

– NELP Briefing Paper –

**Indexed State Taxable Wage Bases:
Taking A Significant Step Toward Better UI Financing**

**Rick McHugh, Staff Attorney
Andrew Stettner, Policy Analyst
National Employment Law Project**

February 2004

Indexed State Taxable Wage Bases: Taking A Significant Step Toward Better UI Financing

Executive Summary

- In the field of unemployment insurance financing, indexing is the automatic adjustment of taxable wage bases in conjunction with growth in wages. While every state has a mix of financing features in its unemployment insurance (UI) program, if asked to name a single step that will improve state UI trust fund solvency, knowledgeable experts would say indexing of taxable wage bases.
- In 2003, states had UI taxable wage bases ranging from \$7,000 to \$30,200. Having higher wage bases is closely associated with having an indexed taxable wage base (TWB). All fifteen states that had UI wage bases of \$15,000 or more in 2003 were states with indexed TWBs.
- Higher taxable wage bases put UI financing on a broader basis and increase the responsiveness of UI taxes when recovering from higher UI benefit payments during a recession. In general, states with higher taxable wage bases can recover from or avoid insolvency better than states with lower taxable wage bases.
- UI programs insure workers against the loss of wages. Indexing permits the financing of UI programs to keep pace with the insured risk, that is, lost wages. Indexed TWBs greatly improve the ability of a state's UI financing mechanism to keep pace with the growth in wages and benefit amounts over time.
- The ability of a state's UI financing mechanisms to produce sufficient revenue is greatly assisted by subjecting more of its wages to UI taxation. States with higher taxable wage bases have better UI trust fund solvency and enhanced ability to raise revenues for UI trust funds when UI claims numbers rise.
- The average reserve ratio of the states with indexed taxable wage bases is 1.96 for the 3rd quarter of 2003. States without indexed taxable wage bases have a substantially lower average reserve ratio of 1.23. Fifteen of the 17 states with indexed taxable wage bases have above-average solvency, that is, they have reserve ratios above the 3rd quarter national reserve ratio of 0.75.
- Indexing improves the average high cost multiple (AHCM) solvency measure. Five of the top 10 states in terms of AHCMs have indexed taxable wage bases. On the other hand, those states with solvency problems are the least likely to have an indexed taxable wage bases – just 2 of the 10 least solvent states utilize TWB indexing.
- Universal indexing of state UI taxable wage bases would have a powerful impact on state UI trust funds. In an analysis of 2002 data, we find that reaching the reserve ratio levels of indexed states would require an additional \$19.8 billion in non-indexed state UI trust funds, a considerable increase over the actual total of \$26.5 billion in non-indexed states' total 2002 reserves. The resulting boost in trust fund reserves would increase state trust fund reserves by 36 percent from their actual level of \$35.7 billion dollars to \$55.5 billion.

Indexed State Taxable Wage Bases: Taking A Significant Step Toward Better UI Financing

By National Employment Law Project

Introduction

By the end of 2003, a dozen state's unemployment insurance (UI) trust funds were facing significant solvency challenges, with six states using federal loans during the year. At the same time, a majority of states had more than adequate trust funds going into 2004, especially considering they have faced three years of higher UI claims related to the 2001 recession and the continuing job slump.

The solvency of state UI trust funds requires balancing revenues and benefits over time. On the revenue side of UI financing, states differ in the amount of wages subject to payroll taxation (called the "taxable wage base"), the maximum and minimum tax rates applied to the taxable wage base, and the responsiveness of tax rates to changes in trust fund balances. While every state has a mix of financing features in its UI program, if asked to name a single step that will improve state UI trust fund solvency, most UI financing experts would identify indexing of taxable wage bases to wage inflation. Indexing is the automatic adjustment of taxable wage bases in conjunction with growth in wages. Seventeen states have indexed taxable wage bases. This fact sheet explains how indexing helps states maintain solvent state UI trust funds.

State Taxable Wage Bases Vary

In 2003, states had UI taxable wage bases ranging from \$7000 to \$30,200. The table below shows the break down in taxable wage bases (TWBs). The majority of states retain low taxable wage bases. The minimum taxable wage base permitted under federal law is \$7000 and 10 states remained at this level in 2003. Another 21 states had 2003 taxable wage bases at \$10,000 or below. While the majority of states have remained at or near the \$7000 federally permitted minimum taxable wage base level, fifteen states had wage bases of \$15,000 or more in 2003. *All of these states were states with indexed TWBs.*

State Taxable Wage Bases-2003

\$10,000 or less	Over \$10 to \$15 K	Over \$15 to \$20K	Above \$20K
(31 States)	(7 States)	(6 States)	(9 States)
Alabama, Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Michigan, Mississippi, Missouri, Nebraska, New Hampshire, New York, Ohio, Pennsylvania, Puerto Rico, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, West Virginia	Connecticut, Maine, Massachusetts, Oklahoma, Rhode Island, Wisconsin, Wyoming	Iowa, Montana, New Mexico, North Carolina, North Dakota, Virgin Islands	Alaska, Hawaii, Idaho, Minnesota, Nevada, New Jersey, Oregon, Utah, Washington

As noted, state taxable wage bases are subject to federal guidelines. States are required to have a taxable wage base at least as high as the wages subject to taxation under the Federal Unemployment Tax Act (FUTA). Congress initially set the FUTA tax base at \$3000 in 1939. It was raised to \$4200 in 1972, and lifted to \$6000 in 1978. The current minimum state tax base was effectively raised to \$7000 when the FUTA

taxable wage base was adjusted in 1983. It has not been raised in the 20 years since that time. Only ten states have state taxable wage bases at the federal minimum of \$7000, although a majority of states remain within a few thousand dollars of that level.

Advantages of Higher Taxable Wage Bases

There are several advantages of higher UI taxable wage bases:

- Higher taxable wage bases put UI financing on a broader basis and increase the responsiveness of UI taxes when recovering from higher UI payments during a recession. In general, states with higher taxable wage bases can recover from or avoid insolvency better than states with lower taxable wage bases. In those states with higher taxable wage bases, a modest percentage increase in taxes leads to a large increase in revenues allowing a trust fund to quickly rebound.
- Higher tax bases permit UI payroll taxes to recover costs more effectively from those employers who are rated higher under state experience rating measures. (Under experience rating, each individual employer's tax rate varies according to their history of layoffs.) States with low taxable wage bases cannot recover costs as effectively from higher rated ("high cost") employers, especially if they have low maximum tax rates combined with low taxable wage bases.
- Low taxable wage bases subject low-wage workers to higher rates of UI payroll taxation than higher taxable wage bases. Economists have found that a low taxable wage base results in a regressive tax falling on lower-wage workers, creating a disincentive to hiring lower-wage workers.

Indexing of State Taxable Wage Bases

Seventeen states index their UI taxable wage bases. This means that their taxable wage bases (TWBs) are annually adjusted in line with growth in wages and salaries. The table below shows the indexing states and each state's indexing criterion.

States with Indexed Taxable Wage Bases-2003

State	Taxable Wage Base	Indexing Criterion
Alaska	\$26,700	75% SAAW
Hawaii	\$31,000	100% SAAW
Idaho	\$27,600	100% SAAW
Iowa	\$19,200	66.7% AWW times 52
Minnesota	\$22,000	60% SAAW
Montana	\$19,700	80% SAAW
Nevada	\$21,500	66.7% SAAW
New Jersey	\$23,900	28 times AWW
New Mexico	\$16,600	65% SAAW
North Carolina	\$15,900	50% SAAW
North Dakota	\$18,000	70% SAAW
Oklahoma	\$11,700	50% SAAW
Oregon	\$26,000	80% SAAW
Utah	\$22,500	75% prior fiscal year wage
Virgin Islands	\$18,000	60% SAAW
Washington	\$29,700	115% of prior TWB but not more than 80% SAAW
Wyoming	\$14,700	55% SAAW

Note: SAAW is state average annual wage. AWW is state's average weekly wage. TWB is taxable wage base.

Source: USDOL *Comparison of State Unemployment Insurance Laws* (July 2003), Table 2.5 with corrections by NELP research.

Most indexing states use a prior 12-month period's state average annual wage (SAAW) as the basis for indexing. The highest index for taxable wage bases is found in Hawaii and Idaho, which set their taxable wage bases at 100 percent of SAAW. The lowest percentage used for indexing is 50 percent of SAAW in Oklahoma. All indexing states round to the nearest \$100 or \$1000.

Advantages of Indexing

UI programs insure workers against the loss of wages. Indexing permits the financing off UI programs to keep pace with the insured risk, that is, loss of wages. This is especially important in the 34 states that index their maximum weekly benefit amounts. States with indexing are the states with higher taxable wage bases, that represent a larger portion of the average paycheck. Of the fifteen states with taxable wage bases over \$15,000, all have indexed taxable wage bases. Oklahoma and Wyoming use lower percentages of SAAW as the basis of their indexing, and for that reason their taxable wage base amounts are somewhat lower than the other indexing states.

UI financing experts have found that states with higher taxable wage bases have better UI trust fund solvency and enhanced ability to raise revenues for UI trust funds when UI claims numbers rise. (Vroman, 2003 and 1998). The Advisory Council on Unemployment Compensation found that increasing state taxable wage bases were associated with improvements in the solvency of UI trust funds, as measured by reserve ratios (percent of total wages in trust fund reserves). (Advisory Council, 1996).

Table 1 at the end of this fact sheet shows the trust fund balances, average high cost multiples (AHCM), and reserve ratios for all 53 UI jurisdictions in the United States. Figures shown are for the end of the third calendar quarter of 2003, the most recent period for which data are available. The reserve ratios are those published by USDOL based upon extrapolated wages. AHCMs were calculated by NELP. (Explanations of UI financing terms are found in NELP's briefing paper "State Unemployment Insurance Trust Fund Solvency: How States Are Doing in the Continuing Job Slump?") States with indexed taxable wage bases are listed in **bold** in Table 1. Several observations are revealed by Table 1:

- Table 1 is sorted by reserve ratio, from the highest solvency states to the lowest. A quick perusal indicates that states with indexed taxable wage bases are bunched towards the top of the solvency distribution, and are largely absent from the list of states with lower solvency.
- The average reserve ratio of the states with indexed taxable wage bases is 1.96 - near the pre-recession 2.0 threshold of solvency. States without indexed taxable wage bases have a substantially lower average reserve ratio of 1.23. Note that 15 of the 17 states with indexed taxable wage bases have above-average solvency, that is, they have reserve ratios above the 3rd quarter national reserve ratio of 0.75.
- Indexing also improves the average high cost multiple (AHCM) solvency measure – which compares reserve levels to prior benefit costs. Five of the top 10 states in terms of their AHCMs have indexed taxable wage bases. On the other hand, those states with solvency problems are the least likely to have an indexed taxable wage bases – just 2 of the 10 least solvent states utilize TWB indexing.
- While indexed taxable wage bases are highly recommended, they are not sufficient to ensure trust fund solvency. The solvency exceptions among indexed TWB states are Minnesota and North Carolina, both with trust funds that are basically broke. Conversely, a number of states have very high trust fund solvency without indexed taxable wage bases, including Puerto Rico, Vermont, Louisiana, Maine, and Mississippi.

Impact of Indexing Taxable Wage Bases on Overall UI Solvency

The decline in the real value of UI taxable wage bases stands in contrast to the nation's other major social insurance program – Social Security, whose taxable wage base stood at \$87,900 in 2004. While UI benefits lack the general cost of living adjustment as with social security, UI benefit payments rise with wage growth over time. In the majority of states, maximum UI benefit levels increase with wage growth. Thirty-four states increase maximum weekly benefits by indexing their levels to state wage levels. Even in those states that don't index their maximum benefits, weekly UI benefit amounts are based on formulas that use pre-layoff wages. These benefit formulas increase weekly benefit amounts for all jobless workers getting less than the maximum weekly benefit. The increase in benefit amounts is demonstrated by the increasing national average weekly benefit amounts (AWBA) over the years. In FY 1997, the U.S. AWBA was \$184.94. By FY 2003, AWBA has risen to \$253.59. The U.S. AWBA is projected to reach \$262.89 by FY 2005.

The increase of UI benefit amounts over time results in additional revenue requirements that must be collected from a fixed proportion of wages in states without indexed taxable wage bases. The failure of UI taxable wages to rise with benefits is aptly described by economist Philip Levine. "A major deficiency in the current system of UI financing is that the infrequent, ad hoc adjustments to the taxable wage base lead to a continual erosion of its financial stability . . . Even in the absence of severe cyclical downturns, these basic relationships indicated that the current system of UI financing will drift toward insolvency." (Levine, 1997).

Without indexing, the UI financing base falls behind wage growth, requiring that UI taxes fall on a decreasing proportion of overall wages. For example, California's TWB of \$7000 is only 17 percent of the state's SAAW, while New York's TWB of \$8500 subjects only 18 percent of its \$46,000 SAAW to UI taxation. In contrast, indexed taxable wage bases in Idaho and Hawaii subject 100 percent of state average wages to UI taxes.

Over time, the ability of a state's UI financing mechanisms to produce sufficient revenue is greatly assisted by subjecting more of its wages to UI taxation. For this reason, universal indexing of state UI taxable wage bases would have a powerful impact on the health state UI trust funds. We estimate this impact by using end of calendar year 2002 figures, the last year for which necessary wage data are available to us. The table below shows that universal TWB indexing increases state UI trust fund solvency significantly, both in terms of reserve ratios and AHCMs.

Estimated Impact of Universal State Taxable Wage Base Indexing – 2002

	Total Wages (billions)	Total Trust Fund Reserves (billions)	Reserve Ratio	Average High Cost Rate	Average High Cost Multiple
Indexed States Totals	\$620	\$9.2	1.49	-	-
Non-Indexed States Totals	\$3,106	\$26.5	0.85	-	-
Actual National Totals	\$3,726	\$35.7	0.96	1.54	0.62
Estimated as if all states had reserve ratio of indexed states	\$3,726	\$55.5	1.49	1.54	0.97

Note: Average high cost rate is the average percent of total wages consumed by UI benefit payments in a 12-month period over the last 20 years or 3 recessions.

We estimated the impact of indexing state TWBs by aggregating the wages and trust funds of two groups of states, those states that index TWBs and those that are non-indexing states. Taken together the

combined trust fund reserves of the 17 states with indexed taxable wage bases represent 1.49% of the combined wages of those states – a composite reserve ratio of 1.49. If the other 36 UI jurisdictions had matched the solvency performance of their indexed neighbors we assume that their composite reserve ratio would likewise be 1.49, rather than their actual reserve ratio of 0.85.

To reach the reserve ratio levels of indexed states requires an additional \$19.8 billion in non-indexed state UI trust funds, a considerable increase over the actual total of \$26.5 billion in non-indexed states' total 2002 reserves. The resulting boost in trust fund reserves brings state trust fund reserves up 36% from their actual level of \$35.7 billion dollars to a projected \$55.5 billion. This adjustment raises the national average high cost multiple to 0.97, instead of the actual overall AHCM of 0.62 reported for 2002 by the U.S. Department of Labor. This increase would represent trust fund solvency equivalent to the pre-recessionary trust fund standard of an AHCM of 1.0 (a full year of reserves). In other words, increasing the use of indexed taxable wage bases would have resulted in a considerable improvement over the actual performance of UI trust funds.

Conclusion

Our review shows that indexing state taxable wage bases is the single most significant step that states can make toward building UI trust fund reserves. The record of state performance in the current job slump shows that UI financing and trust fund solvency are critical to maintaining and building adequate state UI safety nets. In those states that neglected UI solvency or deliberately adopted “pay as you go” financing, jobless workers have faced actual or proposed restrictions requiring them to sacrifice in order to restore UI trust fund solvency. In contrast, states with adequate trust fund reserves have been able to maintain benefit levels without stiff tax increases and even to afford state-funded benefit extensions and eligibility expansions in some cases.

For further information about this briefing paper contact:

Rick McHugh
Midwest Coordinator
National Employment Law Project
(734) 426-6773
rmchugh@nelp.org

Andrew Stettner
Policy Analyst
National Employment Law Project
(212) 285-3025, ext. 110
astettner@nelp.org

Website: www.nelp.org

Unless otherwise noted, all data regarding UI programs are from the U.S. Department of Labor's Office of Workforce Security, Division of Fiscal and Actuarial Services.

References

Advisory Council on Unemployment Compensation (1996). *Defining Federal and State Roles in Unemployment Insurance*, U.S. Department of Labor.

Phillip B. Levine (1997). "Financing Benefit Payments," in Christopher J. O'Leary and Stephen A. Wandner, ed., *Unemployment Insurance in the United States: Analysis of Policy Issues*, (Kalamazoo, Michigan. Upjohn Institute).

Wayne Vroman (2003). "Unemployment Insurance Financing Options in Massachusetts." (Washington, D.C., Urban Institute)(December).

Wayne Vroman (1998). *Topics in Unemployment Insurance Financing*, (Kalamazoo, Michigan. Upjohn Institute).

Table 1: State UI Trust Funds—2003, Highest to Lowest Reserve Ratios

State	Fund Balance 9/30/03 (millions)	Reserve Ratio 3rd Qtr 2003	AHCM 3rd Qtr 2003
Virgin Islands	\$38.6	5.01	2.00
Vermont	\$257.3	3.89	2.06
Puerto Rico	\$533.0	3.88	1.21
New Mexico	\$591.3	3.72	2.66
Wyoming	\$180.8	3.55	1.39
Louisiana	\$1515.0	3.51	1.29
Maine	\$439.6	3.35	1.73
Mississippi	\$665.8	2.89	1.89
Alaska	\$207.1	2.72	0.87
Oregon	\$1049.8	2.58	1.02
Hawaii	\$335.9	2.53	1.49
Montana	\$196.5	2.32	1.37
Iowa	\$705.5	2.15	1.06
Delaware	\$253.8	2.00	1.66
Rhode Island	\$216.6	1.78	0.61
Utah	\$391.0	1.61	1.00
West Virginia	\$223.6	1.59	0.51
Wisconsin	\$1064.5	1.54	0.63
Dist. of Columbia	\$297.5	1.45	1.09
Nevada	\$442.8	1.42	0.84
Washington	\$1087.2	1.40	0.58
New Hampshire	\$242.2	1.39	1.49
Arizona	\$806.4	1.30	1.30
New Jersey	\$1714.3	1.22	0.66
Oklahoma	\$386.8	1.20	0.95
Indiana	\$867.0	1.14	0.94
Michigan	\$1545.5	1.13	0.42
Idaho	\$137.2	1.08	0.45
South Carolina	\$443.0	1.03	0.70
Kansas	\$345.0	0.96	0.66
Maryland	\$651.1	0.93	0.64
Kentucky	\$389.8	0.93	0.44
North Dakota	\$49.5	0.83	0.39
Florida	\$1528.0	0.79	0.96
Tennessee	\$554.4	0.79	0.58
Connecticut	\$476.4	0.78	0.55
Georgia	\$832.6	0.75	0.80
Ohio	\$1074.7	0.74	0.33
Nebraska	\$142.6	0.72	0.75
Pennsylvania	\$1097.5	0.72	0.26
Alabama	\$292.6	0.64	0.46
South Dakota	\$41.4	0.57	0.69
Texas	\$1057.9	0.39	0.37
Arkansas	\$97.6	0.39	0.26
California	\$1833.1	0.38	0.26
Colorado	\$218.6	0.33	0.30
Virginia	\$320.1	0.32	0.39
Massachusetts	\$268.7	0.23	0.13
Missouri	\$3.8	0.01	0.01
North Carolina	\$10.2	0.01	0.01
Illinois	\$5.2	0.00	0.00
Minnesota	\$0	0.00	0.00
New York	\$6.5	0.00	0.00
United States	\$28,132.9	0.75	0.49

Note: States in **bold** have indexed taxable wage bases. Reserve ratios published by USDOL in UI Data Summary 3rd Quarter 2003 based upon extrapolated wages. AHCMs estimated by NELP based upon USDOL data.