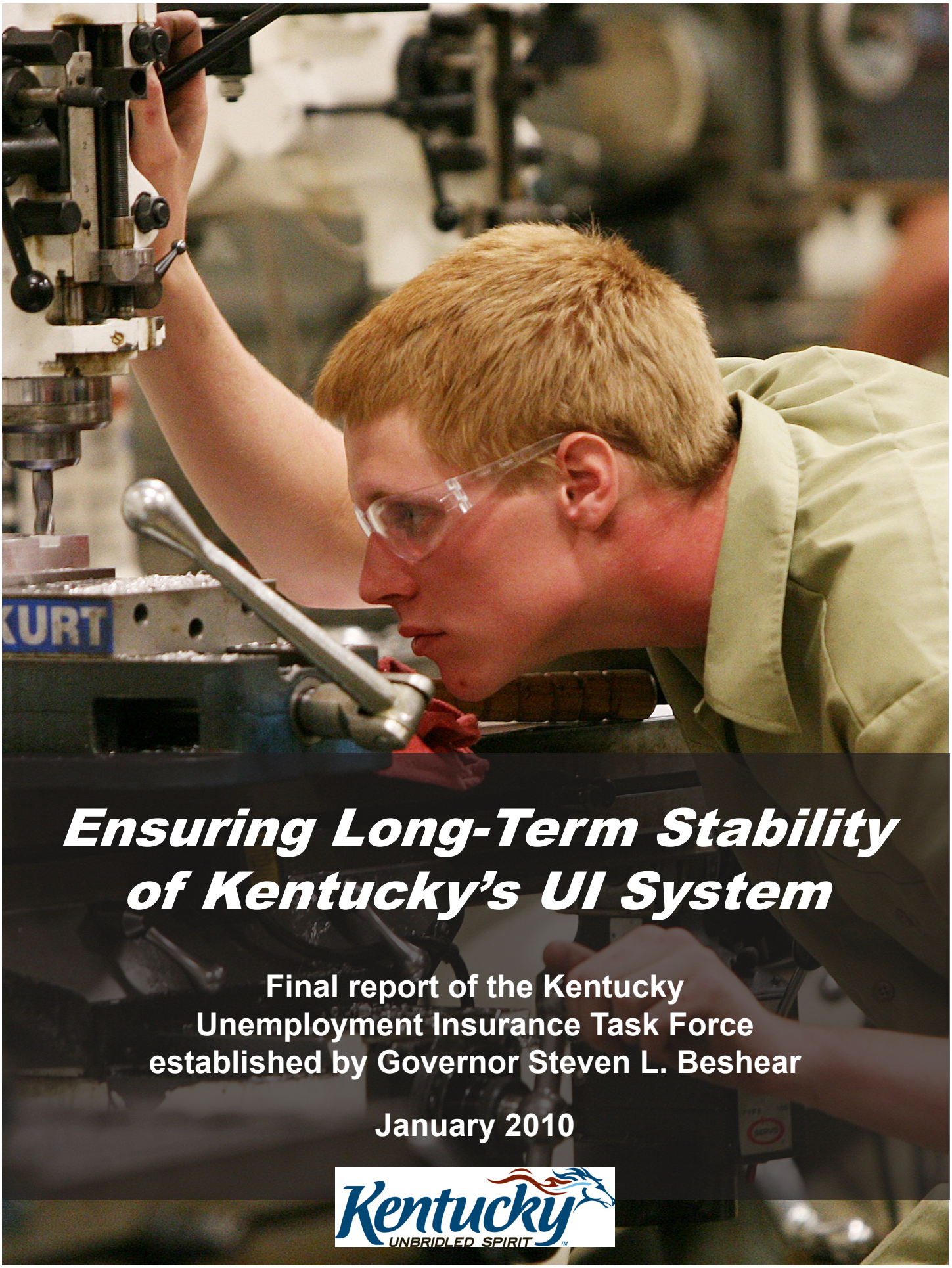

Ensuring Long-Term Stability of Kentucky's UI System

Final report of the Kentucky Unemployment Insurance Task Force established by Governor Steven L. Beshear

January 2010

Kentucky
UNBRIDLED SPIRIT™

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Joseph U. Meyer
Acting Secretary

January 8, 2010

Governor Steven L. Beshear
Commonwealth of Kentucky
State Capitol
700 Capitol Avenue
Frankfort, Ky. 40601

Dear Governor Beshear:

The Governor's Task Force on Unemployment Insurance has completed its study of Kentucky's Unemployment Insurance (UI) system and the state of its UI Trust Fund.

Over the past eight months, the task force met 11 times and had opportunities to participate in five topical sessions. It consulted regularly with two leading UI economists, heard differing perspectives on UI issues and compared Kentucky's status with that of its contiguous states as it explored a wide range of potential policy options.

As directed, the report offers 17 recommendations that would enable Kentucky's UI system to generate sufficient funds to temporarily assist displaced workers; provide a cushion for future economic downturns; and treat employers fairly without diminishing their ability to compete with other states.

These recommendations are an important first step to bring balance to Kentucky's UI system and solvency to the UI Trust Fund. The work of the task force represents the difficult art of merging competing interests in pursuit of the overall best interests of the Commonwealth.

Respectfully Submitted,

Joseph U. Meyer

Joseph U. Meyer
Acting Secretary
Education and Workforce Development Cabinet

UNEMPLOYMENT INSURANCE TASK FORCE MEMBERS

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Rep. Larry Clark	D-46th District
Rep. Ronald E. Crimm	R-33rd District
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*Served during first months

EXECUTIVE SUMMARY

Unemployment insurance (UI) was designed in 1935 when the country was struggling to recover from the Great Depression. Unemployment insurance stabilizes the economy by making it possible for American workers who lose their jobs through no fault of their own to receive temporary assistance while they seek reemployment. The payments help preserve the consumer spending vital to local economies as claimants are able to purchase food and clothing, pay for rent and utilities, buy gasoline, medications and other local goods and services.

Since 2000, Kentucky has paid out more in unemployment benefits than it has taken in through employer contributions. Until 2009, the difference was made up by drawing on reserves that had been built up in earlier years in the Unemployment Insurance Trust Fund.

The trust fund was depleted in 2009, at least in great part, because there is an inherent structural imbalance between the statutory revenue formula (based on limited taxable wages) and the benefit formula (based on gross wages). In this system, benefits rise with wage inflation; revenue rises with job growth. From November 2000 to November 2009, the number of nonfarm jobs in Kentucky has declined by 3.9 percent.[1]

The current economic downturn exacerbated an already serious condition. On Jan. 28, 2009, current employer taxes plus trust fund reserves were no longer sufficient to cover the claims against the system. Kentucky became the sixth state (after Ohio, South Carolina, Michigan, New York and Indiana) to begin borrowing money from the federal government in order to meet its UI obligations. Kentucky borrowed $523.1 million by the end of November 2009.

The federal unemployment plan is self-correcting. As long as a state carries an outstanding balance with the federal government, federal employer taxes increase each year until the state has repaid all funds borrowed from the federal government to meet unemployment insurance obligations.

The choice facing Kentucky is not whether to raise unemployment insurance taxes. Taxes will be raised automatically by the federal government. The choice is whether to raise taxes under the federal plan or through a plan determined by state interests.

Recognizing the need to modernize an outdated system, Governor Steven L. Beshear signed an Executive Order (2009-301) on March 27, 2009, establishing the Unemployment Insurance Task Force. He directed the 19-member bipartisan group – comprised of employers, employees and members of the General Assembly – to study and propose long-term changes to the UI system that would address the fiscal solvency and stability of the UI Trust Fund.

The Unemployment Insurance Task Force recommends that the Governor consider the following specific steps that would enable Kentucky's UI system to generate sufficient funds to temporarily assist displaced workers; provide a cushion for future economic downturns; and treat employers fairly without diminishing their ability to compete with other states.

Recommendation 1:
Increase the **taxable wage base** (TWB) from $8,000 to $9,000 in 2012, and increase thereafter in annual increments of $300 to a TWB of $12,000 in 2022.

Recommendation 2:
Implement a **waiting week** after eligible workers file a claim before they can begin to receive benefits in 2012. Forty other jurisdictions impose a waiting week.

Recommendation 3:
Reduce the Statutory Replacement Rate used to calculate a claimant's weekly benefit amount from 1.3078 percent (68 percent) to 1.1923 percent (62 percent) in 2012, restoring the rate to that in effect prior to 2001.

Recommendation 4:
Change the tax rate schedule triggers that move employers from one tax rate schedule to another to help balance the trust fund at the end of each year. The current triggers are so close that the benefit of a tiered system is lost.

Recommendation 5:
Change the triggers for the maximum increase in the **maximum weekly benefit amount** (MWBA) to provide for a more graduated rate of increase in the maximum weekly benefit.

Recommendation 6:
Back up all calculation dates in KRS 341.270 by one calendar quarter to allow **Office of Employment and Training** (OET) to mail employer UI tax rates prior to Dec. 15 so employers are notified of new rates before the calendar year begins.

Recommendation 7:
Change the procedures for notifying employers about new claims.

Recommendation 8:
Increase the protest period from 10 to l5 days after a claim is filed.

Recommendation 9:
Increase efforts to inform public about the fraud detection efforts.

Recommendation 10:
Improve information sharing among OET, the Department of Revenue, the Finance and Administration Cabinet, the Kentucky Labor Cabinet and other state agencies.

Recommendation 11:
Institute random audits to test accuracy of six-week review information (work search effort reports) submitted by recipients.

Recommendation 12:
Re-examine UI forms and publications for employer and claimant readability to promote effective communication of definitions, rules and procedures.

Recommendation 13:
Review management of appeals process so that stakeholders are better prepared for UI hearings.

Recommendation 14:
Offer training programs for employers managing the unemployment process.

Recommendation 15:
Implement an affirmative outreach program to employers whose reserves are less than negative 3 percent of wage base to explain voluntary contributions as a means of decreasing their tax rate.

Recommendation 16:
Enhance re-employment strategies and services through the Division of Workforce and Employment Services and the one-stop career centers, emphasizing re-employment and retraining for the older, experienced, dislocated worker.

Recommendation 17:
Direct the Cabinet to recommend an acceptable process for recovering the subsidized costs from reimbursing employers. Some employers such as government agencies and non-profit organizations reimburse benefit costs for UI expenses at the end of a quarter instead of paying regular UI taxes.

CONCLUSION

These recommendations are an important step toward restoring balance to Kentucky's unemployment insurance system and solvency to the UI Trust Fund. The work of the task force represents the best of the difficult art of merging competing interests in pursuit of the overall best interests of the Commonwealth. The costs of these recommendations are evenly shared though tax increases and benefit reductions. Kentucky employers will pay less taxes than under the federal plan, and the balance in the trust fund will be significantly higher to protect against future downturns in the economy.

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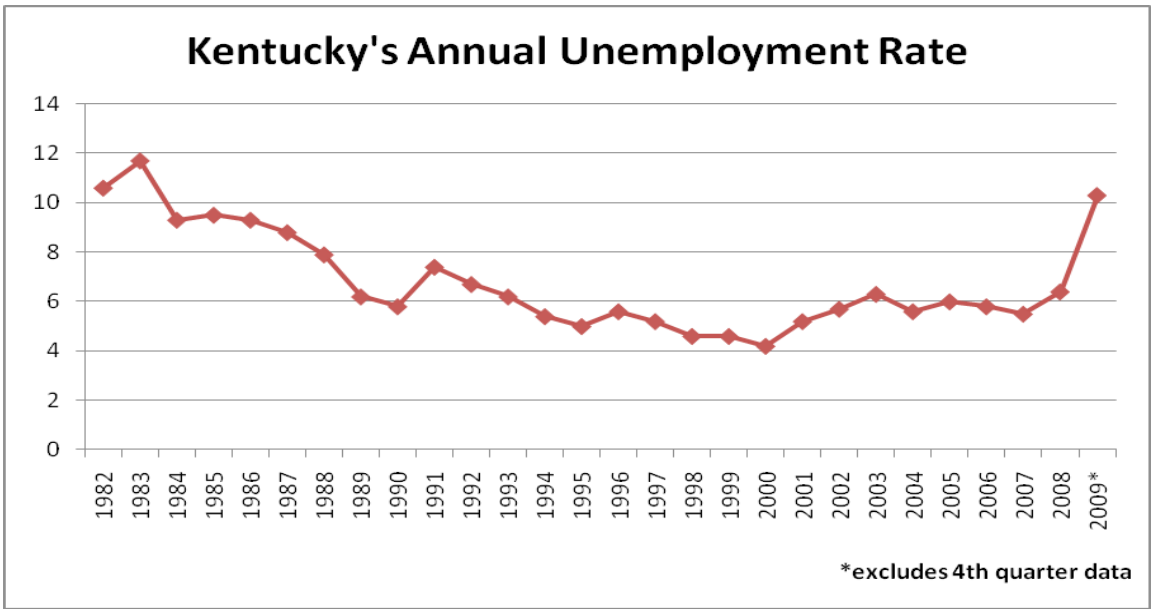
OVERVIEW

There can be no doubt that the global economic crisis is impacting Kentucky. In October 2009, the state's seasonally adjusted unemployment rate stood at 11.3 percent, up from the September 2009 rate of 10.9 percent.[2]

The number of people unemployed in October is estimated at 233,388.[3] This does not include Kentuckians who may have been out of work but who were not actively seeking a job during the last four weeks. To put the numbers in context, in October 2009, 94 of Kentucky's 120 counties had unemployment rates of 10 percent or higher. Just one year ago, in October 2008, only two Kentucky counties had an unemployment rate of 10 percent or higher.[4]

Through the first three quarters of 2009, a total of 417,244 initial claims for unemployment insurance were filed.[5] On Jan. 28, 2009, current employer contributions to UI plus UI Trust Fund reserves were no longer sufficient to cover claims against the system and Kentucky began to borrow money from the federal government in order to honor its UI benefits obligations. As of Dec. 17, 2009, the state's debt to the U.S. Department of Labor (USDOL) stood at $556.4 million.[6]



Provided by the Education and Workforce Development Cabinet, Office of Employment and Training

What is Unemployment Insurance?

Unemployment insurance was designed in 1935 when the country was struggling to recover from the Great Depression. As part of the Social Security Act, its goal is to help stabilize the economy. It does this by making it possible for American workers who lose their jobs through no fault of their own to receive temporary assistance while they seek reemployment.

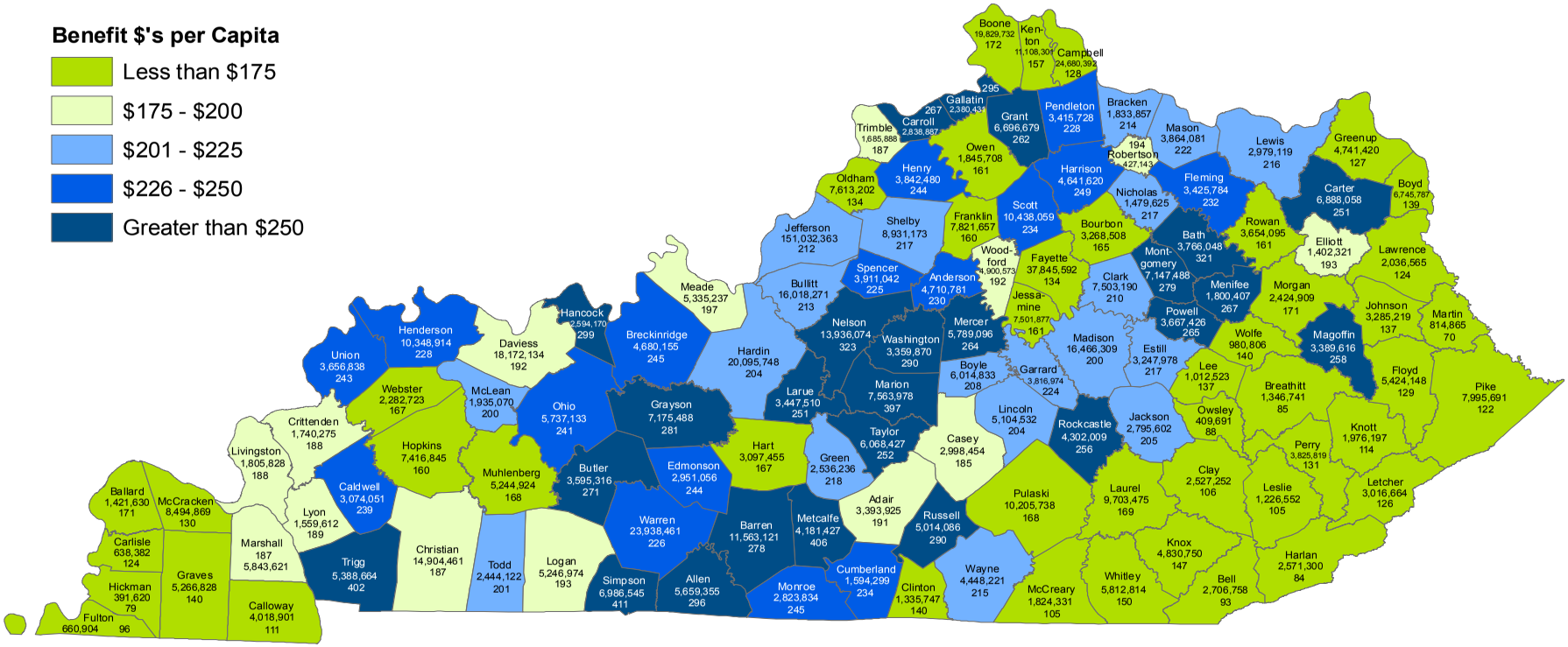
The payments help preserve the consumer spending vital to local economies as claimants are able to purchase food and clothing, pay for rent and utilities, buy gasoline, medications and other local goods and services.

In 2008 in Kentucky, the amount of UI benefits distributed totaled more than $680 million.[7] This year benefits are expected to exceed $1.4 billion (estimates for 2009 also include Extended Benefit payments, Emergency Unemployment Compensation and Federal Additional Compensation).[8]

The UI program is based on a federal-state partnership. Certain "conformity criteria" are established in federal law. As long as these are met, individual states are given a great deal of flexibility in setting tax structures and benefit eligibility criteria. For its part, the federal government guarantees that it will loan states the money necessary to meet benefit claims if the state system becomes insolvent due to economic crisis.

Average Unemployment Insurance Benefit Dollars Paid per Capita by County*

1st Quarter - 3rd Quarter, 2009



Total Value of Claims Paid: $888,936,270**
Kentucky Population: 4,269,245
Average Benefits Paid per Capita: $208

*Average unemployment insurance benefit dollars paid per capita was calculated by dividing total benefits paid per county by total county population. Population data courtesy of Kentucky State Data Center (2008).

**Total includes unclassified county, interstate, UCFE and UCX claims.

Produced by: Research and Statistics Branch, Office of Employment and Training
Kentucky Education and Workforce Development Cabinet

History of UI

Initially, at both the state and federal levels, only the larger businesses and their workers were covered by UI. The trend was, however, to extend coverage to more employers and workers. This expansion of scope was essentially completed in Kentucky in 1977 when most agricultural and domestic employees, along with the public sector workforce, were added to the list of covered workers. Today, most Kentuckians – nearly 1.8 million last year – are in covered employment.[9]

The recession of the mid-1970s and early 1980s had a devastating effect on Kentucky's unemployment insurance system. As a result, the state's UI Trust Fund – its pool of employer taxes available to pay benefits – became insolvent, as did the trust funds of more than half of the other states in the nation. This led to the state borrowing $332,228,020 from the federal government over a four-and-a-half-year period in order to pay unemployment claims. It took six years to repay the loans along with $11,168,237.86 in accrued interest.[10]

Latest Changes to the UI system

Through the combined efforts and concessions of both business and labor, significant changes were made to Kentucky's UI system during the 1982 session of the General Assembly. Tax rates were increased and benefit increases were frozen. The sweeping actions taken, along with an upswing in the national economy, allowed the system to be restored to vitality by the end of the 1980s.

When Kentucky encountered its third recession in as many decades in 1990, the UI Trust Fund had recovered sufficiently to sustain the increased number of benefits without triggering a tax increase for employers. During the 1990s, the trust fund experienced strong and sustained growth. The economic boom and its accompanying low unemployment rate held down the total cost of UI benefits even as the average individual benefit payment was increasing. Revenue exceeded costs year after year and the trust fund balance eventually topped $700 million.[11]

Kentucky, like many other states, believed that its reserves were sufficient to cover future costs with little or no new revenue. A plan was developed to reward both business and labor for the sacrifices made in 1982. In 1998, the General Assembly decreased taxes by approximately $17.5 million and increased benefits by a similar amount.[12] There was also a one-time diversion of some employer taxes to upgrade the technology used to keep the UI system functioning.

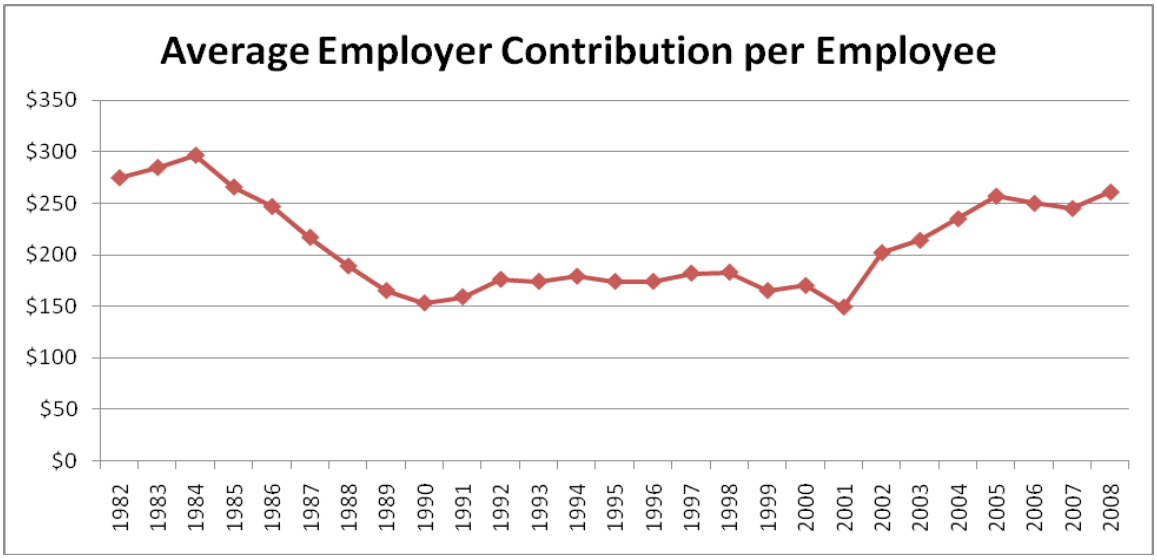
In 2000, taxes were reduced by an additional $37.5 million and benefits were increased by another $12.5 million.[13] At the time of these legislative actions, analyses of the trust fund indicated it would be adequate to meet future needs.

Unfortunately, these analyses failed to anticipate the recession which began in late 2000. The $50 million package of tax cuts and benefit enhancements enacted at the beginning of that year took full effect in 2001, just as the number of new unemployment claims sky- rocketed. Initial claims that year exceeded the previous year by over 41 percent, and the total amount of benefits paid increased by nearly $144 million in one year.[14] As a result, employer taxes to the UI system could not keep pace with the level of benefits paid out and the trust fund reserves began to drain away.

How UI Works

The federal rules for unemployment insurance require employers to pay a tax into the trust fund on at least the first $7,000 of each employee's wages.[15] Kentucky established $8,000 as its taxable wage base in 1982 when that amount represented almost 50 percent of the average annual wage in the Commonwealth.[16] The amount has remained unchanged, even though $8,000 currently represents less than 25 percent of the average annual wage.[17] (Other states use amounts ranging from $7,000 to $37,800 as their taxable wage base.)[18]

UI in Kentucky is "experience rated" – employers pay taxes on employees at different rates depending upon their ratio of tax payments to benefit charges. Employers with "good" experience (taxes exceeding benefits) will be assigned a lower rate than employers with "poor" experience (benefits exceeding taxes). The average tax paid by employers in 2008 was $261 per employee.[19]



Provided by the Education and Workforce Development Cabinet, Office of Employment and Training

Employer tax rates are assigned from one of a series of six **tax rate schedules** determined by the balance in the trust fund and the employer's corresponding **reserve ratio**. The trust fund adequacy rate (TFAR) is the lowest rate available and applied when the trust fund balance equals or exceeds 1.18 percent of total wages paid in covered employment during a fiscal year. Under schedule A, employers will pay a smaller tax than under schedule B (as long as their reserve ratio remains unchanged), while schedule B taxes will be lower than schedule C, and so on.

Tax Rate Schedule Triggers

(Millions)

Trust Fund Balance	Tax RateSchedule
≥ 1.18%	TFAR
$350	A
$275	B
$250	C
$150	D
< $150	E

The employer's reserve ratio corresponds to a specific tax rate under each schedule and is computed by subtracting the net total of benefit payments unemployed workers have claimed against the employer from the employer's net total tax contribution paid to the UI Trust Fund (Appendix A).[20]

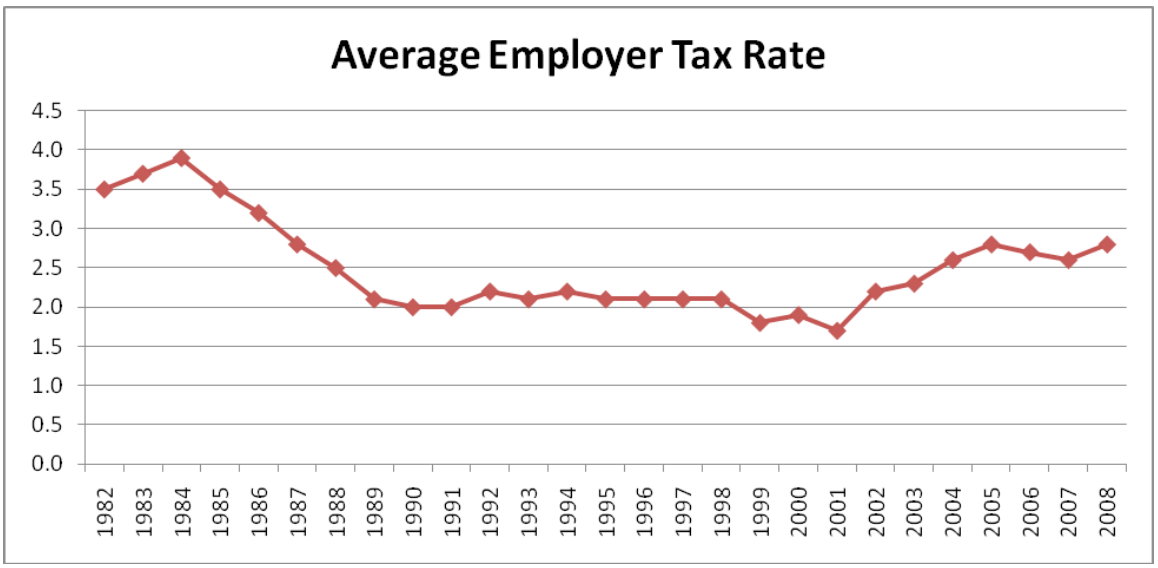
Employer's Net Total Tax Contribution - **Worker's Net Total Benefit Payments** = **Reserve Account Balance**

This amount, known as the reserve account balance, is divided by the employer's three-year **taxable payroll** (the first $8,000 of each worker's wages earned in a calendar year).[21]

Reserve Account Balance ÷ **3-Year Taxable Payroll** = **Reserve Ratio**

The reserve ratio calculation compares the size of the employer's **reserve account balance** to the size of the business and payroll and assigns the matching tax rate.[22]

Rates range from a low of 0.0 percent to a high of 10.0 percent. The average employer tax rate for 2008 was 2.8 percent of the taxable wage base of $8,000 per employee.[23]



Provided by the Education and Workforce Development Cabinet, Office of Employment and Training

Employees who are out of work and eligible can draw benefits through regular UI for up to 26 weeks. The benefit amount of a claim is calculated based on a worker's gross covered wages earned during a standard **base period** (the first four of the five most recent quarters).

To calculate a claimant's weekly benefit amount, wages covered by UI and earned in the base period are multiplied by 1.3078 percent and rounded to the nearest dollar.[24]

For example:

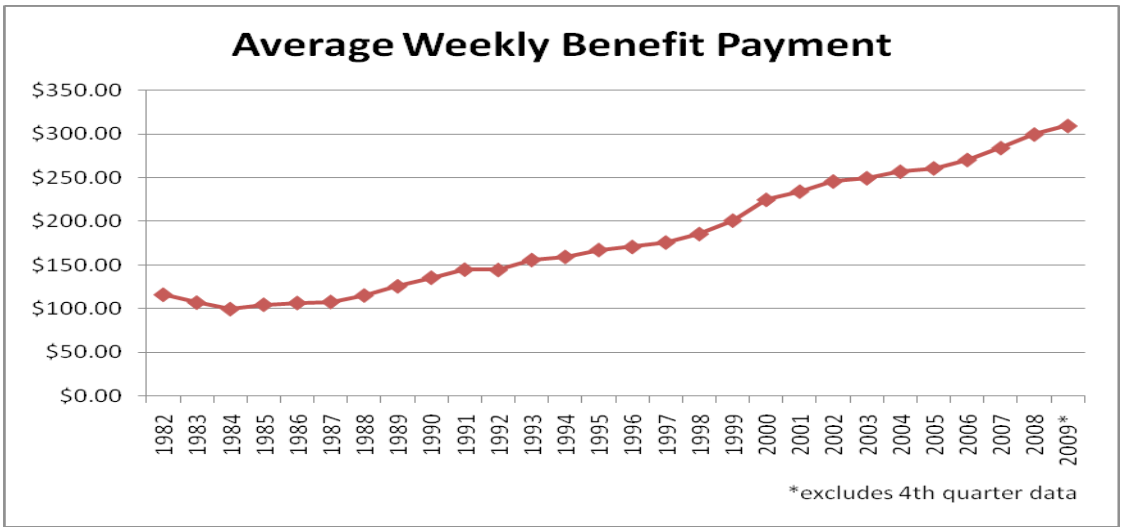
Computing the Weekly Benefit Amount

Total Base Period Covered Wages				Benefit Amount Awarded
$20,000	**x**	**1.3078%**	**=**	**$261.56 or $262.00**

The formula used to calculate benefits translates to a statutory wage **replacement rate** of 68 percent. In other words, UI benefits in Kentucky may replace up to 68 percent of a claimant's base period wages per year (assuming the claimant is eligible for 52 consecutive weeks of benefits).

The 68 percent statutory wage replacement rate divided by 52 equals 1.3078 percent and thus is the reason weekly benefits are determined by multiplying the quotient 1.3078 percent by a claimant's base period wages.

Currently no one gets a benefit greater than $415 per week. The **average weekly benefit amount** from the first through the third quarter of 2009 is $309.38.[25]



Provided by the Education and Workforce Development Cabinet, Office of Employment and Training

The maximum weekly benefit amount is calculated annually based on the previous calendar year's **average weekly wage** (AWW) in covered employment. The maximum benefit amount in Kentucky is currently set to be no more than 62 percent of the AWW.[26] However, in 2009 and 2008 the MWBA did not change from 2007, even though the average weekly wage increased, due to a freeze on the maximum weekly benefit.[27] The balance in the trust fund also governs annual benefit increases to the maximum weekly benefit per the table below.[28]

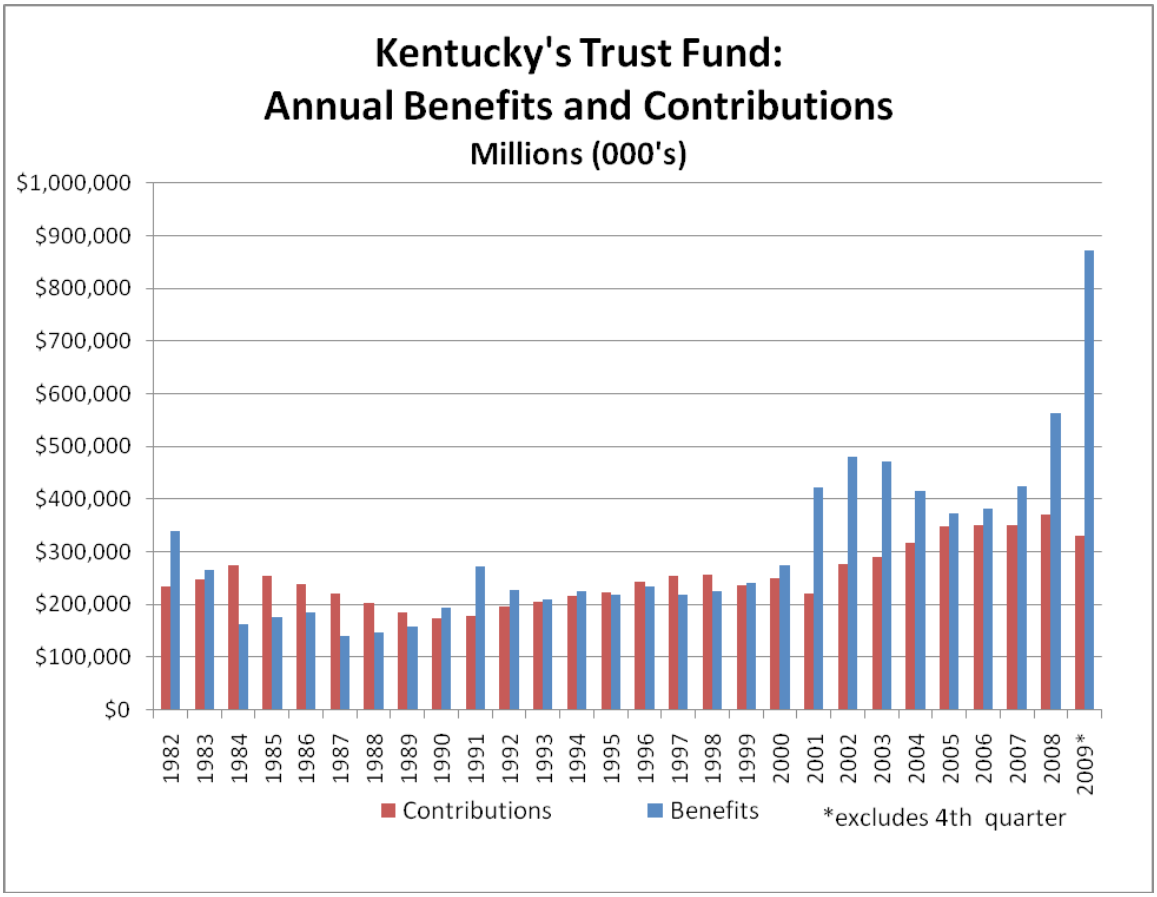
Maximum Weekly Benefit Amount Triggers
(Millions)

Trust Fund Balance	Maximum Increase in MWBA
> $350	Unrestricted
$275	12%
$250	10%
$150	8%
$120	6%
< $120	Freeze on MWBA Increase

When unemployment is low and wages are stable, more money comes into the UI system through employer taxes than is paid out in benefits. The excess goes into the UI Trust Fund, theoretically to ensure that benefits are available to qualified workers in case of an economic downturn when employers typically pay taxes on fewer workers and more people are eligible for benefits.

How UI is not Working

Since 2000, Kentucky has paid out more in unemployment benefits than it has taken in through employer taxes. The excess of regular program benefits paid over taxes received has totaled $1.606 billion between January 2001 and October 2009.[29]



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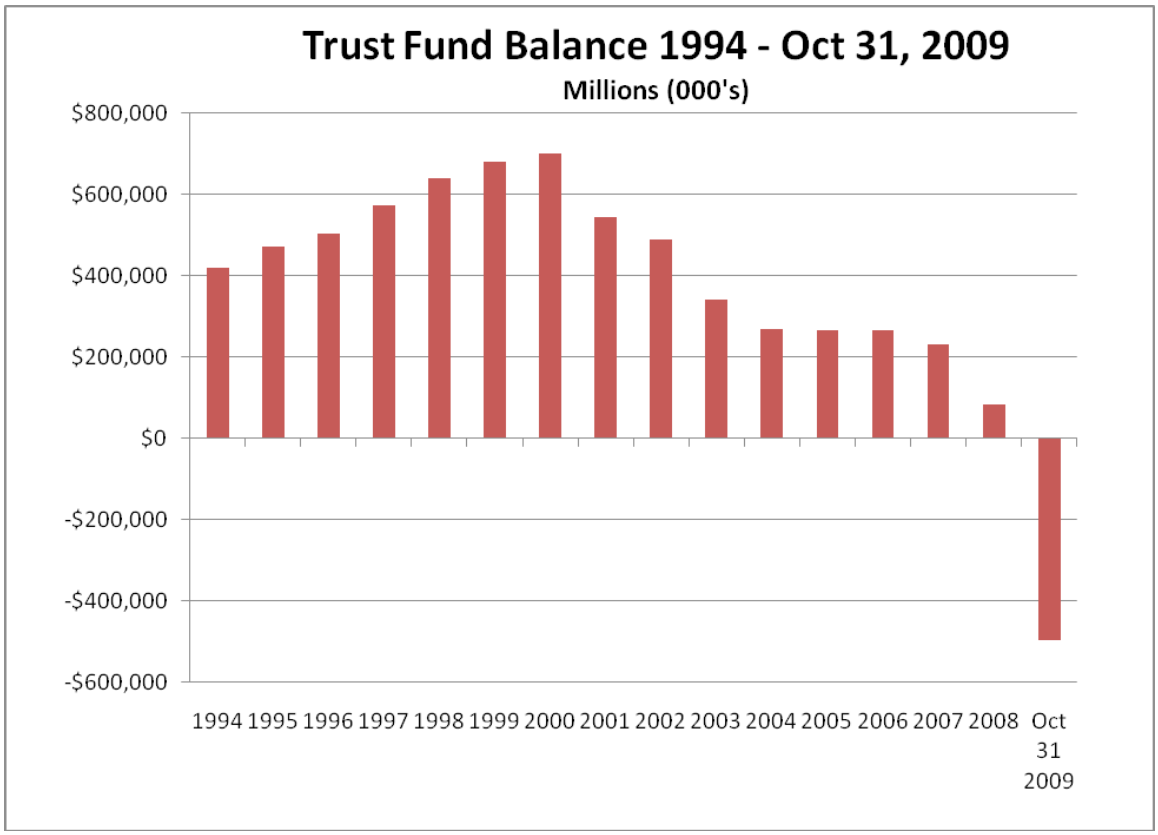
The trust fund was depleted, at least in great part, because there is an inherent structural imbalance between the statutory revenue formula (based on limited taxable wages) and the benefit formula (based on gross wages). In this system, revenue rises with job growth; benefits rise with wage inflation. Kentucky's nonfarm employment has fallen by 3.9 percent between November 2000 and November 2009.[30]

Where Are We Now

The current global economic crisis accelerated the process of UI Trust Fund depletion. Within a very short time, employers were paying taxes on fewer workers as the job market contracted and more people filed for assistance. The trust fund dropped from a balance of more than $700 million in 2000 to approximately $82 million at the end of 2008.[31]



Provided by the Education and Workforce Development Cabinet, Office of Employment and Training

On Jan. 28, 2009, current employer taxes plus trust fund reserves were no longer sufficient to cover the claims against the system. Kentucky became the sixth state (after Ohio, South Carolina, Michigan, New York, and Indiana) to begin borrowing money from the federal government in order to meet its UI obligations.

Since that date Alabama, Arkansas, California, Connecticut, Florida, Idaho, Illinois, Minnesota, Missouri, Nevada, New Jersey, North Carolina, Pennsylvania, Rhode Island, South Dakota, Texas, Virginia, Wisconsin and the Virgin Islands have also required federal assistance to pay UI benefits.[32]

Even though Kentucky continues to borrow money to meet UI payments, benefits to eligible claimants have not and will not be interrupted.

As a part of the **American Recovery and Reinvestment Act** (ARRA), Congress waived the payment and accrual of interest on loans made to bolster states' UI Trust Funds between Feb. 17, 2009, and Dec. 31, 2010.[33] That has been welcome news to cash-strapped states. There is, however, still an enormous issue for states surrounding the repayment of the loans and any interest that may accrue after Jan. 1, 2011. It concerns the yearly decrease in **Federal Unemployment Tax Act** (FUTA) offsets to payments which employers make in addition to their state UI taxes.

FUTA requires employers to pay a tax on the first $7,000 of each employee's wages.[34] The rate is set at 6.2 percent, but "offsets" are in place when Kentucky is in compliance with federal requirements, bringing the effective rate down to 0.8 percent.[35] Everyone in the state pays at the same rate, totaling to a tax of $56 per worker.

If, however, Kentucky has an outstanding balance from its borrowing for two years, the FUTA offsets decrease by 0.3 percent each year until the debt is paid in full.[36] Assuming Kentucky cannot pay off its balance within this period, the FUTA rate would climb to 1.1 percent in 2012, to 1.4 percent in 2013, and so on. The money generated through the higher rate is applied to reducing its debt.

In addition to increases in the FUTA rate, interest would start accruing in 2011 on any unpaid balance that remains. Repaying interest on the debt must be independent of rebuilding the UI Trust Fund Reserve as UI taxes may not be used for any purpose other than paying UI benefits. Payments on the debt may come from future tax revenues only if the funds borrowed were used to directly pay benefits in the past.

However, payments on interest accrued cannot be at the expense of the UI Trust Fund and must be funded by other sources such as a UI surcharge, penalty and interest accounts or appropriations from the General Assembly. While Kentucky employers have been given short-term assistance and relief from the unusually high costs of UI, increases in FUTA rates and interest payments would become a burden shared by all Kentucky employers if an outstanding balance on borrowed funds remains beyond 2010.

Restoring Kentucky's Unemployment Insurance Trust Fund: Challenges and Recommendations

In the face of these problems with UI Trust Fund solvency, Governor Steven L. Beshear appointed a task force on March 27, 2009. It was charged to study Kentucky's UI system and recommend legislative actions to retool the program so that it will generate sufficient funds to temporarily assist displaced workers, build up a cushion in the UI Trust Fund to cover future economic downturns, and treat all employers fairly without diminishing their ability to compete with those in other states.

The task force met 11 times and had opportunities to participate in five topical sessions. It consulted regularly with two leading UI economists, heard differing perspectives on UI issues, and compared Kentucky's status with that of its contiguous states as it explored a wide range of potential policy options.

UI Benefit and Rate Comparison by Surrounding States

State	Total Unemployment Rate	Benefits		Taxes	Trust Fund Borrowing
		Average Duration of Weeks Claimed	Average Weekly Benefit	Taxable Wage Base	
	Nov 2009	2009 Q2	2009 Q2	2009	Dec 10, 2009
Illinois	10.9%	17.7	$345.81	$12,300	$960,178,632
Indiana	9.6%	14.6	$310.74	$7000*	$1,412,784,282
Kentucky	10.6%	15.8	$311.83	$8,000	$545,500,000
Missouri	9.5%	18.0	$259.18	$12,500	$405,375,838
Ohio	10.6%	16.3	$315.33	$9,000	$1,615,137,799
Tennessee	10.3%	14.7	$229.03	$9,000	
Virginia	6.6%	13.5	$313.81	$8,000	$75,591,400
West Virginia	8.4%	13.8	$277.42	$12,000	

*Increases to $9,500 on Jan. 1, 2010
Provided by the U.S. Labor Department and the Bureau of Labor Statistics

The economic conditions of 2009 compounded the structural issues of Kentucky's UI system. As of Nov. 30, 2009, the Unemployment Insurance Trust Fund had paid more than $1 billion in regular UI benefits alone, while collecting only about $360 million in employer taxes during the calendar year.[37] Kentucky had borrowed $523.1 million from the federal government to meet its benefit payment obligations by the end of November 2009.[38]

The federal unemployment plan is self-correcting. As long as a state carries an outstanding balance with the federal government, federal employer taxes will increase by .3 percent per year until the state has repaid all funds borrowed from the federal government to meet unemployment insurance obligations.[39]

The choice facing Kentucky is not whether to raise unemployment insurance taxes. Taxes will be raised. The choice is whether to raise taxes under the federal plan or through a plan determined by state interests.

The task force engaged the services of Dr. Wayne Vroman of the Urban Institute and Dr. Christopher O'Leary of the Upjohn Institute for Employment Research, two nationally recognized experts on unemployment insurance (Appendix B).

Dr. Vroman constructed a comprehensive regression model based on Kentucky's historical UI data and developed projections on future outcomes. The model accounts for behavioral relations between taxes and benefits, those of which are of central interest to policy makers and stakeholders alike.

Projections from the model have been extended to the year 2022 in order to estimate potential costs and savings opportunities within UI, as well as to estimate the overall financial impact of the current recession on the trust fund reserve account, employer taxes and worker benefits.

The data used in the model is based on forecasts from the same underlying assumptions used by the Governor's Office for Economic Analysis to aid the Consensus Forecasting Group (CFG) in making their annual projections.

The experts examined how application of the current law would affect Kentucky's employers, workers and UI program over the next 12 years. The table below demonstrates their projections.

Table 1A. Do-nothing scenario extended to 2022, tax and benefit statutes unchanged

	Unemp. Rate	TWB	FUTA Credit Offset	Taxes to Trust Fund	Trust Fund Interest Earned	Interest Paid on Trust Fund Debt	Total Taxes	Benefits	Annual Trust Fund Deficit	Trust Fund Balance
							[7+8+9]		[8]+[8A]	
	[1]	[2]	[7]	[8]	[8A]	[9]	[10]	[11]	-[11]	[12]
2007	5.55	8,000	0	350	12	0	350	393	-31	231
2008	6.45	8,000	0	370	9	0	370	539	-160	82
2009	10.40	8,000	0	382	0	0	382	1,094	-712	-630
2010	11.08	8,000	0	450	0	0	450	833	-383	-1,013
2011	10.43	8,000	34	509	0	58	601	686	-177	-1,156
2012	9.41	8,000	72	547	0	62	681	601	-54	-1,138
2013	8.77	8,000	113	561	0	59	734	607	-46	-1,071
2014	8.46	8,000	156	566	0	55	777	628	-62	-977
2015	8.17	8,000	202	570	0	48	821	621	-51	-826
2016	7.85	8,000	251	571	0	39	860	607	-36	-610
2017	7.53	8,000	303	567	0	25	895	595	-28	-335
2018	7.10	8,000	359	561	0	9	930	564	-3	21
2019	6.63	8,000	0	551	2	0	551	536	16	37
2020	6.30	8,000	0	568	3	0	568	536	34	72
2021	6.00	8,000	0	584	5	0	584	527	63	134
2022	6.00	8,000	0	593	8	0	593	578	23	158
2010-2022	7.98	8,000	1,491	7,197	17	356	9,044	7,919	-703	158

Provided by Dr. Wayne Vroman: Kentucky's UI costs under a high unemployment scenario if no legislative action is taken (Simulation 1A)
For an explanation of the captions, see Appendix C.

Under the current law, employer taxes would increase through the FUTA credit offset. Employers would pay an additional $1.491 billion to the federal government to retire the principal due to the federal government. Interest charges, paid by employers, will add another $356 million, for a total additional tax for employers of $1.847 billion.

The trust fund would have a balance of $72 million by 2020, and $158 million by 2022, barely enough to cover one month's payment of benefits in 2009. Workers would forego $1.147 billion due solely to the freeze of the maximum weekly benefit. The MWBA will be frozen from 2007 to 2022, representing a significant decrease in purchasing power.

First, though, there is a caveat. The simulations are based on assumptions. They are not predictions of future events. These simulations and assumptions are used for comparing the relative impact of different proposals. The "Do-nothing" analysis, for example, assumes there will not be any economic downturns for the next decade.

In forecasting the costs of Kentucky's future UI program, the experts considered numerous variables that affect employers, claimants, taxes and benefits based upon UI trends in the past. The analysis then focused upon revenue expectations and employer costs. The TWB determines the taxes paid directly into Kentucky's UI Trust Fund, while other costs include the interest due on the loans to the trust fund and the decrease in the FUTA credit offset, which go to the federal government.

Lastly, the costs of benefits are determined based on future wage estimates and the **total unemployment rate** (TUR). The difference between benefits paid and taxes taken into the trust fund, plus the FUTA credit offset, and interest earned determine the balance of the trust fund.

The task force then analyzed a number of alternatives incorporating variations of several tax and benefit changes. Members focused on scenarios that would cost employers less than the current system, ensure that temporary assistance is available to eligible workers, and restore the trust fund reserve account over the next 12 years.

The task force chose gradually increasing the TWB, reducing the statutory replacement rate (decreasing benefits from 68 percent of a claimant's base period wages to 62 percent), adjusting the triggers for the freeze on the MWBA, and changing the triggers that apply to the adoption of a different tax schedule. The effect of the adoption of these tax and benefit changes is shown below in Simulation 18.

Simulation 18. Higher tax base, new thresholds for tax schedules and increases in MWBA, waiting week in 2012, Statutory Replacement Rate = 0.620.

	Unemp. Rate	TWB	FUTA Credit Offset	Taxes to Trust Fund	Trust Fund Interest Earned	Interest Paid on Trust Fund Debt	Total Taxes	Benefits	Annual Trust Fund Deficit	Trust Fund Balance
							[7+8+9]		[8]+[8A]	
	[1]	[2]	[7]	[8]	[8A]	[9]	[10]	[11]	-[11]	[12]
2007	5.55	8000.00	0	350	12	0	350	393	-31	231
2008	6.45	8000.00	0	370	9	0	370	539	-160	82
2009	10.40	8000.00	0	382	0	0	382	1094	-712	-630
2010	11.08	8000.00	0	450	0	0	450	833	-383	-1013
2011	10.43	8000.00	34	509	0	58	601	686	-177	-1156
2012	9.41	9000.00	72	589	0	59	720	550	38	-1046
2013	8.77	9300.00	113	606	0	52	771	556	50	-883
2014	8.46	9600.00	156	613	0	42	812	575	38	-688
2015	8.17	9900.00	202	619	0	30	851	569	50	-436
2016	7.85	10200.00	251	620	0	15	886	555	65	-121
2017	7.53	10500.00	303	616	4	3	922	544	75	257
2018	7.10	10800.00	0	541	14	0	541	519	36	294
2019	6.63	11100.00	0	568	18	0	568	498	88	382
2020	6.30	11400.00	0	551	22	0	551	504	69	451
2021	6.00	11700.00	0	572	26	0	572	505	93	543
2022	6.00	12000.00	0	558	29	0	558	568	18	562
2010 - 2020			1132	6281	58	260	7673	6389	-51	451
2010 - 2022			1132	7410	112	260	8802	7462	60	562

Provided by Dr. Wayne Vroman: Kentucky's UI costs if proposed recommendations are enacted (Simulation 18)
For an explanation of the captions, see Appendix C.

With these changes, the simulation projects that employers will save more than $455 million in federal tax and interest charges compared to the "Do-nothing" scenario. The balance in the trust fund would grow by $404 million, creating a reasonable cushion to protect against future economic down turns. State UI taxes would increase by $213 million over 12 years. Benefit payouts will be reduced by $243 million more than in the "Do-nothing" option and the cap on the MWBA will be removed in 2018 instead of 2022.

Dr. Vroman's analysis indicates that the sacrifices necessary to retire the debt to the federal government and return the system to structural balance will be borne 48 percent by workers and 52 percent by the employer community.

Based upon the model simulations, financial projections, witness testimony, consultant recommendations and the interest of all Kentucky UI stake holders, the task force recommends the following package of changes:

Recommendation 1: Increase the taxable wage base from $8,000 to $9,000 in 2012, and increase thereafter in annual increments of $300 to a TWB of $12,000 in 2022.

The TWB is the amount of each employee's wages upon which the employer pays taxes for unemployment insurance. The federal government requires that states adopt a taxable wage base of at least $7,000. States currently use TWBs that range from $7,000 to $37,800.[40] Of all Kentucky's border states, only Virginia has a TWB as low as Kentucky's.

When Kentucky last made a total revision to its UI legislation in 1982, $8,000 was adopted as the TWB. At that time, this amount represented approximately one-half of the average annual wages in Kentucky. Today, the TWB adopted 27 years ago represents only approximately one-fourth of the average annual wage in Kentucky.[41]

To establish a structural balance in the system, the basis for adjusting the tax system must complement the basis for adjusting benefit obligations.

Benefit obligations are based on increases in wage payments. Kentucky's tax has been static based on a fixed taxable wage base. Revenue growth occurs only when the number of jobs grows. From November 2000 to November 2009, the number of nonfarm jobs in Kentucky has declined by 3.9 percent.[42] The total number of Kentucky nonfarm jobs lost during this nine-year period reported by the Bureau of Labor Statistics totals 71,700.[43]

Members of the task force agreed to establish incremental increases in the TWB sufficient to meet both growth requirements and recovery requirements. The task force chose not to index the TWB to growth in average weekly wages, believing it better to designate the specific adjustments to the TWB in legislation, allowing for more specific oversight by the General Assembly.

Recommendation 2: Implement a waiting week in 2012.

Eligible workers are allowed to draw benefits under regular UI for 26 weeks. In Kentucky these weeks begin immediately after job separation.

Thirty-seven states currently impose a one-week waiting period on benefit claims, in addition to the District of Columbia, Puerto Rico and the Virgin Islands. In all of Kentucky's border states there is a waiting period of one week after eligible workers file a claim before they can begin to receive benefits.

Through the first three quarters of 2009, the average number of benefit weeks claimed under UI was 17.1 weeks.[44] Dr. Vroman's simulation projects Kentucky saving approximately $34 million per year by instituting a waiting week before making the first payment on a claim, although over time, depending on the circumstances, the value of a waiting week varies (Appendix D).[45] These savings come from the one week's benefits that would not be distributed to people who return to work without exhausting their regular benefits. Those claimants who experienced more difficulty in finding a job would still be eligible for the full 26 weeks of regular UI benefits.

Recommendation 3: Reduce the statutory wage replacement rate from 1.3078 percent (68 percent) to 1.1923 percent (62 percent) in 2012.

To calculate a claimant's weekly benefit amount, the covered wages earned in the base period are multiplied by 1.3078 percent, and rounded to the nearest dollar.

Total Base Period Covered Wages				Benefit Amount Awarded
$20,000	**x**	**1.3078%**	**=**	**$261.56 or $262.00**

This calculation corresponds to Kentucky's statutory wage replacement rate of 68 percent. In other words, weekly UI benefits may replace up to 68 percent of a claimant's average weekly wage (limited by the maximum weekly benefit). Base period wages (which represent a whole years worth of earnings) are multiplied by 1.3078 percent, the quotient of 68 percent divided by 52 weeks in a year.

Kentucky's statutory wage replacement rate of 68 percent is currently the highest in the nation.

Reducing the replacement rate from 68 percent to 62 percent (or 1.1923 percent of base period wages per benefit week) restores the rate to that in effect prior to the changes enacted in 2001.[46]

Recommendation 4: Change the tax rate schedule triggers to the following when the trust fund balance is above:

(Millions)

Proposed	Tax Schedule	Current
1.18%	TFAR	1.18%
$500	A	$350
$350	B	$275
$250	C	$250
$150	D	$150
<$150	E	<$150

The triggers that move employers from one tax rate schedule to another are a function of the balance in the trust fund as of the calendar year end. The dollar levels are so close to one another that the triggers eliminate some of the benefit of the tiered system. The move from Schedule B to Schedule C, for example, is predicated on a $25 million change in the trust fund balance. To put this into perspective, $25 million is less than a single week of benefits for Kentucky claimants in 2009.

Recommendation 5: Change the triggers for the maximum increase in the MWBA (so that the MWBA may not increase in adjacent years by more than the following percentage when the trust fund balance is equal to or greater than):

(Millions)

Proposed		Current	
Trust Fund Balance	**Max Increase in MWBA**	**Trust Fund Balance**	**Max Increase in MWBA**
$500	15%	$350	Unrestricted
$400	12%	$275	12%
$300	10%	$250	10%
$200	8%	$150	8%
$120	6%	$120	6%
<$120	Freeze on MWBA Increase	<$120	Freeze on MWBA Increas

The weekly benefit amount is based on a claimant's wage history, subject to a statutory minimum (currently $39 per week) and a statutory maximum (currently $415 per week) that can change annually. The MWBA any UI claimant can receive is 62 percent of the average weekly wage of covered workers in Kentucky. The MWBA generally increases over time with the growth in total wages.

When there is a tax rate schedule increase from one year to the next, the MWBA is frozen. If the tax schedule remains the same or triggers to a lower schedule, the MWBA can again rise relative to wage increases, if the trust fund balance exceeds $120 million. [47]

Currently, annual increases in the MWBA have been limited based on the UI Trust Fund balance and the tax rate schedule in use. If either Schedule A or the Trust Fund Adequacy Rate is in effect, there is no statutory cap on the amount of increase allowed for the MWBA. The maximum benefit would be totally dependent on average weekly wages in Kentucky covered employment. If Schedule B is in effect, the MWBA cannot increase more than 12 percent. Under Schedule C, the MWBA is capped at 10 percent; Schedule D, 8 percent; Schedule E, 6 percent. There are no provisions for reducing the MWBA once it rises.

If the trust fund balance falls below $120 million, the MWBA is frozen and an increase is not allowed. In 2008 and 2009 the MWBA was frozen at the 2007 MWBA $415 per week. Approximately one-third of claimants qualify for the maximum weekly benefit amount. Retaining the feature that freezes the MWBA when the trust fund balance is below $120 million or when a higher schedule is triggered would allow the system breathing room to recover. Currently the MWBA is projected to be frozen at $415 a week until 2022.[48] With the proposed change, the cap will be allowed to float five years sooner.

Recommendation 6: Back up all calculation dates in KRS 341.270 by one calendar quarter to allow OET to mail employer tax rates prior to Dec. 15.

Under the current system, employers are not notified of their annual UI tax rate until late February or early March. By the time employers receive notification of their tax rate, it has already been in effect since Jan. 1 of that year. Employers should be notified further in advance and prior to the date that the new tax rate becomes effective.

Backing up all computation dates used in KRS 342.270 by one calendar quarter will allow businesses to improve their planning and budgeting capabilities. With this change, OET will be able to mail out employer tax rates by mid-December, allowing employers to better prepare for paying the tax bills they receive.

Recommendation 7: Change procedure for notifying employers about new claims; allow voluntary use of electronic notice for employers; use tax address or other address preferred by employer instead of relying on address provided by applicant.

Under the current system, employers are notified at the address provided by the claimant whenever a claim is filed against them. Some employers have multiple locations but only one center that handles all employment matters. This allows an opportunity for information to be delayed as it is rerouted to the proper location.

To improve the system and to take advantage of available technology, the task force recommends that employers be given the option of using electronic notification for UI claims filed against them. Employers would be responsible for maintaining accurate e-mail address accounts with OET if they choose to use this method of notification.

Recommendation 8: Increase the protest period from 10 days to l5 days after a claim is filed.

Many Kentucky businesses are small employers with limited resources. Imposing strict timelines with a small window for protesting claims charged against them has the potential for creating an unnecessary hardship on employers. Additional time is needed so that Kentucky employers can manage their account and protest questionable charges without creating undue burden. Preparing a case and disputing a UI claim can be time consuming and therefore the protest period should provide the employer sufficient time to do so.

This increase in the time to file a protest will not increase the time it takes for a claimant to begin receiving benefits.

Recommendation 9: Increase efforts to inform public about the fraud detection efforts used in UI and their success; more knowledge may deter fraud.

The Unemployment Insurance Division employs sophisticated fraud detection programs and is highly rated in its efforts to combat fraud. Greater public awareness of the probability of being caught and the penalty for fraud may enhance compliance and reduce efforts to defraud the system.

Recommendation 10: Improve information sharing among OET, the Department of Revenue, the Finance and Administration Cabinet, the Kentucky Labor Cabinet and other state agencies, in order to better identify individuals and entities that create for themselves a competitive advantage by paying employees in cash, thereby potentially avoiding paying correct amounts of UI, payroll, workers compensation and income taxes.

Increased collaboration and information sharing between cabinets and agencies responsible for auditing employer finance and worker activities will improve opportunities for detecting employer fraud.

Whistleblower protections should also be emphasized to encourage the reporting of fraudulent activities.

Recommendation 11: Institute random audits to test accuracy of six-week review information (work search effort reports) submitted by recipients.

The most effective way to lower UI benefit costs is to get people who have lost their jobs back to work. Currently regular UI claimants are required to do at least one job search per

week. Random audits (checking with employers listed by claimants as their weekly contacts) should be implemented to ensure that bona fide search activities are taking place.

Recommendation 12: Re-examine forms and publications for readability and effective communication of definitions, rules and procedures.

Kentucky's system of unemployment insurance is complex, and most people have very little contact with it. All forms and publications, whether in print or online must be understandable to their prospective users and provide effective communication of UI definitions, rules and procedures.

Recommendation 13: Review management of appeals process.

The appeals process can be both daunting and complex. Attorneys are not required.[49] To better ensure that parties are prepared, both parties should be given a list of issues and witnesses before the hearing. If the information is not provided in advance then a continuance should be provided.

Unemployment insurance laws can be highly technical. Decisions of the referees and the Unemployment Insurance Commission provide guidance for the practical application of the law.

The OET should improve the analysis of the issues and decisions arising during the appeals process. The analysis should be used to better train disputed claims investigators and appeals referees, in an effort to secure more uniformity and consistency across the state in the application of UI rules.

Update the Kentucky Unemployment Insurance Digest. This resource compiles UI Commission Orders in a searchable format. Making it more user-friendly for laypersons that are not as familiar with the complexities of the UI system, as are legal practitioners and OET staff, would provide better guidance for employees and employers alike by making this useful material more widely available to those who might need it.

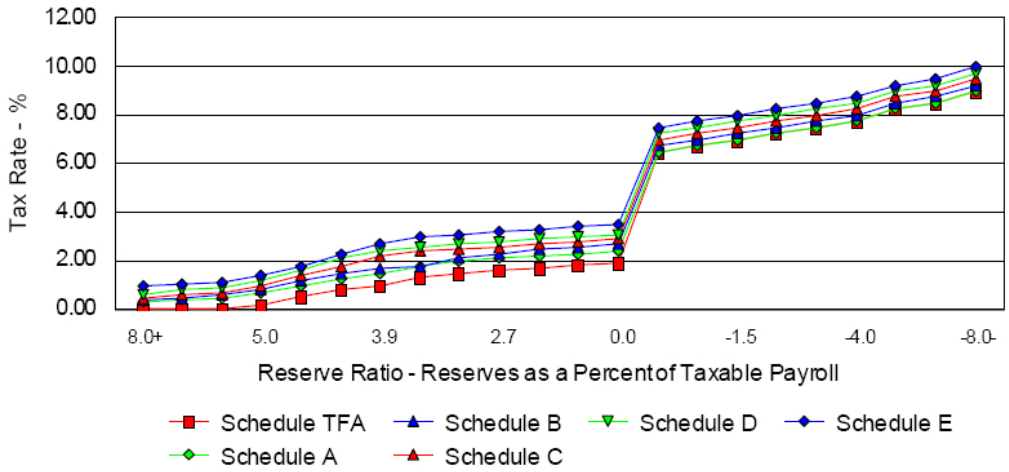
Recommendation 14: Offer training programs for employers managing the unemployment process. Review completion of forms; offer mock appeals hearings; explain voluntary contributions. Offer these programs both independently and in conjunction with employer organizations.

The OET should develop a program to help employers and worker organizations become more familiar with the ins and outs of the UI process. It could include such things as completing forms, presenting mock appeals hearings, and explaining voluntary contributions. Information could be delivered in employer facilities, at meetings of employer groups, by Webinar or in other ways that would assist employers in understanding the UI system.

Recommendation 15: Implement an affirmative outreach program to employers whose reserves are less than negative 3 percent of wage base to explain voluntary contributions as a means of decreasing their tax rate.

When an employer's reserve ratio moves from a positive balance to a negative balance there is a sharp increase – in fact a more than four percentage points increase --in the tax rates assigned to the employer.

Tax Rates on Six Rate Schedules



Information provided by the Education and Workforce Development Cabinet, Office of Employment and Training, Kentucky's Unemployment Insurance Employer Guide 2008

Employers are allowed to make **voluntary contributions** (tax payments) to the UI system in addition to those required by statute. When made within 20 days following the mailing of tax rate notices (but no later than the end of the first quarter of the year), these voluntary payments are added to the employer's reserve account and, thus, may reduce the tax rate which will be applied during the year.

During the past several years, an average of about 200 Kentucky employers per year took advantage of voluntary contributions to reduce their tax rates. In each year, the reduced tax rates cost the overall UI system approximately 1 percent in revenue.

The OET should reach out to employers whose reserve accounts have moved from positive to low negative balances. This should assist struggling employers to stay in business and to maintain their staff levels.

On the other hand, the privilege of voluntary contributions should not be abused. Voluntary contributions should be allowable only when doing so moves an employer's account from a negative reserve ratio to a positive one and should be limited to once every other year.

Recommendation 16: Enhance re-employment strategies and services through the Division of Workforce and Employment Services and the one-stop career centers, emphasizing re-employment and retraining for the older, experienced, dislocated worker.

The best approach for restoring fiscal solvency for the trust fund is to get people back to work. The current changes in the economy are altering the types of jobs available in the workplace. Greater efforts must be made to prepare employees for the job market, to retrain those who have lost their employment for the jobs of the future, and improve the knowledge and performance level of Kentucky's employees to support the employer community.

Recommendation 17: Direct the Cabinet to recommend an acceptable process for recovering the subsidized costs from reimbursing employers.

Not all employers participating in the UI program pay an unemployment tax on their employees. The USDOL stipulates that certain types of employers (e.g. governmental entities and 501 (c)(3) non-profit organizations meeting certain subjectivity requirements) are eligible to elect a reimbursing employer status if they so chose.

Instead of paying regular UI taxes, reimbursing employers agree to cover 100 percent of the UI benefit costs paid to laid-off employees when they are the responsible charging employer. OET covers the cost upfront of reimbursable claims and retroactively bills liable employers for the full amount of claims charged at the end of each quarter.

Under the current system, reimbursing employers do not pay any portion of the losses due to a reimbursing employer going out of business or the loss of interest accrual (which occurs between the time OET pays reimbursable worker's benefits and the time reimbursable employers repay OET). Given the current financial circumstances of Kentucky's UI system, the task force thinks it is appropriate to manage the collective liability costs that reimbursing employers may have on the trust fund.

There are several allowable options to manage these risks, provided by the federal government and the USDOL.

1. **Lost interest account**: States may prevent the loss of interest to the UI Trust Fund by requiring either advance payments or additional payments in order to practice sound cash management principles and protect the solvency of the UI Trust Fund.

2. **Establishing collective liability for unrecovered UI costs:** States are permitted to minimize contributing employers from subsidizing unrecovered UI costs from reimbursing employers by establishing a collective liability method for reimbursing employers.

   This method is useful when there is not a single reimbursing employer responsible for previously employing a claimant. In this scenario, multiple reimbursing employers can be required to collectively pay the benefits based on the claimants' time spent in their employ. Collective liability accounts may charge reimbursing employers up to 100 percent of the uncollected UI costs, but not in excess of this amount.

3. **Payments from contributing and reimbursing employers:** Collective liability may also be discharged through socializing unrecovered UI costs amongst all employers, without regard to whether an employer is contributing or reimbursing. Under this method all employers would be assessed a uniform rate (surcharge) that would be applied to all covered employers. There would not be conflict with compliance criteria as long as reimbursing employers are not singled out and the following stipulations are met:

   - Provisions for charging reimbursing employers are the same as they are for contributing employers

   - OR serve to decrease the liability of reimbursing employers in comparison to contributing employers

   - AND unrecovered UI costs (as a percentage of total UI costs) are not greater for contributing employers than the unrecovered costs of reimbursing employers

   If these conditions are not met, reimbursing employers would be improperly subsidizing the contributing employers' unrecovered UI costs. The USDOL requires all of these conditions to be met in order to enact the uniform payment method.

UI Modernization

Adopted as part of the American Reinvestment and Recovery Act (ARRA), Unemployment Insurance Modernization offers financial incentives to states to update certain elements of their unemployment system.

Kentucky is eligible for $90 million in UI incentive funds for the following changes.

- To qualify for the first $30 million of the eligible incentive, Kentucky must establish an alternative base period (ABP) which includes the most recently completed calendar quarter.

  Option One: All applicants for unemployment compensation will have a base period for wages earned consisting of the most recent four completed calendar quarters prior to the benefit year.

  Option Two: Applicants for unemployment compensation determined to be monetarily ineligible under the current system will be reconsidered using a base period for wages earned consisting of the most recently completed four calendar quarters prior to the benefit year.

- To qualify for the remaining $60 million of the eligible incentive, Kentucky must adopt two of these four program expansions:

  - Increase the benefit payable by providing an allowance of at least $15 per dependent, per week, with a maximum cap of the lesser of $50 or 50 percent of the individual's weekly benefit amount

  - Part-time workers are eligible for benefits if they are seeking only part-time employment.
    - This provision would allow eligible part-time workers to receive benefits while searching for part-time employment. Currently only those searching for full-time employment are eligible.

  - Allow benefits for a person who quits work for compelling family reasons, including:
    - Domestic violence,
    - Illness or disability of member of immediate family or
    - Need to accompany a spouse due to relocation.

  - Authorize weekly benefits for up to 26 weeks for a person who (a) is unemployed; (b) has exhausted all benefits including EUC; and (c) has enrolled in an approved training program for a high-demand occupation.

The benefit of the ABP is that it accounts for a worker's most recent wage history, which is presumably higher. Higher wages mean higher benefit payments for workers.

The economic analysis of the two different options show that monetary eligibility increases most with Option Two, while administrative costs increase the most under Option One.

Costs and Benefits of Alternative Base Period		
	Option One	**Option Two**
Increase in Monetary Eligible Claims	0.90%	2.82%
Increase in UI Benefit Payments	1.55%	1.17%
Normal Year UI Benefits Increase	$8,767,030	$5,609,603
Recession Year UI Benefits Increase	$12,117,754	$9,152,843
Normal Years of ABP Covered by Stimulus Funds	4.0	5.4
Recession Years of ABP Covered by Stimulus Funds	2.5	3.3

Provided by Dr. Christopher O'Leary: *Unemployment Modernization in Kentucky* (Power Point) UI Task Force Meeting: Oct. 27, 2009

The cost of maintaining the changes from a standard base period (SBP) to an ABP would exceed the $30 million benefit in 2.5 to 4 years under Option 1 and 3.3 to 5.4 years under Option 2.[50]

If Kentucky were to adopt an ABP, it then is eligible for an additional $60 million in stimulus funding by enacting two of four program expansions.

Dr. O'Leary's analysis of the UI modernization program expansions found results similar to the ABP analysis. The costs of implementing permanent program expansions would consume the federal incentives in the matter of years or even months.

The data indicated that implementing a dependent's allowance (and excluding spouses as dependents) would be approximately five times as costly as implementing an ABP. The portion of the ARRA grant intended to assist Kentucky in making this adjustment (approximately half of the phase two incentive) would be spent in about one year in normal economic conditions, or as early as eight months in recessionary periods.[51]

Implementing a program that allows workers to receive benefits when they leave a job for compelling family reasons would cost nearly triple the amount of implementing the ABP. The estimated expenses of this program expansion would consume the incentive funds within the first year.

The cost analysis of the remaining two programs, a training allowance for claimants that have exhausted their benefits and a provision for making part-time workers looking for part-time work eligible to receive UI benefits, was not completed as of Dec. 31, 2009.

The task force believes that the decision to accept modernization monies would best be saved for a later date. The ARRA permits states to consider modernization through 2011. Because of the current financial condition of the UI Trust Fund, it is appropriate to address program expansion only after the structural imbalance issues are addressed.

ENDNOTES

[1] U.S. Bureau for Labor Statistics, State and Area Employment, Hours and Earnings (Kentucky, Statewide, Nonfarm, Seasonally Adjusted) 21 Dec. 2009 < http://www.bls.gov/data/ >.
In Nov. 2000, there were 1,830,500 nonfarm jobs in Kentucky. By Nov. 2009, that number had declined by 71,700 for a total of 1,758,800 nonfarm jobs in Kentucky, according to preliminary estimates by the Bureau of Labor Statistics.
[2] U.S. Bureau for Labor Statistics, Local Area Unemployment Statistics Program (seasonally adjusted).
[3] ibid
[4] ibid
[5] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[6] *UI Budget.* 17 Dec. 2009: <http://workforcesecurity.doleta.gov/unemploy/budget.asp>.
[7]*Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[8] ibid
[9] U.S. Bureau for Labor Statistics, Quarterly Census of Employment and Wages, (Kentucky Statewide, All industries, Total Covered) 21 Dec. 2009: < http://www.bls.gov/data/ >.
[10] Education and Workforce Development Cabinet, Office of Employment and Training. Email.
[11] ibid
[12]*Governor's Task Force on Unemployment Insurance*. 15 April 2009. Education and Workforce Development Cabinet, Office of Employment and Training.
[13] ibid
[14] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[15] 26 U.S.C. §3306
[16] KRS 341.030 (7)
[17] ibid
[18] *End of Session Strategy on UI and Appropriations Taking Shape.* 11 Dec. 2009: <http://www.workforceatm.org/sections/pdf/2009/bu121109.pdf>.
[19] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[20] *Unemployment Insurance Employer Guide.* Education and Workforce Development Cabinet, Office of Employment and Training. Print publication.
[21] ibid
[22] ibid
[23] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[24] KRS 341.380 (2)
[25] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[26] KRS 341.380 (3)
[27] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[28] KRS 341.380 (3)
[29] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[30] U.S. Bureau for Labor Statistics, State and Area Employment, Hours and Earnings (Kentucky, Statewide, Nonfarm, Seasonally Adjusted) 21 Dec. 2009 < http://www.bls.gov/data/ >.
In Nov. 2000, there were 1,830,500 nonfarm jobs in Kentucky. By Nov. 2009, that number had declined by 71,700 to total of 1,758,800 nonfarm jobs in Kentucky, according to preliminary estimates by the Bureau of Labor Statistics.
[31] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.

[32] *UI Budget.* 17 Dec. 2009: <http://workforcesecurity.doleta.gov/unemploy/budget.asp>.
[33] UIPL 14-09
[34] 26 U.S.C. §3306
[35] 26 U.S.C. §3301 & 26 U.S.C. §3302
[36] 26 U.S.C. §3302
[37] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[38] ibid
[39] 26 U.S.C. §3302
[40] *End of Session Strategy on UI and Appropriations Taking Shape*, The Urban Institute, 11 Dec. 2009: <http://www.workforceatm.org/sections/pdf/2009/bu121109.pdf>.
[41] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[42] U.S. Bureau for Labor Statistics, State and Area Employment, Hours and Earnings (Kentucky, Statewide, Nonfarm, Seasonally Adjusted) 21 Dec. 2009: < http://www.bls.gov/data/ >.
In Nov. 2000, there were 1,830,500 nonfarm jobs in Kentucky. By Nov. 2009, that number had declined by 71,700 to total of 1,758,800 nonfarm jobs in Kentucky, according to preliminary estimates by the Bureau of Labor Statistics.
[43] ibid
[44] *Compars*. Education and Workforce Development Cabinet, Office of Employment and Training. Excel Spreadsheet.
[45] Vroman, Wayne. *Effects of Specific Benefit Reductions2010-2012*. Excel Spreadsheet, 18 Nov. 2009: UI Task Force Meeting.
[46] KRS 341.380 (2)
[47] ibid
[48] Vroman, Wayne. *SimSum12210,* The Urban Institute, 21 Dec. 2009: Excel Spreadsheet.
[49] KRS 341.470 (3)(a)
[50] O'Leary, Christopher. *Unemployment Modernization in Kentucky.* W.E. Upjohn Institute for Employment Research, Power Point, 27 Oct. 2009: UI Task Force Meeting.
[51] O'Leary, Christopher. *Unemployment Insurance Modernization in Kentucky: Dependents Allowance Simulations*, W.E. Upjohn Institute for Employment Research, 23 Oct. 2009: Power Point.
[52] KRS 341.380 (2)

Appendix A

Employer Tax Rate Schedules

Referred to on page 17

Reserve Ratio	Trust Fund Adequacy Rate	A	B	C	D	E
8.0% and over	0.000%	0.30%	0.40%	0.50%	0.60%	1.00%
7.0% but under 8.0%	0.000%	0.40%	0.50%	0.60%	0.80%	1.05%
6.0% but under 7.0%	0.008%	0.50%	0.60%	0.70%	0.90%	1.10%
5.0% but under 6.0%	0.208%	0.70%	0.80%	1.00%	1.20%	1.40%
4.6% but under 5.0%	0.508%	1.00%	1.20%	1.40%	1.60%	1.80%
4.2% but under 4.6%	0.808%	1.30%	1.50%	1.70%	2.10%	2.30%
3.9% but under 4.2%	1.008%	1.50%	1.70%	2.20%	2.40%	2.70%
3.6% but under 3.9%	1.308%	1.80%	1.80%	2.40%	2.60%	3.00%
3.2% but under 3.6%	1.508%	2.00%	2.10%	2.50%	2.70%	3.10%
2.7% but under 3.2%	1.608%	2.10%	2.30%	2.60%	2.80%	3.20%
2.0% but under 2.7%	1.708%	2.20%	2.50%	2.70%	2.90%	3.30%
1.3% but under 2.0%	1.808%	2.30%	2.60%	2.80%	3.00%	3.40%
0.0% but under 1.3%	1.907%	2.40%	2.70%	2.90%	3.10%	3.50%
-0.5% but under 0.0%	6.500%	6.50%	6.75%	7.00%	7.25%	7.50%
-1.0% but under -0.5%	6.750%	6.75%	7.00%	7.25%	7.50%	7.75%
-1.5% but under -1.0%	7.000%	7.00%	7.25%	7.50%	7.75%	8.00%
-2.0% but under -1.5%	7.250%	7.25%	7.50%	7.75%	8.00%	8.25%
-3.0% but under -2.0%	7.500%	7.50%	7.75%	8.00%	8.25%	8.50%
-4.0 but under -3.0%	7.750%	7.75%	8.00%	8.25%	8.50%	8.75%
-6.0% but under -4.0%	8.250%	8.25%	8.50%	8.75%	9.00%	9.25%
-8.0% but under -6.0%	8.500%	8.50%	8.75%	9.00%	9.25%	9.50%
Less than -8.0%	9.000%	9.000%	9.25%	9.50%	9.75%	10.00%

Appendix B

Consultant Vitas

Referred to on page 24

Wayne Vroman **October 2008**
Economist
Labor, Human Services and Population Center
The Urban Institute

Education

1967 Ph.D., Economics, University of Michigan
1962 B.A., History, University of Michigan
Ph.D. Thesis- The Macroeconomic Effects of Social Insurance

Career Brief

Dr. Vroman, an economist at The Urban Institute since 1977, has directed several Institute research projects. His academic experiences have included positions in two economic departments (Oberlin College and the University of Maryland) and a visiting appointment in the business school at the University of Berkeley. He has worked at two federal agencies (the Social Security Administration and the Office of Economic Opportunity) and at the National Commission on State Workmen's Compensation Laws.

Much of Dr. Vroman's research starting with his Ph.D. thesis has been concerned with the economic effects of social insurance. He has conducted projects on the earnings test in the OASDHI program and projects on the incidence of employer payroll taxes. Dr. Vroman's research on workers' compensation includes an examination of the incidence of the employer insurance premiums which finance the program and three studies of permanent partial disabilities. He has also examined numerous issues associated with the provision of unemployment insurance benefits. He has developed an unemployment insurance modeling capability implemented as spreadsheet software and used in analysis of UI funding issues. Models to examine state trust fund solvency and related policy questions have been developed in fifteen states. He has authored five books on social insurance topics, Employment Termination Benefits in the U.S. Economy, The Funding Crisis on State Unemployment Insurance, Unemployment Insurance Trust Fund Adequacy in the 1990s, Topics in Unemployment Insurance Financing and Unemployment Compensation Throughout the World: A Comparative Analysis (with Vera Brusentsev).

Dr. Vroman has investigated several other topics in labor economics such as money wage inflation, union wage contracts, cost-of-living adjustments and income policies. The effects of immigration, imports and minimum wages on wage inflation have been studied. He has conducted several analyses of the earnings of black men. These studies have focused on changes in relative earnings since 1964, the effects of transfer payments on labor supply and relative earnings, the effects of industrial change on relative earnings, ant the effects of urban central city employment growth on black unemployment. He is co-editor of the 1992 Urban Institute book Urban Labor markets and Job Opportunity.

Dr. Vroman has worked on projects dealing with social protections and labor markets in Western Europe, Eastern Europe, CIS and Asian countries. He has studied work-sharing and job creation programs in Germany, Sweden and Belgium. He has worked on World Bank missions to Armenia, Slovakia, Turkmenistan, Kazakhstan, Bulgaria, Barbados and Belize; IMF missions to Armenia and Georgia and U.S. AID supported projects in Bulgaria, the Czech Republic, Kazakhstan, Poland, Romania and Ukraine. He developed for the World Bank a simulation model of unemployment benefit payments in CIS countries. He has also authored reports for the World Bank on labor markets and social protection in Turkey and Indonesia.

Professional Background

1977- Present	Economist, The Urban Institute
Fall 1987	Lecturer, Foreign Service Institute, Washington D.C.
Fall 1985	Visiting Professor of Economics, University of Maryland
1973-77	Assistant Professor of Economics, University of Maryland
1971-72	Associate Director and Chief Statistician, National Commission on State Workmen's Compensation Laws
1969-71	Division of Economics and Long Range Studies, Social Security Administration, Department of Health, Education and Welfare
1967-69	Assistant Professor of Economics, Oberlin College

Christopher J. O' Leary

May 2009

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1993-present, Senior Economist
1987-1993, Economist

Western Michigan University, Kalamazoo, Michigan 49008
1994-present, Adjunct Associate Professor
1990-1994, Adjunct Assistant Professor of Economics

Education Ph.D., Economics, University of Arizona 1986
M.A., Economics, University of Arizona, 1979
B.A., Economics, University of Massachusetts, Amherst, 1977

Biographical Statement

Christopher J. O'Leary is a senior economist at the W.E. Upjohn Institute for Employment Research. His research on unemployment insurance (UI) has examined experience rating, benefit adequacy, profiling, partial benefits and reemployment bonuses. The research on bonuses and UI partial benefits involved large field experiments with random trials in Washington state. He has evaluated job training, wage subsidies, public works, self-employment, and employment service programs for labor ministries in Canada and the economic transition countries of Hungary, Poland, Serbia, and China. For the U.S. Labor Department he developed a prototype frontline decision support system for one-stop career centers under the reemployment accounts. His research has also been sponsored by the World Bank, the International Labor Office (ILO), and the Organization for Economic Cooperation and Development (OECD). He recently examined labor market information (LMI) systems for the Canadian employment ministry. Currently, for the U.S. Labor Department he is investigating the use of UI and public employment services by recent recipients of Temporary Assistance to Needy Families (TANF). His papers have appeared in *Journal of Human Resources, Journal of Policy Analysis and Management, Monthly Labor Review, International Labour Review, New England Economic Review, Economics of Transition,* and *Applied Economics*. He is co-author of *Manual on Evaluation of Labour Market Policies in Transition Economies* (Geneva: International Labour Office. 2001), and co-editor of research volumes on unemployment insurance, job training, and employment services. O'Leary completed undergraduate studies at the University of Massachusetts at Amherst and earned a doctorate in economics from the University of Arizona. In 1999 he was elected to the National Academy of Social Insurance.

Appendix C

Explanation of Captions Used in the Simulation Tables

Corresponds to Tables on pages 25 and 27

Unemployment Rate — Based on historical trends, future unemployment rates were projected to estimate the percentage of unemployed workers.

TWB — The taxable amount of a worker's salary which is paid by the employer.

FUTA Credit Offset — If the UI Trust Fund is insolvent or owes money at the end of a calendar year, the federal government subsequently reduces the federal unemployment tax credit by .3 percent (thus increasing employer taxes) the following year until the debt is repaid or solvency is restored. These figures estimate the expected increase in UI taxes due to a negative trust fund balance or outstanding debt, and do not exist when the trust fund is solvent.

In normal years when the trust fund balance is above $0 the FUTA tax is .8 percent on the first $7,000 earned per worker. The figures in this column do not account for the normal .8 percent paid annually.

Taxes to Trust Fund — UI taxes paid by Kentucky employers include regular state UI tax.

Trust Fund Interest Earned — When the UI program is solvent at the end of the year, interest is earned on the balance in the trust fund and credited to the trust fund reserve account.

Interest Paid on Trust Fund Debt — When an outstanding balance exists against the trust fund at the end of a year, interest accrues on the debt. Payments on interest owed must come from another source besides the trust fund. Currently stimulus funds are providing Kentucky with an interest forgiveness period on all borrowed debt until December 31, 2010.

Total Taxes — Total taxes include the FUTA Credit Offset, taxes to the trust fund and interest owed on trust fund debt.

Benefits — Benefit payments are estimated based on future unemployment rate expectations, wage projections and the balance in the trust fund, which all affect the total benefit payouts in a year and trust fund liabilities.

Annual Trust Fund Deficit — The annual trust fund deficit is the difference between taxes and interest paid into the trust fund less the benefits paid out from the trust fund.

Trust Fund Balance — This figure estimates the balance in the trust fund and is determined by adding the current year's trust fund surplus (or deficit) to the previous year's ending trust fund balance, along with adding any trust fund interest earned and funds generated from the FUTA Credit Offset.

Appendix D

Savings Effect of Specific Benefit Reductions: 2011 to 2020

Referred to on page 29

Projections by Dr. Wayne Vroman All amounts in millions of dollars	Total Benefits 2011-2020	Total Benefits 2011-2016	Benefits in 2011
1. High Unemployment Scenario Savings	6080	3750	686
2. One Week Waiting Period	138	188	34
3. Reducing Replacement Rate from 0.68 to 0.575	377	245	45
4. Reducing Max WBA/AWW 0.62 to 0.55	158	141	26
5. Combination 3 and 4	512	375	68
6. Combination 2, 3 and 4	750	544	99

WBA - Weekly Benefit Amount **AWW -** Average Weekly Wage

In this exercise, Dr. Vroman analyzed the cumulative impact of three specific benefit reduction alternatives (and combination thereof) over time. The financial benefit of the reductions is affected by other elements of the system, such as balance in the trust fund and tax schedule triggers.

Because of the relationship with other parts of the system, a benefit change is not linear. While the waiting week will generate $34 million in savings in its first year of adoption, for example, it will not generate $34 million every year because other parts of the system react to increase benefit payouts.

GLOSSARY

American Recovery and Reinvestment Act of 2009 (ARRA)
An economic stimulus package enacted in February 2009 in the wake of the economic downturn. Amongst a variety of measures within the act is an expansion of unemployment benefits, lending additional assistance to both states and unemployed workers.

Average Weekly Benefit Amount (AWBA)
Benefits paid for total unemployment divided by weeks compensated for total unemployment.

Average Weekly Wage (AWW)
Total wages divided by UI covered employment, divided by 52 weeks.

Base Period Wages (BPW)
Wages earned while working in UI covered employment used to calculate a claimant's UI benefit amount. There are two different methods used in determining BPWs: the standard base period (SBP) and the alternative base period (ABP).

Kentucky uses SBP wages or wages earned during the last four of the five most recent completed quarters. This method provides employers more time to submit quarterly earnings, allows benefits to be based on wages that have already been reported by employers and reduces OET administrative expenses in comparison to the ABP method.

Determining Standard Base Period Wages

<table>
<tr><td>Oct
Nov
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Dec</td><td></td><td>Apr
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June</td><td colspan="2" rowspan="2">When Claim is Filed During these Months</td></tr>
<tr><td rowspan="3" colspan="2">Benefit Amount Awarded Reflects Covered Wages from these 4 Quarters</td><td>Apr
May
June</td><td>Jul
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The **ARRA** encourages states to adopt a system utilizing ABP wages, or the wages earned during the most recent four completed quarters. The ABP method provides claimants with benefits that reflect their most recent wage history. Additional administrative costs arise with utilizing this method because employers must submit quarterly earnings reports earlier than under the SBP. Also, manual requests must be made by OET staff for earning records on claims filed before the deadline.

Determining Alternative Base Period Wages

Jan Feb Mar	Apr May June	Jul Aug Sep	Oct Nov Dec	Jan Feb Mar			
	Apr May June	Jul Aug Sep	Oct Nov Dec	Jan Feb Mar	Apr May June	When Claim is Filed During these Months	
Benefit Amount Awarded Reflects Covered Wages from these 4 Quarters		Jul Aug Sep	Oct Nov Dec	Jan Feb Mar	Apr May June	Jul Aug Sep	
			Oct Nov Dec	Jan Feb Mar	Apr May June	Jul Aug Sep	Oct Nov Dec

Federal Unemployment Tax Act (FUTA)
A federal law that imposes an employer tax used to fund state workforce agencies.

Maximum Weekly Benefit Amount (MWBA)
The largest weekly benefit a claimant can receive is 62 percent of the previous year's **AWW** in covered employment. In years when the ending trust fund balance falls below $120 million, the MWBA will remain unchanged from the previous year.[52]

Office of Employment and Training (OET)
The agency under Kentucky's Education and Workforce Development Cabinet responsible for providing job services, unemployment insurance services, labor market information, and training opportunities.

Replacement Rate
The proportion of base period wages replaced by UI benefits. In Kentucky, claimants may receive up to, but no more than, 68 percent of their base period wages. If 68 percent of base period wages is greater than the MWBA, claimants will receive the MWBA.

Reserve Account Balance
The difference between net total benefit payments attributed to an employer and the net total tax contributions paid by the employer into the Unemployment Insurance Trust Fund. This amount is used to calculate the employer's **reserve ratio** and UI tax rate each calendar year.

Reserve Ratio
An employer's **reserve account balance** divided by the employer's three-year **taxable payroll**, which determines an employer's applied tax rate each year according to the **tax rate schedule** (Appendix A).

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Obtaining Report

This report can be accessed online at:

www.educationcabinet.ky.gov

General Questions

General questions about this report should be directed to the Education and Workforce Development Cabinet's Office of Communication Services at (502) 564-0372.