Policy Points

Raising Taxable Wage Base Is Best Way to Keep State Unemployment Fund Solvent

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Recession puts state unemployment fund at risk.

The full impact of the national recession has finally reached the Mountain State, according to two key indicators released during the first week of March. The state budget slipped into the red at the end of February, as West Virginia joined 46 other states with budget deficits. To make hard times harder, the state unemployment rate jumped from 4.4 in December to 6.2 percent in January. Even when seasonally adjusted, the 5.3 percent rate was highest reported in more than four years.[i]

The number of unemployed West Virginians has swelled by more than 10,000 over the past year, and the pace of job loss is accelerating. This poses significant challenges to the solvency of the state's Unemployment Insurance Trust Fund. The problem for the state is double-edged: Rising joblessness reduces the amount of unemployment tax payments going into the fund, while it simultaneously increases withdrawals to pay for benefits.

Without a sound foundation, a prolonged recession will eventually deplete the trust fund, as has already happened in nine other states. While predictions vary, the question is when, not if, the Trust Fund will go broke. State Unemployment Compensation Director Michael Moore puts the worst case scenario of insolvency in 2012,[ii] and says without fundamental changes to the existing revenue base that, "you're eventually going to hit a wall."[iii] Other experts say that even a mild recession could exhaust the fund by the end of 2010.[iv]

Indexing taxable wage base provides long-term solution.

In West Virginia, gross wages are taxed up to $8,000 through employer contributions at a rate of 2.7 percent. These taxes are then withheld by businesses and paid quarterly to the trust fund. These funds are then paid out in the form of benefits to jobless workers as a temporary income support. These funds provide financial stability to unemployed workers, their families, and the local economy.

West Virginia's taxable wage base has not kept pace with the rising wages since 1981 and is the oldest unchanged taxable wage base in the country. During this period, the maximum weekly benefit increased by 119 percent, from $194 in 1981 to $424 in 2009.[v] Last year, before the surge in unemployment, the fund took in $142 million and paid out $164 million.

There is broad agreement that action needs to be taken to strengthen the fund and preserve benefits for West Virginia workers and their families. The best way to meet both immediate and long-term needs is to raise and index the taxable wage base used for calculating unemployment taxes. "Indexing" is the automatic adjustment of taxable wage bases in conjunction with growth in wages. Tax payments would increase to reflect increases in wages earned and unemployment benefits paid, thereby maintaining a constant positive balance in the fund. Sixteen states had indexed taxable wage bases in 2004.[vi]

A 2005 legislative audit also recommended indexation of the taxable wage base as the most appropriate solution to maintaining a solvent unemployment insurance trust fund.[vii] Reasons cited included the following:

- Periodic automatic adjustments to the taxable wage base would prevent the Legislature from having to impose a solvency tax on employers and employees during a weak economy, which would worsen economic conditions. This emergency procedure resulted in the state borrowing as much as $519 million from the federal unemployment compensation system during the 1980's, issuing bonds, and imposing a solvency tax on employees and employers to repay the federal loans. This move would save the state an additional $64 million in interest and fees associated with paying back the federal government's loans.[viii]

- Indexing would reduce the regressive nature of the unemployment tax, since taxes on all employees – regardless of wage level – are capped at $8,000.

- Indexing would reduce the inequity of many high-salary employers receiving more benefit payments than they pay in unemployment taxes. In 2004, for instance, 49 percent of total benefits paid were to companies that paid only 27 percent of the total unemployment tax.

Employers and Employees Both Benefit Under Indexation.

The Governor has also proposed legislation that would impose a temporary tax increase on both employers and employees should the trust fund's balance reach a low point. This "insolvency tax" on employers (1/2 of 1 percent) and employees (15/100 of 1 percent) would engage whenever the trust fund dips below $180 million and disengage once it exceeds $250 million. Although this approach would prevent the outright depletion of the trust fund, it has significant drawbacks. The most serious is that it imposes additional taxes on both employees and employers during economic conditions when they are least prepared to shoulder this burden. It is also reactive, rather than proactive, and requires more administrative time and resources than does a constant, indexed taxable wage base.

It is possible to analyze the costs associated with the annual, average per employee costs on both employers and employees under each proposal. Table 1 below demonstrates that using the average wages paid we can compare the two proposals to see which is better for employers and employees alike. The total additional taxes imposed on employers with the insolvency tax would be $116.75 per employee, on average, and only $108 with the increase in the taxable wage base by 50 percent.

Additionally, employees would also benefit with the indexation option as opposed to the insolvency tax because the Governor's proposal would impose an additional $35.03, on average, in taxes per year on employees' gross wages. The table also demonstrates that the indexation is the preferred policy option because 1.) indexation doesn't hit employers and employees during a bad economy, 2.) indexation doesn't place limits on benefit increases, 3.) indexation doesn't require future "sudden and dramatic" government interventions, and 4.) indexation minimizes the regressive nature of the taxable wage base. See endnote for further discussion on the methodology used to arrive at the annual, average per-employee costs.

Table 1: Annual, Average Per Employee Cost Comparison of Two Proposals[ix]

Solutions Matrix	Employer Costs	Employee Costs	Other Costs: Are Taxes Poorly Timed?	Other Costs: Places Cap on Benefit Increases?	Other Costs: Requires Further Adjustments?	Other Costs: Maintains Regressive Nature?
Impose Insolvency Tax[x]	$116.75[xi]	$35.03[xii]	Yes	Yes	Yes	Yes
Raise Taxable Wage Base[xiii]	$108.00[xiv]	0	No	No	No	No
Cost Difference?	$8.75	$35.03	-	-	-	_
Which is Better Proposal?	**Raise Taxable Wage Base**	**Raise Taxable Wage Base**	**Raise Taxable Wage Base**	**Raise Taxable Wage Base**	**Raise Taxable Wage Base**	**Raise Taxable Wage Base**

Action needed now to preserve fund solvency

The best policy solution available to the Legislature is to raise and index the taxable wage base as soon as possible. A higher taxable wage base that is indexed to employee's wages would allow the trust fund balance to stay ahead of the increased benefits paid from the fund during economic downturns. Increasing the taxable wage base to $12,000 would bring West Virginia closer to the national average of $13,750.[xv] This amount would increase an employer's annual tax payment by only $108 per employee. If the taxable wage base had been indexed during the past three decades by 119 percent to match the increase in benefits, employers would now be paying the tax for employees with gross taxable wages up to $17,520.

Indexation is the better policy option compared to the insolvency tax in its effect on both employers and employees because, on average, indexation would be less costly. The insolvency tax proposal would cost employers an additional $8.75, per employee and employees would likewise pay an additional $35.03 in taxes on gross wages. Indexation also remedies the underlying structural defect of the UI Trust Fund because it would now allow for the revenue stream to increase over time during periods of growing wages and productivity. Indexation would also remove restrictions on future benefit increases that are now included in the current insolvency proposal.

In summary, indexation would naturally correct for changes in wage growth over time and thereby, eliminate the need for sudden and dramatic increases in tax liabilities on employers and employees during a contracting economy. Indexation is simply the cheaper policy option for both employers and employees that provides the only long term solution to an historical and recurring problem.

[i] Workforce West Virginia. "State Unemployment Rate at 6.2 Percent in January." Press release, February 26, 2009.

[ii] Dickson, Angelina. "Director of West Virginia Unemployment Compensation speaks at DBCA luncheon." Weirton Daily Times, March 4, 2009. Accessed at: http://www.weirtondailytimes.com/page/content.detail/id/518093.html?nav=5006.

[iii] "Chamber urges benefit cuts to keep unemployment trust fund in black," The Charleston Gazette, January 14, 2009.

[iv] "Unemployment Insurance Financing: State Trust Funds in Recession as of December 31, 2008," National Employment Law Project, http://www.nelp.org/page/-/UI/Trust_Fund_Solvency_Update.pdf

[v] WV Center on Budget & Policy analysis of Unemployment Compensation division of Workforce WV, June 10, 2008, "Maximum Weekly Unemployment Benefit Increases," http://www.wv.gov/news/commerce/Pages/MaximumWeeklyUnemploymentBenefitIncreases.aspx

[vi] National Employment Law Project. "Raise and Index Taxable Wage Bases: Stronger Financing for UI." Accessed at http://nelp.3cdn.net/7e9c6174a614f7e914_p4m6bni8f.pdf.

[vii] WV State Legislative Auditor, Preliminary Performance Review, May 2005, http://www.legis.state.wv.us/Joint/PERD/perdrep/UnempComp_5_2005.pdf

[viii] WV borrowed $519,141,000 using the federal Unemployment Insurance trust fund loans from 1981 through 1987 and paid back a total of $555,202,755 in repayments to the federal government. The interest and fees incurred from borrowing federal money cost the state an additional $36,061,755 over and above the repayment of the principal loan. After adjusting for inflation, that amount would equal, $64,363,373[viii] in 2009 dollars.

[ix] In order to calculate the annual, average per employee tax incidence under both proposals we must first recognize that the insolvency tax is a gross tax on wages. Since firms vary in the amount of employee wages paid it is useful to examine the average wages paid during the base period. Average wages collected are directly correlated with average benefits paid to jobless workers. Since data is not readily available on the average wages collected we can algebraically back into this number because we do know what the average benefit payments were in 2008. Wages are calculated in the base period and used to determine eligibility and benefit levels. Since the average weekly unemployment benefit in West Virginia in 2008 was $246 we can go to the WV Workforce Computational Table and derive the average taxable wages paid. Referencing the tables we can see that in order to obtain an average weekly benefit of $246 employers must have paid an average $23,350 in taxable wages into the unemployment insurance trust fund. Now, we can proceed to calculate the average incidence of the insolvency tax on both the employers and employees since we now know the average taxable wages that were paid during the base period. The information is provided by the WV Workforce Unemployment Compensation Benefit Rate Table "WVUC-B-59, effective July 6, 2008." Information on average weekly benefit can be found at, http://workforcesecurity.doleta.gov/unemploy/5159report.asp

[x] Insolvency tax is calculated as .005 percent of gross taxable wages on employers and .0015 percent of gross taxable wages on employees. See Governor's bill, SB 246 or HB 2336,

http://www.legis.state.wv.us/Bill_Status/Bills_history.cfm?input=246&year=2009&sessiontype=RS&btype=bill or
http://www.legis.state.wv.us/Bill_Status/Bills_history.cfm?input=2336&year=2009&sessiontype=RS&btype=bill

xi WV Center on Budget & Policy Analysis of Workforce West Virginia's Unemployment Compensation Benefit Rate Table's "Average Weekly Wages Paid in Base Period," of $23,349 X .005 percent = $116.75.

xii WV Center on Budget & Policy Analysis of Workforce West Virginia's Unemployment Compensation Benefit Rate Table's "Average Weekly Wages Paid in Base Period," of $23,349 X .0015 percent = $35.03.

xiii WV Center on Budget & Policy Analysis of current recommendation of increasing taxable wage base from $8,000 to $12,000.

xiv WV Center on Budget & Policy Analysis of current employer tax liability of 2.7 percent for most employers multiplied by the estimated $4,000 increase in taxable gross wage liability from $8,000 to $12,000, $4,000 X .027 = $108.00.

xv "The Comparison of State Unemployment Insurance Laws," January 1, 2008, US Department of Labor, Employment and Training Administration, pages 2-4, 2-5. Accessed at: http://workforcesecurity.doleta.gov/unemploy/uilawcompar/2008/comparison2008.asp

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