Increasing the Taxable Wage Base Unlocks the Door to Lasting Unemployment Insurance Reform

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Long-term underinvestment by states in their unemployment insurance (UI) systems—and a race to the bottom in benefits among certain states—left the UI safety net badly prepared for the COVID-19 pandemic, and Congress was forced to enact a series of emergency measures to meet the needs of jobless workers. President Biden's American Families Plan, and his FY 2022 budget proposal, calls on Congress to make lasting reforms to the unemployment insurance safety net so that Congress would not be left holding the bag when the next crisis comes. In Congress, a discussion draft by Senators Ron Wyden (D-OR) and Michael Bennet (D-CO) sets out parameters for needed minimum federal standards for unemployment benefits, but does not address financing. Among other things, their proposal suggests increasing the maximum unemployment benefit to two-thirds of the state's average weekly wage; requiring states to provide twenty-six weeks of benefits at all times and to trigger-in automatic extension when the state's unemployment rate is high; and establishing a federal jobseekers allowance that, like the Pandemic Unemployment Assistance program, would cover workers not eligible for regular UI.

As Congress considers how to incorporate UI reform into a budget reconciliation package, this fact sheet highlights the single critical financing reform that should be included: an increase to the taxable wage base. The taxable wage base is the portion of each worker's annual earnings that are subject to UI taxes, and states are required to have a wage base that is at least as high as the federal one (in order for their state's employers to receive a credit against federal unemployment taxes). However, the federal taxable wage base has not been significantly increased in nearly a century. Both the UI and Social Security taxable wage base started at $3,000 in the late 1930s, but the base for UI stands at $7,000 today, while the base for Social Security over time has been increased to $142,800. A federal policy that raises the minimum unemployment insurance taxable wage to at least one half of the Social Security wage base would improve the solvency of the UI system and allow states to have a greater role in financing adequate benefits during the next economic downturn.

The Connection between Adequate Financing and Adequate Benefits

- **Unemployment insurance is a self-financing system, supported by payroll taxes.** There can be no sustainable reform to UI benefits if the financing is not fixed. In recent decades, state financing of the program has been consistently inadequate, and this lack of resources has been a driving factor in restrictions and weakening of the program.

- **During the financial crisis of the Great Recession, thirty-six state unemployment trust funds went bankrupt.** As a result of insolvency, ten states cut the number of weeks of benefits, marking the first time ever in the history of the program that the basic package of benefits had been pulled back from twenty-six weeks. In addition, numerous states cut the amount of benefits and adopted tighter qualification rules rather than levying fair taxes. As a result, the percentage of jobless workers receiving UI benefits hit an all-time low of 26 percent in 2013.

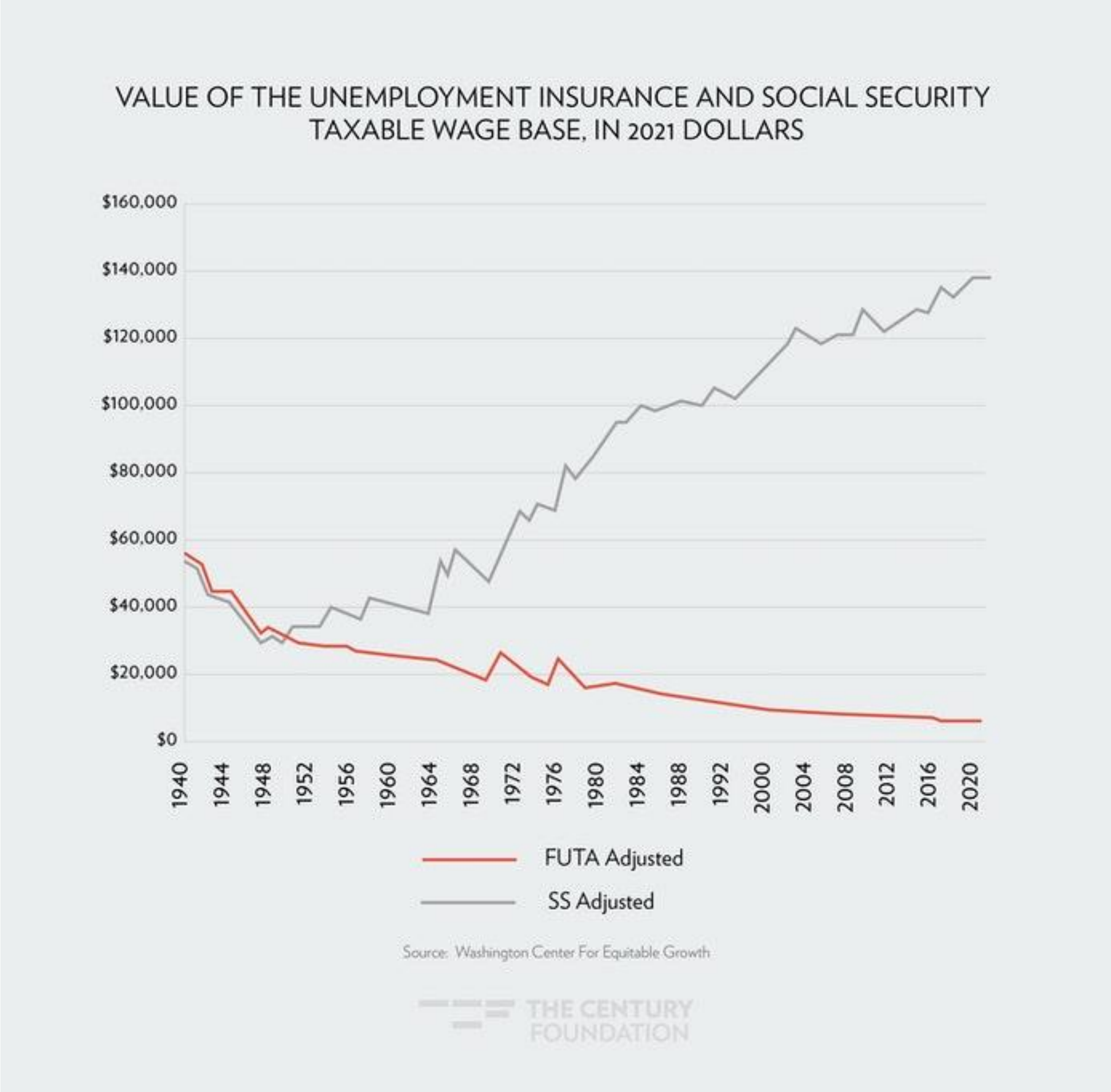
- **The current financing system was too weak to rebuild funds after the financial crisis.** Nationally, taxes never increased to more than 1 percent of wages after the financial crisis, and only thirty-one states reached the recommended U.S. Department of Labor financing targets established in 2010 by the time the pandemic hit in 2020. These standards recommended that states have at least one year of recession-level benefits stored in their trust fund during good economic times. Many of the states that achieved solvency did so by brutally cutting benefits back (Florida and North Carolina); problematically, many of these same states then shrunk their available financing by levying ultra-low taxes by 2020 (0.1 percent of total wages in Florida, 0.24 percent in North Carolina, and a record low of 0.42 percent nationwide in 2021).

- **The cycle of insolvency, insufficient taxes, and benefit cuts is set to begin again.** Twenty states are in debt due to the spike in claims during the pandemic, and fifteen of these twenty had insufficient funds saved before the pandemic. Already, states such as Tennessee have enacted drastic benefit cuts in an effort to reduce increases in employer taxes.

- **Without a financing floor, benefit standards won't work.** Even if Congress enacted a set of benefit standards along the lines of what Senators Wyden and Bennet have called for, states would be motivated to find cost-cutting measures—such as difficult application procedures and onerous work search requirements—that would put benefits out of reach for many low-wage and workers of color. Federal financing changes are critical in order to stem this trend, and put the system on a more sure footing for badly needed positive reforms to the benefits.

The Current Federal Taxable Wage Is Base No Longer a Meaningful Federal Floor for State Unemployment Taxes

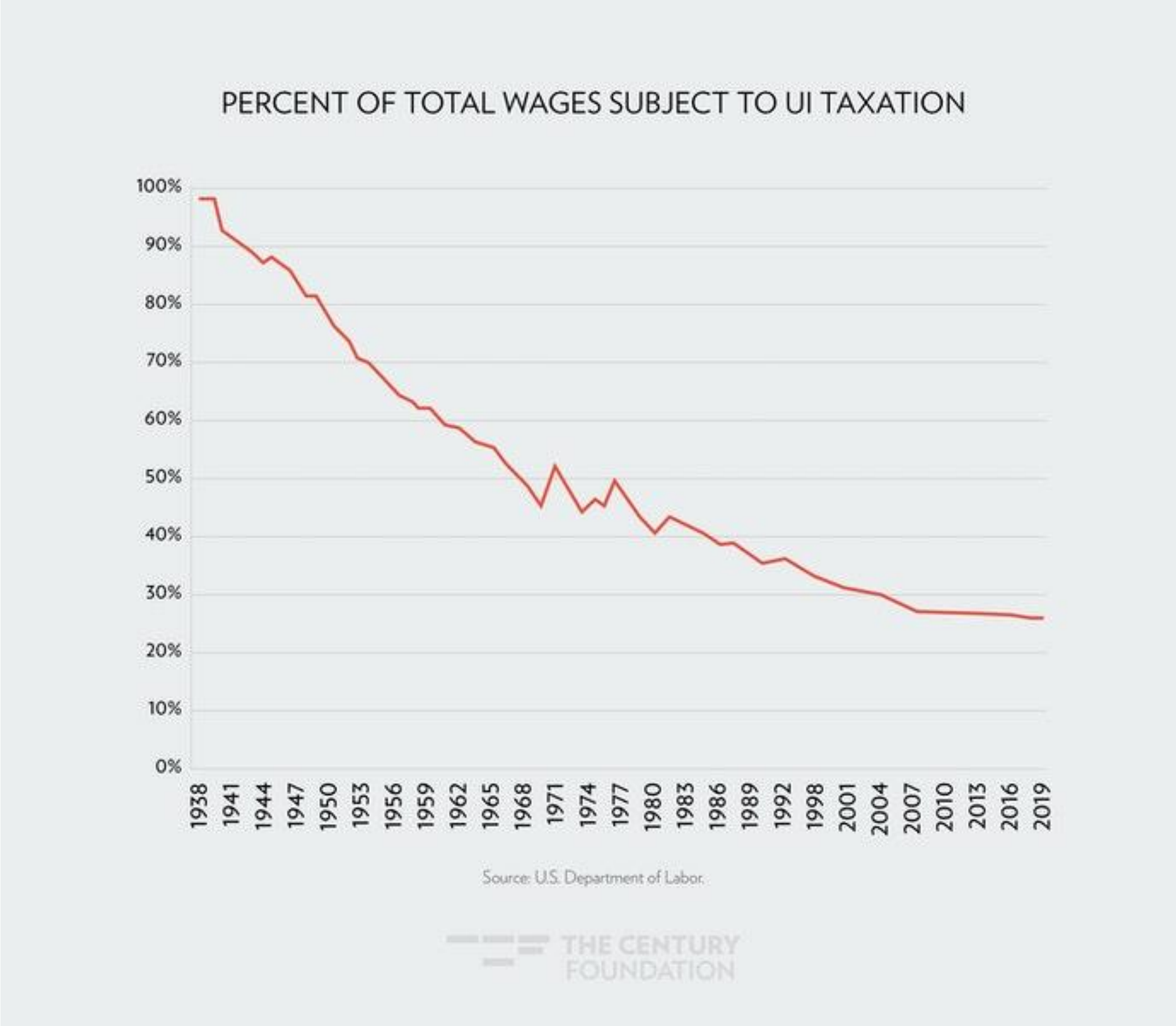
- **Federal law sets the parameters on how much of payrolls must be subject to unemployment insurance taxes.** The original wage base for Social Security and unemployment insurance taxation—$3,000 in the 1930s—would be more than $55,000 in current 2021 dollars, much higher than today's base of $7,000. The Social Security wage base currently is $142,800 and has been indexed to changes in the national average wage since 1977. In contrast, the federally established minimum taxable wage base for UI benefits has not been changed since 1982, and is not indexed to inflation. Figure 1 illustrates the decline in the real value (in 2021 dollars) of the UI taxable wage base—from over $55,000 in 1940 to just $7,000 in 2021—as compared to the steady rise in the real value of the indexed Social Security wage base. The current UI taxable wage base is way out of line compared to the wages workers earn today and their need for UI protections.



- **The UI taxable wage base varies widely by state, with many large states having insufficient financing.** With the federal floor so low, the taxable wage base varies widely, from a high of $56,100 in Washington State to a low in five states that have the minimum taxable wage base of $7,000, with the latter including several populous states: California, Arizona, and Florida. (See Map 1.) As a result, 24 percent of the U.S. workforce lives in states with the minimum taxable wage base of $7,000. and more than half of the workforce lives in fourteen states and Washington D.C. that have a taxable wage base of less than

$10,000—a group that includes populous states such as Georgia, Michigan, Ohio, and Texas. In contrast, nineteen states index the UI taxable wage in proportion to average wages, leading to much higher wage bases, such as $56,500 in Washington State, $43,000 in Idaho and $36,200 in New Jersey. These states are far more likely to have solvent trust funds. Some states made improvements in their UI system after the financial crisis, and a handful are moving in the right direction in 2021 (such as a recent decision by Connecticut Governor Ned Lamont to increase the base to $25,000). Nevertheless, indexing and larger wage bases have not become as widespread as they need to be under the current federal regime.

- **The ever-shrinking taxable wage base makes designing an effective system extremely difficult.** According to the U.S. Department of Labor, the share of wages subject to UI taxation has declined from 97.9 percent of all wages in 1938 to 25.3 percent in 2019. (See Figure 2.) The actuaries that are consulted today to create an effective system drawing resources from this base face a daunting challenge. In general practice, unemployment insurance benefits that have been paid out are charged back to the employers that have laid off workers. A surge in unemployment triggers an increase in tax rates for several years, based on actuarial tables; many states use a four-year average of benefit costs when making this computation. But among high-wage employers, where most workers collect the maximum unemployment weekly benefit amount, the revenues gained from taxation of the low wage base are not enough to recover benefits paid. In simple terms, UI benefits are based on a rate that currently averages a payout of nearly 50 percent of a worker's wages, but taxes can only be charged on 25 percent of a worker's wages. It is not surprising that the U.S. Department of Labor found that most states in 2020 were charging below the minimum financing rate needed to recover benefits and build a trust fund. A higher taxable wage system will allow this mechanism to actually work and remain self-financing.



- **The low taxable wage base makes the typical state unemployment tax deeply regressive, penalizing employers in low-wage industries and by association their workers.** In California in 2020, for example, taxes would only be assessed on 6 percent of the wages of a software engineer earning $125,000 per year, while a fast food worker earning the average annual wage of $24,250 per year would have taxes assessed on nearly 25 percent of their salary. Moreover, since the unemployment tax is due on the first $7,000 per worker per year, and fast food workers turn over quickly, it is easy to imagine a low-wage employer paying quadruple taxes to cover one single full-time equivalent line. This is a distorted system in which businesses in low-wage industries pay far more than their share of UI taxes and the most-profitable companies pay far too little. By keeping the federal taxable wage base low, federal policy has had the unintended impact of shifting UI financing on to those employers with the least means to support the program. And because employers can economically pass along the cost of these taxes on to their workers through lower wages and benefits, workers are impacted as well.

- **A low taxable wage base puts the brunt of unemployment taxes on employers of people of color.** Workers of color are concentrated in low-wage industries, where UI taxes are levied on a much larger share of their wages. For example, black workers make up 28.8 percent of all home health care workers, and earn only $15.62 per hour in these jobs. These workers would reach full tax liability required under federal law ($7,000) after 448 hours of work. On the other end of the income spectrum, white workers make up 75 percent of investment workers, earning $49.35 per hour and able to reach the full tax liability in just 140 hours of work. Put simply, employers of workers of color are subject to UI taxes for more hours per year because of the low-taxable wage base. Moreover, taxable wage bases are especially low across the deep south, which is disproportionately African-American, and in California, Texas, Arizona, and Florida, where Latinx workers are concentrated. In these states especially, employers of workers of color are taxed for far more hours of work than employers of better-paid white workers. This outsized tax burden on employers of low-wage workers of color is, in essence, structural racism.

Policy Solutions

- **The UI taxable should be significantly increased to 50 percent ($71,400) or 100 percent ($142,800) of the Social Security taxable wage base, and then indexed.** As outlined in a comprehensive policy framework issued by the U.S. Department of Labor in June, a significant upward shift in the federal taxable wage base will ensure that state unemployment insurance taxes are assessed on a similar number of hours of work for low-wage and higher-wage workers. If new federal standards require states to pay more in state unemployment benefits because of minimum standards, state unemployment taxes will need to rise gradually to cover these costs. These higher taxable wage bases will ensure that any such increases would be evenly spread among employers, and not only target the low-wage labor force. Because states can adjust their rate schedules, this won't mean that effective tax rates will need to increase at the same level as the base. It would just mean that states would have to adopt a state taxable wage base that is at least this new federal minimum and adjust their actuarial schedule accordingly.

- **The Federal Unemployment Tax Act (FUTA) credit should be adjusted to provide a stiffer federal tax penalty to states that do not comply.** The federal unemployment tax plays another important policy role. Employers operating in states that charge a state unemployment tax and have a UI system that complies with federal laws receive a 90 percent credit against the federal tax. Currently, employers in states with a compliant UI program can claim a credit for $378 of the $420 federal unemployment tax per full-time worker: this makes the effective FUTA tax equal to $42 per worker. It is possible that, faced with strong minimum federal standards, some states might opt to give up trying to comply with federal law and allow the full $420 tax to be assessed rather than meet more stringent federal standards. The level of the federal unemployment tax should be increased above the $420 per worker per year to a level equivalent to something closer to 1 percent of the Social Security wage base ($1,428 per year). This would provide a greater financial incentive for states to comply with a set of new, more aggressive benefit standards. Employers should still be offered a generous credit of 90 percent (or more) against this federal unemployment tax if their states do comply. Congress could also consider a graduated credit for noncompliance that would raise federal taxes in states that don't comply, but give them time to fix their system before the full federal tax kicks in.

Looking Ahead

Originally equal to the Social Security wage base, the unemployment insurance taxable wage base has failed to keep pace with economic growth, hampering the ability of the federal–state UI partnership to be consistently solvent and able to pay adequate benefits. The low taxable wage base takes the responsibility of unemployment financing away from the most-profitable companies, which only pay taxes on a sliver of their payrolls. Increasing and indexing the taxable wage base is the most important reform of UI financing needed.

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HEADER PHOTO: PEOPLE WALK BY A HELP WANTED SIGN IN THE QUEENS BOROUGH OF NEW YORK CITY. SOURCE: SPENCER PLATT/GETTY IMAGES

Available at Increasing the Taxable Wage Base Unlocks the Door to Lasting Unemployment Insurance Reform (tcf.org)