**Issue # 1: Experience Rating System**

<u>Summary:</u> Experience rating is the system of assigning tax rates to employers. In general terms, the system compares past tax payments to wages paid by the employer and a tax rate is assigned which can range from "zero" to seven percent. One significant problem is an inequity in the system because certain employers and industries pay significantly less in taxes than their workers receive in benefits. Even though an average worker receives about $2,600 on a claim, the maximum tax an employer is asked to pay on that worker is $490. An additional problem is benefit payments in recent years have been twice as much as tax revenue from the current system.

<u>Public Testimony:</u> None.

<u>Council Action:</u> David Owen MOVED that equity issues of the experience rating system be addressed as part of the long-term strategies and that in the interim, the Department of Labor establish a direct dialogue with employers and industries that tend to have negative account balances. The discussions should explain possible solutions to the equity issues such as tax rate changes, increases in the taxable wage base or interest assessments on negative balance accounts. An overview of these discussions will be reported back to the Council. Jason Dilges SECONDED. Motion carried.

Paul Alyward MOVED that the Department of Labor prepare a comparison of the South Dakota experience rating system to systems in other states as part of the long-term strategy of the council. Jason Dilges SECONDED. Motion carried.

**Issue #2: Wage Base**

<u>Summary:</u> The wage base is the amount of wages on which the UI tax is paid. Current law sets the wage base at $7,000, where it has been fixed since 1983. This fixed amount creates a structural imbalance in the system because benefits are based on income which inflates each year because the maximum weekly benefit is fifty percent of the average weekly wage.
The result is benefits increase every year as income rises, but tax revenue is more fixed and increases primarily as new workers join the labor force.

<u>Public Testimony:</u> None.

Council Action: David Owen MOVED that as part of the short-term strategy, the taxable wage rate be indexed to an inflation rate so that it changes with wage levels and is comparable to changes in benefit amounts. Paul Aylward SECONDED. Motion carried.

David Owen MOVED that the approved short-term strategy of indexing the taxable wage base be amended so that the taxable wage base could not exceed $9000. SECONDED by Paul Aylward. Motion failed on a roll call vote. 1 Yea (Owen) and 7 Nay.

David Owen MOVED that the Council recognize that the $7,000 wage base is too low for current benefit levels and should be increased, in addition to indexing it to wage levels, as part of the long-term strategy. Robert Anderson SECONDED. Motion carried unanimously.

**Issue # 3: Interest Income**

Summary: The state UI trust fund is held in the US Treasury and earns interest income. Total income was $2.6 million in 2003. This income is prorated and added to the accounts of all employers who have money in the fund. Eliminating this interest credit would increase interest revenue to the trust fund by about $800,000 a year.

Public Testimony: None.

Council Action: David Owen MOVED that as part of the short-term strategy, the interest credit to employer accounts be eliminated. Robert Anderson SECONDED. Motion carried on a roll call vote. 7 Yea, 1 Nay (Wheeler).

**Issue #4: Non-charged benefits**

Summary: In certain circumstances, benefits are paid but charged to the general trust fund rather than to the account of the former employer. In 2004, there were $4.7 million in UI benefit payments made in this category. Under current law, fifty percent of these non-charged benefits are pro-rated back to the accounts of all employers. There is no system to pay the other fifty percent of charged benefits, and they are deducted from the trust fund as an unfunded expense. Pro-rating the entire one hundred percent of these benefits to employers would increase tax revenue by about $800,000 and provide funding for these benefits.

Public Testimony: None.

Council Action: David Owen MOVED that as part of the short-term strategy, one hundred percent of non-charged benefits be pro-rated to the accounts of employers. Carol Hinderaker SECONDED. Motion carried.

**Issue # 5: Zero Percent Tax Rate**

Summary: South Dakota is one of the few states which provides for a “zero” tax rate. Employers who have accumulated a sufficient balance in their experience rating account pay no taxes. This rewards employers who have few claims. However, it is not based on sound actuarial principles whereby all members of an insurance program pay premiums at some level to fund a system.

Public Testimony: None.

Council Action: Homer Harding MOVED that as part of the long-term strategy, the “zero” tax rate option be reviewed. David Owen SECONDED. Motion carried.

**Issue #6: Tax surcharge based on fund balance**

Summary: Current law contains a provision whereby an additional surtax be added to the tax rate for all employers in certain situations. The current surtax begins at 0.1 percent when the fund is less than $11 million at the start of the year and increases with lower fund balances. The trigger point of $11 million has not changed nor been adjusted for inflation since 1961. Benefit payments have increased over the years to a level whereby the trust fund could become insolvent during a calendar year even if the surtax were in effect.

Public Testimony: None.

Council Action: David Owen MOVED that the as part of the short-term strategy, the Council recommend the surcharge required under 61-5-23 be determined quarterly rather than annually. SECONDED by Paul Aylward. Motion carried.

Paul Aylward MOVED that as part of the short term strategy, the Council recommend when the trust fund surcharge is triggered, it will stay in effect until the trust fund balance is at 150% of the trigger dollar amount. SECONDED by Robert Anderson. Motion carried.

David Owen MOVED that as part of the long term strategy, the Council recognize that the $11 million surcharge trigger contained in 61-5-23 may be too low for current benefit levels and should be reviewed as well as indexed to inflation and that the Council also review the relationship of the future fund to the Unemployment Insurance trust fund solvency issue. SECONDED by Jerry Wheeler. Motion carried on a roll call vote. 7 Yea and 1 Nay (Dilges).

**Issue #7: Social Security and Unemployment Offset**

Summary: Current law requires that pension income be deducted from UI payments if the employer paying the claim also paid into the pension. The amount of the pension deducted is the share funded by the employer.

Fifty percent of the Social Security benefit is also deducted from all claims because employers pay fifty percent of the premium. Eliminating the current deduction would increase benefit payments by about $500,000.

Public Testimony: Sam Wilson, Assistant State Director, AARP, testified in support of eliminating the Social Security deduction from UI payments. The basis for his support is that there are many older workers in the labor force who rely on Social Security benefits along with wages earned for their support. He also distinguished Social Security from other pension or retirement income in that it was earned through a lifetime of work with all employers, rather than employment with one specific employer.

Council Action: Paul Aylward MOVED that the Council support legislation for 2006 which would eliminate the current deduction of Social Security payments from UI benefits. David Owen SECONDED. Motion failed on a roll call vote.
1 Yea (Aylward) and 7 Nay.

David Owen MOVED that the Council consider the Social Security offset issue, along with other issues which impact the payment or denial of benefits, as part of their discussions of long-term UI financing issues. Carol Hinderaker SECONDED. Motion carried on a roll call vote. 7 Yea and 1 Nay (Wheeler).

Respectfully submitted on January 24, 2005, by the Unemployment Advisory Council Members:

| | |
|---|---|
| Pamela S. Roberts | Carol Hinderaker |
| Robert Anderson | David Owen |
| Paul Aylward | Jason Dilges |
| Jerry Wheeler | G. Homer Harding |

| UI TAX RATE (%) | ACCOUNT BALANCE PER EMPLOYEE REQUIRED FOR RATE* | RESERVE RATIO** |
|---|---|---|
| 0.0 | $336 | 1.6 and > |
| 0.1 | $315 | 1.5 and < 1.6 |
| 0.2 | $294 | 1.4 and < 1.5 |
| 0.3 | $273 | 1.3 and < 1.4 |
| 0.4 | $252 | 1.2 and < 1.3 |
| 0.5 | $210 | 1.0 and < 1.2 |
| 0.6 | $168 | 0.8 and < 1.0 |
| 0.7 | $126 | 0.6 and < 0.8 |
| 0.8 | $84 | 0.4 and < 0.6 |
| 0.9 | $42 | 0.2 and < 0.4 |
| 1.0 | $0 | 0.0 and < 0.2 |
| 1.2 | -$105 | -0.5 and < 0.0 |
| 1.4 | -$210 | -1.0 and <-0.5 |
| 1.6 | -$315 | -1.5 and <-1.0 |
| 1.8 | -$420 | -2.0 and <-1.5 |
| 2.0 | -$525 | -2.5 and <-2.0 |
| 2.5 | -$630 | -3.0 and <-2.5 |
| 3.0 | -$735 | -3.5 and <-3.0 |
| 3.5 | -$840 | -4.0 and <-3.5 |
| 4.0 | -$945 | -4.5 and <-4.0 |
| 4.5 | -$1,050 | -5.0 and <-4.5 |
| 5.0 | -$1,155 | -5.5 and <-5.0 |
| 5.5 | -$1,260 | -6.0 and <-5.5 |
| 6.0 | -$1,365 | -6.5 and <-6.0 |
| 6.5 | -$1,470 | -7.0 and <-6.5 |
| 7.0 | < than -$1470 | < than -7.0 |

RATES FOR NEW NONCONSTRUCTION EMPLOYERS

| | |
|---|---|
| 1.2 | YEAR 1 |
| 1.0 | YEARS 2 & 3*** |

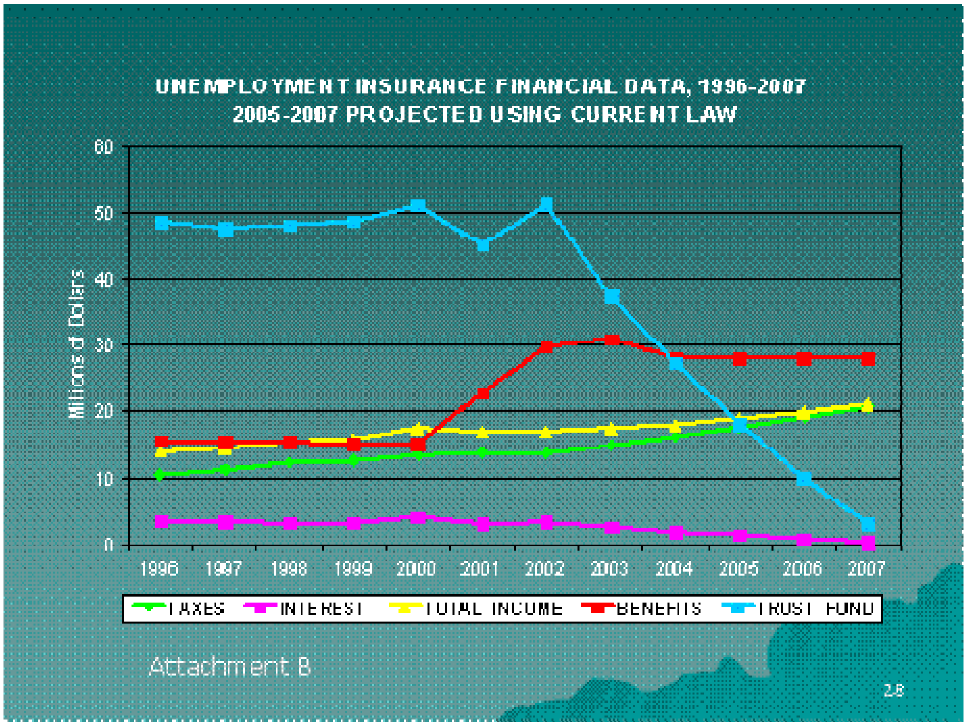
RATES FOR NEW CONSTRUCTION EMPLOYERS

| | |
|---|---|
| 6.0 | YEAR 1 |
| 3.0 | YEARS 2 & 3*** |

*ASSUMES EMPLOYEE EARNS AT LEAST $7,000 PER YEAR

** RESERVE RATIO EMPLOYER ACCOUNT BALANCE DECEMBER 31
EMPLOYER TAXABLE PAYROLL FOR PRIOR 3 YEARS

**Attachment A**


UNEMPLOYMENT INSURANCE FINANCIAL DATA, 1996-2007
2005-2007 PROJECTED USING CURRENT LAW
Millions of Dollars
60
50
40
30
20
10
0
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
TAXES
INTEREST
TOTAL INCOME
BENEFITS
TRUST FUND
Attachment B
2-8

**UNEMPLOYMENT INSURANCE FINANCIAL DATA, 1996-2007**

| | TAXES | INTEREST | TOTAL REVENUE | BENEFITS | TRUST FUND |
|---|---|---|---|---|---|
| 1996 | 10.5 | 3.5 | 14.0 | 15.6 | 48.6 |
| 1997 | 11.2 | 3.3 | 14.5 | 15.5 | 47.7 |
| 1998 | 12.3 | 3.2 | 15.5 | 15.4 | 48.1 |
| 1999 | 12.6 | 3.2 | 15.8 | 15.1 | 48.7 |
| 2000 | 13.4 | 4.1 | 17.5 | 15.2 | 51.1 |
| 2001 | 13.8 | 3.1 | 16.9 | 22.8 | 45.1 |
| 2002 | 13.7 | 3.3 | 17.0 | 29.8 | 51.2 |
| 2003 | 14.9 | 2.6 | 17.5 | 31.0 | 37.4 |
| 2004 | 16.2 | 1.8 | 18.0 | 28.1 | 27.3 |
| 2005 | 17.6 | 1.4 | 19.0 | 28.1 | 18.2 |
| 2006 | 19.1 | 0.8 | 19.9 | 28.1 | 10.0 |
| 2007 | 20.7 | 0.4 | 21.1 | 28.1 | 3.0 |

05-'07 BENEFITS SAME AS '04

**Attachment C**