

## How is Alaska's trust fund faring?

**A**laska's unemployed workers depend on a healthy unemployment insurance trust fund to weather bad economic times. Alaska's employers depend on a healthy trust fund to keep employment taxes low. Given the poor national economy, and the fact that many states' trust funds have become insolvent, it's fair to ask, "How is Alaska's trust fund doing?"<sup>1</sup>

By design, the financing structure of Alaska's trust fund – where tax revenue is held, to pay unemployment insurance benefits – allows for adjustments to the tax rates in response to changing economic conditions. The structure replenishes the fund as needed, seeks tax stability and minimizes the tax burden.

The depressed U.S. economy, in recession since December 2007,<sup>2</sup> and Alaska's slowing economy have both contributed to the state's increased unemployment rolls. Even so, Alaska's trust fund is healthy and will remain healthy even under much more stressful economic conditions. It would take an unprecedented increase in unemployment and a decline in total wages paid to drive Alaska's unemployment insurance trust fund into the insolvency that other states are facing.

### Congress creates an emergency program

Congress created a new federal program in July 2008, plus a series of extensions, to meet the

<sup>1</sup> One of the primary duties of the Alaska Department of Labor and Workforce Development is to pay unemployment benefits. The department is charged with continuously evaluating the health of Alaska's unemployment insurance system and identifying where it can be improved. Throughout this article, all references to the Department of Labor are to the Alaska Department of Labor.

<sup>2</sup> According to the National Bureau of Economic Research, a private group of economists charged with dating the start and end of national economic downturns

spike in unemployment insurance claims caused by the recession: the Emergency Unemployment Insurance program, or EUC08. Congress paid for the program with federal money, so there's no direct cost to the states, but claimants must deplete their state-funded regular benefits first.<sup>3</sup>

### State trust funds – the financial bad news

Many states that could handle an ordinary recession were simply unprepared for the severity of the current recession. Thirty-four states as of April 5 had exhausted their funds and were borrowing money from the federal government to pay unemployment insurance benefits to claimants.

### How Alaska's fund stands

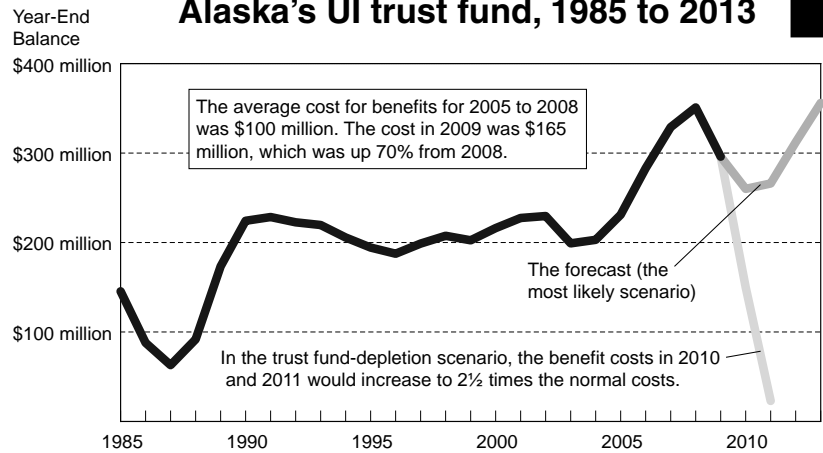
Alaska employers pay unemployment insurance taxes based on their tax rate. Then a solvency tax is on top of that: a solvency tax credit, solvency tax or "zero solvency tax," when nothing is added or subtracted, all based on how the trust fund is doing.<sup>4</sup> The tax rate, plus the solvency credit or tax, is then the final tax rate that employers pay.

In the fall of 2008, when the national economic crisis was unfolding, the 2008 unemployment insurance tax rates for Alaska employers already included a solvency tax credit – lowering rates – because the trust fund had been slightly overfunded. The solvency tax credit was increased for 2009 because the fund was still overfunded, giving employers record-low tax rates.

<sup>3</sup> Throughout this article, all references to benefits and claims are to the state-funded regular benefits.

<sup>4</sup> How the trust fund is doing, based on its solvency, is measured by the reserve rate, which is discussed later.

## The Worst-Case Scenario Alaska's UI trust fund, 1985 to 2013



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

But by the fall of 2009, the trust fund began to decline slightly. Alaska had collected less tax revenue – because of lower tax rates – and the amount of benefits paid out increased substantially.

Tax calculations use three years of data to smooth out the impact of changing economic conditions. While benefit costs for the most recent year, fiscal year 2009,<sup>5</sup> were more than 35 percent above an unusually low fiscal year 2008, they were similar to costs in the early 2000s. The trust fund balance was within its solvency target range. As of Sept. 30, 2009 – the trust fund is measured on the same day each year – the trust fund balance was \$319 million, within the solvency range of \$318 million to \$349 million. The trust fund was fully solvent, and employers are paying the second-lowest tax rates on record during 2010.

### Financing Alaska's system – the general concepts

The big picture dynamics of the trust fund are simple. The fund balance, or reserve, is a product of tax revenues in, versus benefits that the state pays out. Revenues are fairly steady and slower to change. Costs – dictated by how many people collect benefits and for how long – can change dramatically and quickly.

The financing for Alaska's program is based on a formula-driven, reactive system. The amount of fund revenue needed, the portion of wages subject to taxation, and the tax rates for employers and employees<sup>6</sup> are computed each year, as determined by economic data. The system is primarily cost-driven, keeping benefit payment costs and tax revenues in balance.

The system is also designed to maintain solvency, keeping fund reserves in pace with a usually growing economy. Alaska's system will buffer, or slow down, changes in tax rates, according to the concept of counter-cyclical financing. That's done using multi-year data.

<sup>5</sup> All references to the fiscal year are to the state fiscal year. (Fiscal year 2009 runs from July 1, 2008, to June 30, 2009.) If the fiscal year isn't noted, then it's a calendar year.

<sup>6</sup> Alaska is one of three states where workers are required to help finance the unemployment insurance system.

Alaska's UI financing history goes back to 1937.<sup>7</sup> There were changes in methodologies along the way, primarily in 1960, in 1974, and most importantly in 1981. At times, the state had one tax rate for all employers; other times it used various rate schedules. Later, it had fixed rates for all employees. During all the different rate methodologies, though, Alaska had a fixed taxable wage base on employees' earnings that changed infrequently.

Finally, in 1981, Alaska left behind the set-in-stone approaches and started its present system, which is driven by an economic formula. It was fortuitous timing, because only five years later the price of oil crashed and the state went through the severe 1986-1987 recession. Now, nationally, more than half the state systems are bankrupt. Alaska's system, meanwhile, is busy paying claims but is financially sound.

### A good design or just luck?

The success of Alaska's unemployment insurance financing system in meeting the annual financial demands, maintaining solvency and stabilizing tax rates, is due to good design and has little to do with luck.

Yet Alaska has been fortunate that its system hasn't been put under the same severe stress as some states such as California and Michigan.

<sup>7</sup> Alaska authorized its first benefit payments to workers on Jan. 1, 1939.

Alaska's economy isn't dependent on an inflated housing market, a declining manufacturing sector or an ailing financial industry, but it is dependent on the price and quantity of oil that it produces.

## Keeping enough on reserve

All state unemployment insurance systems are designed to cover their ongoing costs,<sup>8</sup> and all states have some method of experience rating their employers in order to assign tax rates.

Experience rating is used to fairly allocate the share of tax burden among employers based on each employer's experience with unemployment benefits. There are four experience-rating systems used in the U.S. They're all designed to measure direct costs, or approximate costs.

The real issue of solvency is having enough reserves in each state system to meet the challenge of a severe recession. Each state has its own defined measure, or target level, for its trust fund, and some response in place that's used when a benchmark is met. The current national recession is an acid test. Many states will have to re-examine their idea of adequate reserves and their provisions for them.

## The details of Alaska's solvency system

Maintaining an adequate reserve, in sync with a growing economy, is a critical part of Alaska's financing system. The state's solvency measure is the reserve rate – simply the trust fund balance as a percentage of the total wages of covered employment.<sup>9</sup>

Alaska's solvency is examined each year, according to an economic formula, and an adjustment is made if needed.

The state has a target range; the midpoint is roughly 3.15 percent. If the reserve rate is at

<sup>8</sup> State unemployment insurance taxes can only be used to pay benefits, not administrative costs. The federal government pays for the administration of each state's unemployment program.

<sup>9</sup> The majority of Alaska workers who are paid wages are covered by the state's unemployment insurance laws. Those who aren't covered include the self-employed, business owners, fishermen, unpaid volunteers or family workers and private household workers. Federal workers are also not covered.

least 3.0 percent but less than 3.3 percent, then a zero solvency tax is in effect. If the reserve rate drops below 3.0 percent then a solvency tax, ranging from 0.1 percent to 1.1 percent, is applied. If the reserve rate is 3.3 percent or higher, then tax credits ranging from 0.1 percent to 0.4 percent are applied, lowering the final tax rates of employers.

The solvency adjustment may not change by more than 0.3 percent in a single year. For example, the trust fund balance on Sept. 30, 2009, was \$319 million and the reserve rate was 3.007 percent. Therefore, for 2010, there's no solvency tax in effect.

## The solvency tax expectation for 2011

Alaska's Sept. 30, 2009, reserve rate was at the bottom of the range for no solvency tax; it barely avoided having the smallest solvency tax in effect for 2010. Because of persisting benefit claim levels in the fall and early winter of 2009, a solvency tax is looking more likely for 2011. Due to the rise in tax rates, the Department of Labor expects that during 2010 the system will receive more revenue into the fund than during 2009. That revenue, however, may not offset the higher levels of benefit payments.

If Alaska were proportionately repeating what happened in the 1986-1987 recession in 2009, its trust fund balance would have been about \$220 million for the new tax calculation for 2010, and it would have been headed to a low point of roughly \$128 million. Instead, the Department of Labor's expectation is that by fall 2010, there will be a moderate decline from 2009's \$319 million mark, even with higher tax revenue, and persisting higher – but hopefully lessening – benefit payments.

## The current picture

Although the current Alaska employment projections are for a modest reduction in jobs this year, the Department of Labor also anticipates a reduction in total benefit payments in the last half of 2010. Even with an anticipated increase in unemployment insurance tax revenues, higher benefit costs in the early part of the year will

likely reduce the trust fund value by Sept. 30, 2010 – again, the value on that date is used to determine whether the fund is solvent.

A solvency tax is likely in 2011. Three years of cost and wage data are used to determine the final tax rates, and the most recent year’s cost data, for fiscal year 2010, will raise the three-year cost figure used in the calculation. The taxable wage base will likely remain flat or see modest growth.

### Avoiding a major economic downturn

In the last few decades, Alaska has felt little negative impact during national economic downturns, such as in the early 1980s and early 2000s. Alaska’s biggest economic crisis was in 1986-1987 when world oil prices were cut in half, and Alaska’s wellhead price hovered between \$5 a barrel and \$10 a barrel.

The low oil prices caused an oil industry pull-back, a rapid reduction in state tax revenues and cuts in government spending. Residential and commercial real estate, built in anticipation of ever-growing oil income, soon became vacant. Foreclosed properties were common, and there was a spike in unemployment claims for the construction industry and other employment sectors.

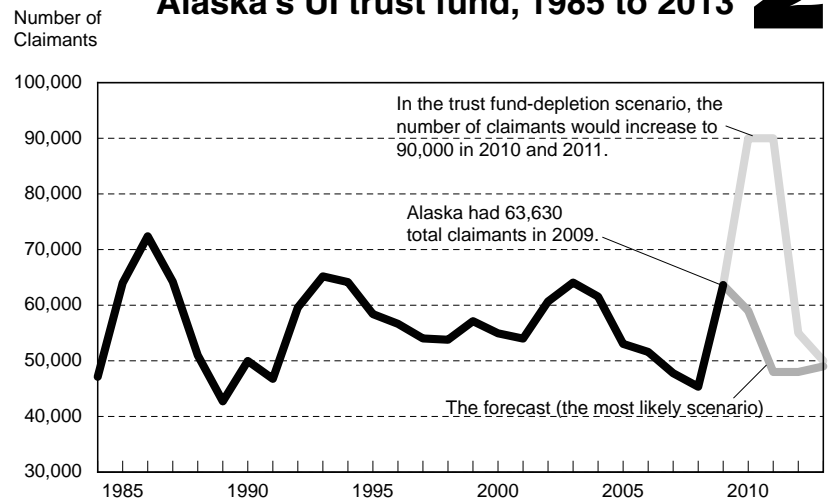
The state’s trust fund lost 60 percent of its value before it began to recover, and it took a decade to achieve tax rate stability.

In contrast, Alaska logged positive job growth in fiscal year 2009, which began with a 4.4 percent increase in total wages over fiscal year 2008. As mentioned earlier, the state’s trust fund remains financially sound, it was at full solvency at the end of 2009, and no additional solvency tax will be required in 2010.

### What conditions would bankrupt Alaska’s trust fund?

To put this question in perspective, again, it’s helpful to look at the current situation – the impact on Alaska from the national recession from 2008 to the present and ongoing. The number of claimants increased 40 percent from 45,343

## Claimants in a Worst-Case Scenario Alaska’s UI trust fund, 1985 to 2013 **2**



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

in 2008 to 63,630 in 2009. Benefit costs to the trust fund rose 70 percent from \$97 million to \$165 million. Net unemployment insurance tax revenue decreased from \$123 million to \$103 million, mainly because lower tax rates were in effect. The year-end trust fund balance dropped by \$56 million, from \$352 million in 2008 to \$296 million in 2009.

Alaska’s system could easily handle what happened in 1986-1987. A repeat economic crunch of similar proportions would be a strain on Alaska’s system but it would be manageable.

Back in 1986, the annual unemployment rate was 11 percent, with 11.5 percent for the highest month. Alaska had more than 200,000 in the labor force and lost more than 20,000 jobs during the crisis. Total payrolls fell \$750 million and average annual wages declined 3 percent.

To develop the stress needed to deplete Alaska’s trust fund in just 1½ years, the state would have to spend both the value of the fund – roughly the \$300 million in reserve – and the incoming tax revenue (\$180 million is projected). Alaska’s benefit costs averaged about \$100 million a year from 2005 to 2008.

The state’s cost in 2009, versus the tax revenue, saw the trust fund decline by the \$56 million to close the year at \$296 million. Alaska’s spending

# 3 Looking at Different Scenarios

## Alaska's UI trust fund, 2006 to 2013

Year <sup>1</sup>	Covered Employment	Covered Wages	Active Claimants	Trust Fund Benefit Costs	Trust Fund Year-End Balance
2006	290,309	\$11,815,332,100	51,597	\$101,046,776	\$283,208,172
2007	294,016	\$12,568,881,883	47,776	\$92,981,216	\$329,028,495
2008	297,925	\$13,333,856,024	45,343	\$97,255,782	\$351,449,213
2009	295,840	\$13,533,863,864	63,630	\$165,956,856	\$295,937,797
<b>Most Likely Scenario</b>					
2010	295,000	\$13,736,870,000	59,000	\$156,000,000	\$260,000,000
2011	301,000	\$14,355,000,000	48,000	\$132,000,000	\$266,000,000
2012	307,000	\$15,001,000,000	48,000	\$113,000,000	\$313,000,000
2013	314,000	\$15,676,000,000	49,000	\$115,000,000	\$356,000,000
<b>Fund-Depletion Scenario</b>					
2010	276,000	\$12,654,163,000	90,000	\$265,000,000	\$150,000,000
2011	265,000	\$12,275,000,000	90,000	\$265,000,000	\$23,000,000
2012	278,000	\$12,900,000,000	55,000	\$150,000,000	insolvent
2013	295,000	\$13,700,000,000	50,000	\$125,000,000	insolvent

<sup>1</sup> Calendar year

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

pace from 2009, based on spending \$165 million a year, for 18 months would be \$248 million, or 52 percent of the spending rate required to deplete the fund.

In essence, to reach insolvency, Alaska would have to spend, in benefit payments, 2½ times more than it has spent in the recent period of

accelerated spending. And it would have to hold that level for two years. (See Exhibit 1.)

To get to the spending rate that would zero out the trust fund in one to two years – the disaster scenario – the claimant count would have to increase again by at least a half, to reach about 90,000 claimants. (See Exhibits 2 and 3.) That would be about a third of the average yearly labor force.

During 2009, in contrast, about 58,000 of Alaska's 63,000 claimants were paid benefits from the state's trust fund, for an average cost of nearly \$3,000 a claimant.

Even given such a disaster scenario, the fund would begin to return to solvency in several years as taxes increased and claimants exhausted their eligibility for benefits. It might take 10 years for the tax rates to stabilize.

The bottom line: In this time of economic uncertainty, it's important to know that even under the harshest potential economic conditions, Alaska's unemployment insurance trust fund will continue to provide an important safety net to Alaska's workers.

### A Safety Minute

#### Workers' Memorial Day

April 28th is Workers' Memorial Day, a day to remember the people who have been killed or injured on the job, including those who are now disabled. It's also a day that commemorates people working together for safer and healthier workplaces.

Sixteen workers on average die each day in the United States from injuries they received at work, and another 134 die from work-related illnesses, according to the National Institute for Occupational Safety and Health, a federal agency within the Centers for Disease Control and Prevention.

Alaska had 33 workplace fatalities in 2008, the most recent year with completed investigations. The majority of those deaths occurred in the transportation industry.

Under the Occupational Safety and Health Act of 1970, employers are responsible for providing a safe and healthful workplace for their workers. Since the act was passed, workplace fatalities nationally have been cut by more than 60 percent and occupational injury and illness rates have declined by 40 percent. At the same time, U.S. employment has more than doubled to 115 million workers at 7.2 million worksites, according to the federal Occupational Safety & Health Administration.

Safety and health consultants with the Alaska Department of Labor and Workforce Development's Occupational Safety and Health provide free assistance and tools for employers and workers to reduce worksite injuries, illnesses and deaths. AKOSH is within the Labor Standards and Safety Division. For more information, call (800) 656-4972.