

*CB 08-06 November 25, 2008***THE BOTTOM LINE**

The changes in employment law described in this brief add new costs and uncertainties to an already challenging employment environment.

# KEEPING A LID ON LABOR COSTS IN WASHINGTON

After several years of quiet, the past few years have seen an increase in legislation that threatens to boost the already high cost of operating a business and employing workers in Washington. This brief reviews Washington's delicately balanced competitive position and the ways that recent legislation contribute to tipping that balance toward making the state a less attractive place for business.

**WASHINGTON: A BOUTIQUE STATE**

With its high average wages, high business taxes and very high employment taxes, Washington would seem not to be a great place to do business. Indeed, Forbes Magazine ranked the state 28th in the country for the cost of doing business (Badenhausen 2008), and a CNBC ranking similarly showed Washington as 35th among the states in the cost of doing business. (CNBC 2008)

And yet, when looking at all competitiveness factors, the Forbes survey ranked Washington as the third best state for business overall, and CNBC ranked it 18th best. Joel Kotkin, the influential urban geographer, ranked Seattle as the 10th best large metro area for business, and ranked Tacoma and Spokane the second and 14th best medium-sized metro areas and Bellingham and the Tri-Cities 14th and 16th best among small cities for business. (Kotkin, Shires 2008)

What do we make of such rankings? The obvious conclusion is that while the cost of setting up shop in Washington is very high, other factors, such as a well educated workforce and the presence of signature firms, offsets those disadvantages. But this places the state in a vulnerable position, since it depends for its attractiveness on just a few key factors, such as technology, that can change quickly. Other top-ranked states, like Virginia and Utah, have a much more balanced array of competitiveness factors.

Washington is a boutique state for business: high quality, but at a high price. This can seem an attractive positioning, until one realizes that, like in the retail sector, boutiques are subject to the whims of fashion and the vagaries of the economy.

**LESSONS FROM CALIFORNIA**

Once again, California provides the cautionary tale. Once considered among the best places for business, the state let its position slide, and now ranks 34th on the CNBC list and 25th on the Forbes list. Hollywood, Silicon Valley and perpetual sunshine are no match for the fact that California pulled a ranking of dead last for the cost of doing business in the Forbes rankings and 48th in the CNBC rankings, ahead of only Hawaii and New York.

The Washington Alliance for a Competitive Economy is a coalition of business organizations working together to build economic opportunity for all Washingtonians.

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Certainly no one in California intentionally sabotaged the state's business climate, and most of the regulations were adopted with the best of intentions for making the state a great place to live and work. The problem is that the costs add up, and at some point the high cost of doing business in the state outweighs the state's obvious advantages.

The accretion of costs has taken its toll on the states' dynamism. California has always been thought of as the golden destination for Americans, but for years, California has experienced a substantial net outmigration to other states. The Census Bureau reports that in 2007, 263,000 more Californians moved to other states than people in other states moved to California. A substantial number of those out-migrants moved to Washington.

### **KEEPING A BALANCE IN WASHINGTON**

The cost of doing business has many components, but labor costs make up the largest variable. And within the larger labor cost picture, it is employment taxes and mandated benefits that make the big difference from one state to another. Washington already has among the highest average wage rates in the country, so adding additional costs through taxes and regulation further threatens to let labor costs overwhelm the state's competitive advantages.

Over the past decade or so the business community and others worried about the state's competitiveness have managed to keep the labor cost side of the picture from deteriorating much further. A number of bills have passed in recent years, however, that add new or expanded regulations for employers, and while the impact of each is difficult to quantify, the cumulative impact threatens to send Washington down California's well-worn path.

### **LEGISLATIVE ACTION IN KEY AREAS**

#### Unemployment Insurance

Washington has among the most liberal and expensive unemployment insurance (UI) programs in the country. In 2006 Washington had the second highest UI tax rates, behind only Alaska, and 20 percent higher than the number three state, Oregon. In 2007 Washington had the fifth highest average benefit.

The high cost of UI in Washington has long been a sore point with the business community and a source of concern about the state's basic competitiveness. In 2003, the Legislature passed a landmark bill – SB 6097 – to rein in UI costs over a period of years. It did not take long, however, for the Legislature to gut its work and put the state back in its historically weak competitive position with respect to employment taxes.

In 2005 the legislature decided to “adjust the balance between the goal of reducing the impacts of involuntary unemployment on workers and the desirability of reducing costs by making adjustments that allow reasonable improvements in benefit equity.” The “adjustment,” of course, simply meant reverting back to the policies that existed before the 2003 reforms.

The first adjustment of HB 2255 is the requirement that the unemployment insurance system be “liberally construed” so that when there is a question of whether a workers is entitled to receive payments, the benefit of the doubt goes to the worker. Stacking the deck in favor of the worker makes it difficult to challenge questionable claims and increases the record keeping burden on businesses.

Next, HB 2255 changed the way the weekly benefit amount (WBA) is calculated. Previous reforms had set the benefit at 4 percent of the claimant's

average wages in the base year. HB 2255 changed the WBA to 3.85 percent of the claimant's average wages in the two quarters of the base year in which wages were highest. The change to this formula (commonly called "two-quarter averaging") increased benefits for seasonal workers and slightly lowered benefits for year-round workers.

HB 2255 also provided that to the extent that two-quarter averaging caused claimants to receive higher benefits than they would have received if benefits had been calculated as 1 percent of annual wages, the additional benefits would not be charged to the employers' experience rating accounts, which are used to calculate UI tax rates. This experience rating calculation is commonly called "four-quarter averaging."

The liberal-construction, two-quarter-averaging-for-benefits and four-quarter-averaging-for-taxes provisions of HB 2255 were subject to sunset clauses. The following year, these sunset clauses were repealed by SB 6885.

Using two-quarter averaging for benefits while simultaneously using four-quarter averaging for taxes put Washington's UI system out of compliance with federal law, which requires taxes to be based on benefits actually paid.

One of the features of Washington's UI program that makes it so expensive is the extensive "good cause" provisions that allow workers to collect benefits even if they voluntarily leave their job. SB 6885 provides that a spouse who quits a job when his or her spouse receives a mandatory military transfer could qualify for unemployment insurance benefits under certain circumstances. SB 6751, adopted in the 2008 session, adds to the list of voluntary quit provisions by allowing workers who left their employment to pursue certain apprenticeship programs approved by the Washington state apprentice training council to collect unemployment benefits. This represents a somewhat radical shift in UI, turning it from a safety net to bridge the gap between jobs into an explicit subsidy for worker training.

The cumulative impact of all these changes to UI will be to make Washington's already expensive system costlier. The continuing enrichment of the program goes a long way toward explaining why Washington's per-employee cost is over two and a half times the national average.

#### Family/Sick Leave

Family leave policies put business in a bit of a quandary. On the one hand, family-friendly policies help attract and retain good employees and make it easier to hire from non-traditional pools of talent. At the same time, prolonged vacancies leave holes in the operation, and with today's lean workforces, it is difficult to pick up the slack.

Washington's Family Leave Act was modified in 2006 to conform more closely to the federal Family and Medical Leave Act. Under SB 6185 employees are entitled to 12 weeks of unpaid leave for the birth or placement of a child, to care for a seriously ill family member, or for a serious health condition that makes the employee unable to perform his or her job duties. Upon returning to work the employee must be returned to their original position or its equivalent at a workplace within 20 miles. This applies to all state and local governments, departments and agencies as well as all private employers with 50 or more employees.

Since inception of the Family Leave Act, the Legislature has expanded definitions and eligibility in several ways. SB 5850, passed in 2005, clarified the definition of sick leave so that it includes programs granted under

state law or collective bargaining agreements. HB 2602, from the 2008 session, extends family leave benefits to victims of domestic violence, stalking, or sexual assault, who can now obtain leave to seek treatment or counseling, or to relocate or to assist a family member who has been a victim of such a crime. The Family and Military Leave Act, SB 6447, allows a person married to a member of the Armed Forces, National Guard, or Reserves to take 15 days of unpaid leave while the military spouse is on leave from deployment or before and up to deployment.

The original family leave program was built around unpaid leave, but that began to change in 2007, as Washington became one of the very few states to offer paid family leave through a state-run insurance program. SB 5659 establishes a wage replacement program that provides \$250 per week for up to five weeks to employees who regularly work more than 35 hours per week and who are on family leave. The first claims cannot be filed until October 1, 2009, which is a good thing, since the program has still not been funded and administrative responsibility remains murky.

Competitive pressures in the past few decades have caused businesses to downsize and streamline their workforces. One of the effects of this process is that little slack remains in businesses' workforces to fill in for temporarily absent employees. And even if there is slack, employees increasingly carry with them extensive knowledge that may not exist anywhere else in the firm. Thus, expanded leave requirements can place a hardship on businesses as they struggle to keep operations running smoothly.

### Wages

In the past, claims for a violation of wage payment laws, such as those governing minimum wages, overtime compensation, final wages and withholding, were handled through civil courts. The 2006 legislature, through HB 3185, created an administrative procedure for wage payment complaints that operates through L&I. If an employer is in violation of a wage payment requirement L&I can issue a citation for \$500 to \$20,000. Appeals of an L&I decision are heard by an Administrative Law Judge.

It is not clear how this new procedure will affect businesses. On the one hand, an administrative process should be less cumbersome and costly than a lawsuit. On the other hand, a less cumbersome process may invite more actions by employees, since the cost to them will be lower.

### Discrimination and hiring

Over the years Washington's Law Against Discrimination has been expanded to include additional protected groups. Most recently, through HB 2661, protection was extended to include sexual orientation and gender expression or identity. This makes it illegal for employers to fire or refuse to hire a person based on sexual orientation or gender expression. This does not require employers to establish goals or quotas and does not supersede other state laws relating to marriage.

Antidiscrimination laws in Washington have long prohibited discrimination based on the "presence of any sensory, mental, or physical disability," and employers are required by federal law to make reasonable accommodations for people with disabilities. The definition of disability that had been in use was successfully challenged in court, and the Legislature followed up in the 2007 session with SB 5340, which codifies a very broad definition of "disability." Under the new definition, the 'disability' exists whether it is temporary or permanent, common or uncommon, mitigated or unmitigated, or whether it limits the ability to work or engage in any other activity encompassed within Washington's anti-discrimination law.

‘Impairment’ includes a physiological disorder, cosmetic disfigurement, anatomical loss affecting one or more of several specified body systems, and mental, developmental, traumatic, and psychological disorders.”

With such an expansive definition of disability and impairment, employers face two costly problems. First, they must make “accommodations” in the workplace for a far wider range of potential disabilities: it will be difficult to meet the needs of an employee whose disability is poorly defined. Second, the potential for discrimination claims rises as the definition of disability becomes both more expansive and less specific.

The 2007 legislature extended new protections to prospective employees who may have a shady financial history. SB 5827 prohibits an employer or prospective employer from requesting a credit report for an employee or prospective employee if it contains information on the individual’s credit worthiness, credit standing, or credit capacity. Employers can get credit reports if that information is substantially job related and the employer discloses to the individual in writing the reasons the employer is using that information. This legislation removed an important tool employers have had to gain insights into the reliability and trustworthiness of a potential employee.

### Industrial Insurance

Washington not only has among the most expensive unemployment insurance programs in the country, it also has the third most expensive workers compensation program. Under HB 3139, passed in the 2008 session, this program could get more expensive. The bill, requires that benefits be paid as soon as an order is issued by L&I and continue while an appeal is pending. If the employee loses the appeal they must repay the overpaid benefits, but there is no guarantee that the repayment will happen, especially if the employer is privately insured.

### **ADDING IT ALL UP**

Washington is already among the most expensive places to run a business and have employees. It ranks near the top for business taxes overall, and has among the most expensive workers compensation and unemployment insurance programs. The state has the nation’s highest minimum wage and fifth highest average manufacturing wage.

These high costs take their toll in the sectors where labor costs are a competitive issue and cannot be offset by the state’s high levels of education and high quality of life. One disturbing indicator of the impact of labor costs is the fact that Washington has among the lowest levels of investment in manufacturing plant and equipment. On an investment-per-employee basis, Washington ranks 42nd, according to the Census Bureau’s Annual Survey of Manufacturers. This means that too many Washington employers are seeing plant and equipment as a poor investment, and that we can expect the state’s manufacturing capital stock to deteriorate and manufacturing jobs to disappear.

The impacts of the changes in employment law described in this brief are difficult, if not impossible to quantify. But taken together they add new potential costs and uncertainties to an already challenging employment environment. By expanding eligibility for benefits and creating broader definitions of protected groups, the new laws increase the possibility for actions against employers, forcing them to create elaborate new protections for themselves and driving up administrative and legal costs.

Diminishment of a state’s competitive position does not happen overnight:

it is a slow erosion, rather than a landslide. Californians are probably not aware that their state is increasingly viewed as a good place for business to avoid. And Washingtonians are probably unaware that doing business in their state carries a heavy price tag; so far we have gotten away with it. But allowing basic competitiveness to deteriorate while touting Mount Rainier and Microsoft does not constitute a sound economic development strategy.

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