LEGISLATIVE REPORT

Federal Funding Shortfall

SEPTEMBER 2023

Employment Security Department
WASHINGTON STATE

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Executive summary

The 2023-25 Enacted Operating Budget[1]contained a General Fund-State appropriation for the Employment Security Department (Employment Security) to backfill the agency's shortfall in federal funding.

This report is the first of two[2], which detail the use of these funds and provide recommendations for long-term solutions to address the impact of federal funding reductions on administration of the unemployment insurance (UI) program.

Highlights include:

- Federal funding never fully supports Washington's UI program.
- Ongoing funding challenges will require continued and increased leveraging of state accounts.
- Employment Security will continue to identify program efficiencies that reduce cost, but additional state revenue sources should be considered to ensure long-term sustainability and a UI program that provides equitable access to services while maintaining program integrity.

Background

Budget proviso

The 2023 Enacted Operating Budget provided $10,000,000 of the General Fund—State appropriation for fiscal year 2024 and $11,227,000 of the general fund—state appropriation for fiscal year 2025 solely to address a projected shortfall of federal revenue that supports the administration of the UI program.

The proviso directs Employment Security to submit two reports to the governor and appropriate committees of the legislature in November 2023 and November 2024 outlining

[1] Engrossed Substitute Senate Bill 5187 (2023)

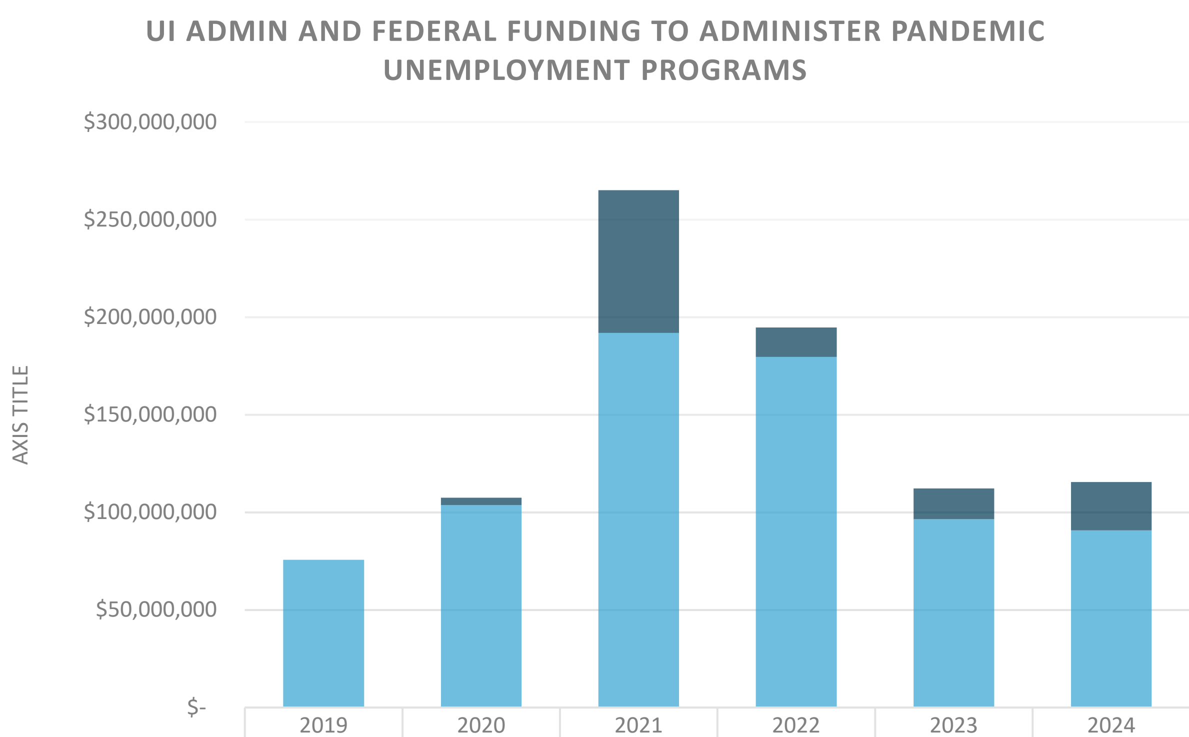
[2] ESSB 5187(225)(25)(b) directs Employment Security to submit the initial report by November 1, 2023, and the subsequent by November 1, 2024.

how this funding is being utilized and recommendations for long-term solutions to address future decreases in federal funding.

Federal funding history

During the last three years, Employment Security experienced unprecedented levels of unemployment claims due to the COVID-19 Pandemic, as well as a nationwide surge in identity theft cases. The prolonged public health emergency introduced new programs and required changes to nearly all work processes and systems necessary to operate the unemployment compensation system. Federal grants temporarily increased during the pandemic to support these rapid changes, but funding subsequently dropped dramatically in Federal Fiscal Year 2023, while ongoing costs associated with pandemic era claims remain. Federal funding is now on par with pre-pandemic rates.

Table 1: Unemployment Insurance admin and federal funding to administer pandemic unemployment programs funding 2019-2024



	2019	2020	2021	2022	2023	2024
119 UI Cares Act	$0	$3,835,339	$72,974,772	$15,011,791	$15,690,055	$24,888,743
119 UI Admin Grant	$75,741,583	$103,715,348	$191,981,833	$179,692,655	$96,570,131	$90,707,410

Washington's system is funded by multiple sources, but primarily through grants awarded by the United States Department of Labor (USDOL). Federal funds are distributed on two levels:

Base funding:

- Granted at the beginning of the federal fiscal year.
- Apportioned to states quarterly and drawn by Employment Security as needed.

Above base funding:

- Additional funds available on a quarterly basis for claims-related workloads processed above the base level.
- Funded currently at less than 50% of the state's total request as a result of federal budget reductions. Prior to the pandemic, above base requests made by states had been funded at 100%.

In April 2022 and again in July 2022, USDOL informed state agencies of reductions to previously committed federal UI Administrative funds, reducing projected revenue by over $9,000,000. On September 13, 2023, USDOL issued the Federal Fiscal Year 2024 UI Admin grant planning targets[3] which includes the amount of base funding for each state. Washington's allocation is approximately $90.7M. However, this will not be final until the federal fiscal year 2024 budget is passed. If the appropriation is less than this amount, USDOL will revise and reissue the final base allocations. Because the $90.7M grant award is contingent on enactment of a federal fiscal year budget with sufficient funding to meet USDOL planning targets, Employment Security assumes 90% of the award amount ($81.63M), aligned with what the allocation might be without a new federal budget. The plan year begins on October 1, 2023, and extends into the first quarter of SFY 25 (July-September 2024).

The Resource Justification Model (RJM) is a data collection system that collects UI administrative expenditures used by state agencies to operate UI programs from the most recently completed federal fiscal year. The data collected through the RJM contributes to the calculations that determine the amount of federal funds allocated to each state. This complex formula, owned and managed by USDOL, solely determines the percentage of the total UI base administrative funding to allocate to the state, not what the actual cost is to maintain a UI program that meets adequate levels of performance or modern norms of customer service.

The factors that determine the total expected cost for UI administration, such as salary and productivity measures, have not been updated since the 1990s. USDOL included an update to these factors in their FFY 2022 budget request, but it did not come to fruition. Updating those

[3] Unemployment Insurance Program Letter No. 13-23

factors would have increased the amount of total UI federal administrative funding available for operations nationally by $420M for FFY 2022.[4]

Federal funding does not accurately capture the growing role and costs of UI business processes and therefore falls short of meeting customer needs. Inadequate funding makes it more challenging to maintain USDOL standards and customer expectations.

State accounts

Employment Security has never been fully funded by the federal UI Administration grant, providing on average 72% of funding needs. To address the remaining costs of administering the UI program, Employment Security has historically relied on two state resources:

- The Administrative Contingency Account – Fund 120, also known as Penalties and Interest (P&I).
- The Employment Services Administrative Account – Fund 134, also known as the Claimant Placement program (CPP).

P&I receives revenues from penalties and interest from employers for late or incorrect unemployment taxes and interest from UI recipients who must repay benefits to which they were not entitled.

CPP was established in 1985 and receives its revenues from an employer tax of 0.02-0.03% of taxable wages (based on rate class). This funding source was established to augment federal funds to support employment programs.

These accounts provide funding to support ongoing reemployment efforts, maintaining systems and technology that support the UI program, compliance, data collection and analysis, and other mandatory programming.

Summary of funding

Employment Security is leveraging the $10M in GF-S provided for state fiscal year 2024 to meet personnel and contract costs for the technology systems that support the UI program. Personnel costs make up 89% of monthly UI expenses. Employment Security anticipates receiving a new federal award in November (assuming the passage of a new federal budget).

[4] *See* FY 2022 Department of Labor Budget in Brief

However, because 25% of the federal award must be reserved for the first quarter of SFY25 – as the federal fiscal year runs October 1 through September 30 – Employment Security needs to use approximately $8.9M of the GF-S to cover personnel costs.

The remaining $1.1M will be spent to maintain contract requirements with UI technology vendors. Specifically, the Unemployment Tax and Benefits System (UTAB) and the Next Generation Tax System (NGTS). UTAB is the state's system for paying unemployment insurance benefits to workers. The NGTS is the state's system for collecting taxes from employers.

Next steps

The proviso directs Employment Security to describe strategies to address future decreases in federal funding. As stated above, historically, federal funding has only supplied approximately 72% of the costs to operate the state's UI program.

In the immediate term, Employment Security is committed to identifying program efficiencies, including:

- Reducing the fraud backlog, which in turn improves the claims backlog;
- Adjusting adjudication processes to enable faster processing time;
- Prioritizing system improvements that most directly impact workloads; and
- Updating letters and instructions to claimants to improve outcomes and reduce adjudication complexity.

Currently, the CPP and P&I accounts are the financial tools available to address the gap between federal funding and total operational costs. This is true not only in the UI program, but also employment programs reliant on similarly decreasing or stagnant federal funding, as well as work throughout the agency that supports both UI and employment program operations.

To address long-term sustainability of the state's UI program, various state funding options could be considered:

- Reducing non-UI program reliance on CPP and P&I funding through alternative funding sources, such as competitive discretionary grants;
- Ongoing appropriation of general fund-state to support administration of the UI program; and
- Increase of revenue collected through state P&I or CPP accounts.

Increasing revenue collected through state P&I would likely entail increasing costs for failure to comply with UI requirements. Increasing CPP revenue – currently collected through a 0.02-0.03% tax as part of Washington employers' overall state UI tax – could be pursued in a manner that does not increase the overall UI tax if it is offset by a reduction in the UI social tax. The social tax is a shared cost across employers that helps support UI trust fund health. Accordingly, consideration of this option would entail balancing the state's dual goals of a strong UI trust fund and effective administration of the UI program and services to job seekers.

Employment Security will continue working to develop proposals for further consideration in the November 2024 report to the Legislature, including working with the Unemployment Insurance Advisory Committee on these and other options.