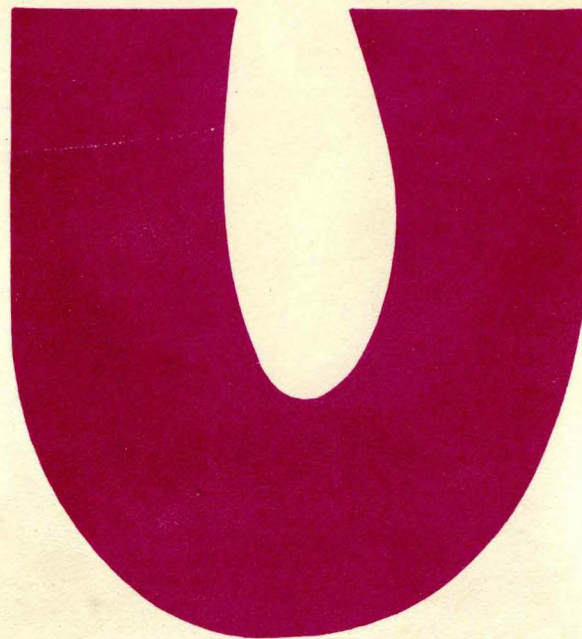


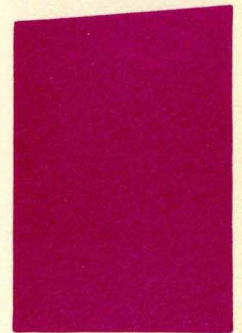
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A STUDY ON THE EFFECT OF AN INCREASE IN THE TAXABLE WAGE BASE UNDER THE IOWA UNEMPLOYMENT INSURANCE PROGRAM



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A Study on the Effect
of an Increase in the Taxable Wage Base
Under the Iowa Unemployment Insurance Program

IOWA EMPLOYMENT SECURITY COMMISSION

Des Moines, Iowa

Prepared by

RESEARCH & STATISTICS DIVISION

May 1965

Foreward

In making this study, we wish to emphasize that the Iowa Trust Fund, when measured by accepted actuarial methods, is in the strongest position of any state with the exception of one. Further, since 1954, including estimates for calendar year 1964, the average tax rate paid by Iowa employers is the lowest in the nation when measured by either taxable or total wages. In view of the strong position of the Iowa Unemployment Trust Fund, any increase in the revenue resulting from a changed tax base could be modified by compensating changes in tax rates.

However, the \$3,000 tax base limitation does result in tax inequities between individual employers and industries. The purpose of this study is to determine (1) the extent and nature of these inequities, and (2) if these inequities can be minimized by an increased tax base. A higher tax base might well require a general revision of the rate structure to maintain the fund at a predetermined level.

As initially written into the Iowa law, all wages paid by a covered employer were subject to the unemployment tax. In 1940 the tax base was reduced to \$3,000 to bring it into line with Old Age and Survivors Insurance and thus make reporting easier for employers. Since 1940 the taxable wage base for Old Age and Survivors Insurance has been increased periodically to a current level of \$4,800 while the \$3,000 ceiling is still in effect for the unemployment insurance program.

Highlights of the Study

1. In 1940, over 94 per cent of the wages in covered employment were subject to the State Unemployment Insurance Tax; by 1963, only 58 per cent of the wages were taxable. Projecting to 1967, it is estimated that only 51 per cent of the wages will be taxable.
2. This widening gap between total wages and taxable wages has the effect of limiting the effectiveness of experience rating--as benefit costs approach or exceed a rate of 2.7 per cent of taxable wages, the range and impact of a variable rates system is limited.
3. Raising the taxable wage base to \$3,600 would increase taxable wages by about 14.4 per cent. A \$4,200 base would increase taxable wages by 28.0 per cent, and a \$4,800 base would provide 38.8 per cent more in taxable wages.
4. An increase in the taxable wage base to \$3,600 would have a different effect on each major industrial group. In general, those industries with the lowest percentage of wages taxed would have their taxable wages increased the most. An increase in the tax base would have the effect of equalizing the per cent of wages taxed between major industrial groups.
5. Increasing the tax base would require employers whose accounts show benefits charges totaling more than their contributions to the fund to finance a larger proportion of the cost of their unemployment.
6. If an increase in the taxable wage base was considered desirable, a revision in the tax rate schedule could be instituted to avoid unnecessary increases in the fund balance.

7. Where Iowa assigns a "zero" tax rate for employers qualifying under experience rating provisions of the law, several states have required that all employers contribute toward certain costs of the unemployment system which are not reflected in employer rates. These costs include certain types of benefits not charged to employer accounts and benefits charged to maximum rate employers which are in excess of the contributions paid by the employer.

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A Study on the Effect of an Increase in the Taxable Wage
Under the Iowa Unemployment Insurance Program

I. Why a Taxable Wage Base Study Is Necessary

The tax base of \$3,000 written into the Iowa Law in 1940 has failed to keep pace with the increase in wages. For example, in 1940 the average annual wage in Iowa was \$1,230 1/, whereas in 1963 it had increased to \$4,900. Thus, in 1940 over 94 per cent of wages in covered employment were subject to the state unemployment insurance tax; by 1963, only 58 per cent of the wages were taxable. Projecting this to 1967, it is estimated only 51 per cent of the wages will be taxable.

This widening gap between total wages and taxable wages has the effect of:

- (1) forcing higher tax rates on certain industries and employers, raising a question of tax equity;
- (2) preventing employers traditionally experiencing high levels of unemployment from bearing their fair share of the cost of their unemployment, resulting in an inequitable distribution of costs;
- (3) limiting the effective operation of experience rating--as benefit costs approach or exceed a rate of 2.7 per cent of taxable wages, the range of rates is necessarily limited;
- (4) restricting improvement in benefit levels; and
- (5) limiting the responsiveness of the rates to economic fluctuations and long range changes in liability--ignoring growing payrolls above \$3,000 apparently does not provide for potential liability changes.

1/ Total wages in covered employment divided by average number of persons in covered employment.

Table I shows the experience of Iowa employers for calendar year 1963 under the \$3,000 tax base. Inequities are illustrated by the proportion of total wages to taxable wages in the various industrial groups. In manufacturing 53 per cent of total wages are taxed, compared to 73 per cent in service and agriculture.

Table I - Iowa Unemployment Insurance Tax Rates by Industry: 1963 Calendar Year

Industry	Average Covered Employment	Total Covered Wages (thousands)	Taxable Wages		Average Tax Rate	
			Amount (thousands)	Per cent of Total Wages	Per cent of Taxable Wages	Total Wages
Total - <u>All industries</u> ^{1/}	456,417	\$ 2,236,958	\$ 1,300,805	58.2	0.80	0.46
Mining	3,015	16,480	10,197	61.9	1.97	1.22
Construction industry	28,382	166,285	106,467	64.0	2.05	1.32
Manufacturing	177,195	1,044,644	553,310	53.0	0.89	0.47
Transportation, communication, electric, gas and sanitary services	32,232	181,866	97,210	53.5	0.31	0.16
Wholesale and retail trade	145,670	563,674	364,607	64.7	0.51	0.33
Finance, insurance, and real estate	28,731	143,534	81,340	56.7	0.28	0.16
Service industry	37,827	112,744	82,087	72.8	0.76	0.56
<u>Manufacturing industries</u>						
Food and kindred products	50,898	307,690	158,407	51.5	0.50	0.26
Textile mill products	691	2,424	1,812	74.8	0.56	0.42
Apparel and other finished products	3,783	12,730	10,040	78.9	1.53	1.21
Lumber and wood products, except furniture	3,566	17,195	10,956	63.7	0.67	0.42
Furniture and fixtures	2,353	12,665	7,158	56.5	0.58	0.33
Paper and allied products	2,687	15,159	8,289	54.7	0.49	0.27
Printing, publishing, and allied products	11,137	58,669	31,730	54.1	0.21	0.11
Chemicals and allied products	5,478	33,256	17,599	52.9	0.56	0.30
Petroleum refining and related industries	240	1,545	855	55.3	1.63	0.90
Rubber and miscellaneous plastic products	5,463	36,753	17,438	47.4	0.55	0.26
Leather and leather products	633	1,958	1,623	82.9	1.70	1.41
Stone, clay and glass products	6,130	35,116	19,964	56.9	1.38	0.78
Primary metal industries	7,070	47,216	22,551	47.8	0.64	0.31
Fabricated metal products, except ordnance	9,261	53,542	29,344	54.8	0.60	0.33
Machinery, except electrical	35,764	230,496	115,549	50.1	1.78	0.89
Electrical machinery, equipment and supplies	21,338	121,058	67,009	55.4	0.87	0.48
Transportation equipment	2,405	12,617	7,537	59.7	0.96	0.57
Professional, scientific and controlling instr.	1,763	10,843	5,650	52.1	0.69	0.36
Miscellaneous manufacturing	4,451	20,747	13,098	63.1	0.99	0.62

Source: ES-202

^{1/} Includes Agriculture

IN 1940, TAXES WERE PAID ON 95 PER CENT OF TOTAL WAGES.

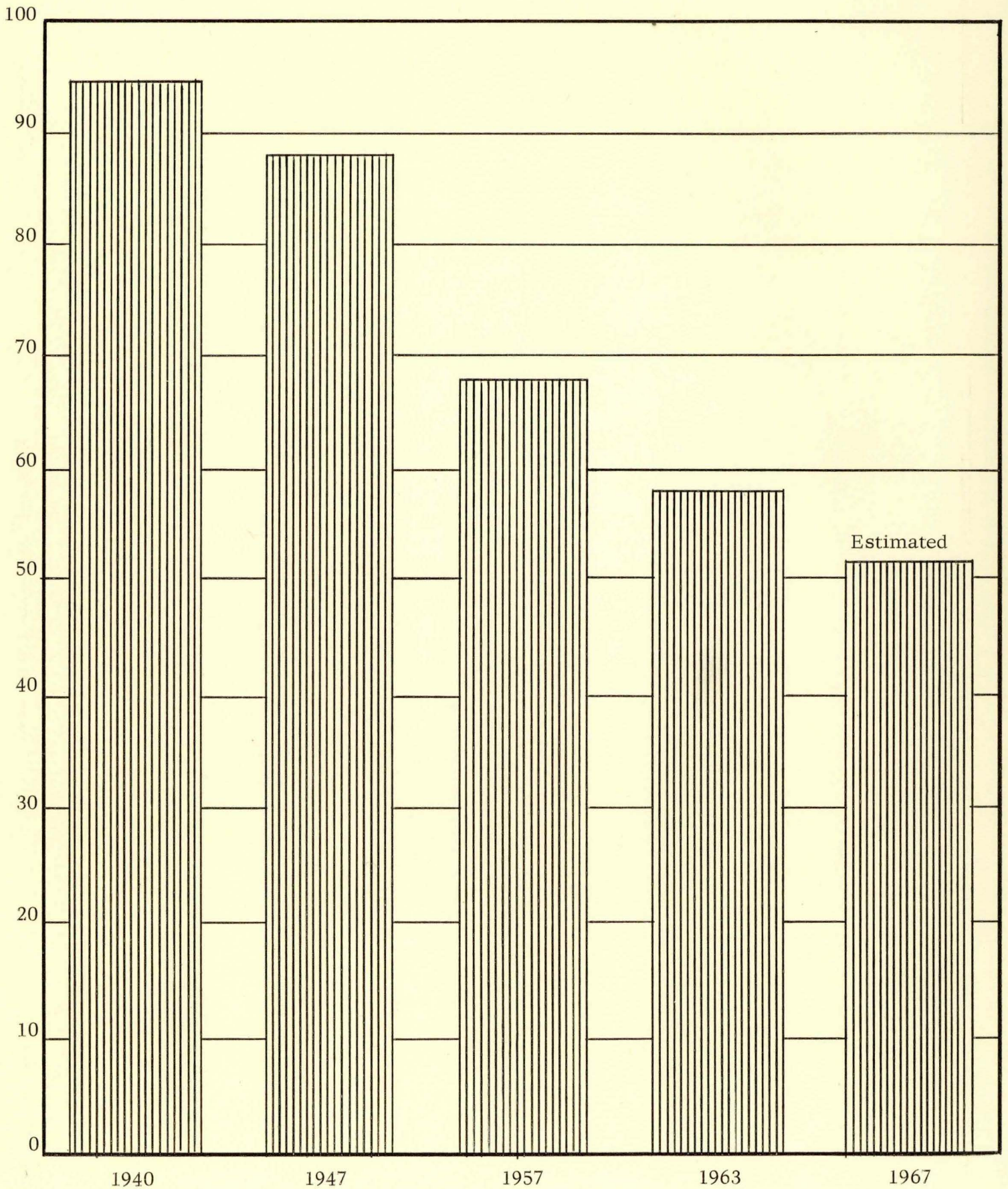
IN 1947, TAXES WERE PAID ON 88 PER CENT OF TOTAL WAGES.

IN 1957, TAXES WERE PAID ON 68 PER CENT OF TOTAL WAGES.

IN 1963, TAXES WERE PAID ON ONLY 58 PER CENT OF TOTAL WAGES.

BY 1967 WE ESTIMATE THAT ONLY 51 PER CENT OF THE WAGES WILL
BE TAXABLE.

Taxable Wages as a Percent of Total Wages for Specified Years: Iowa



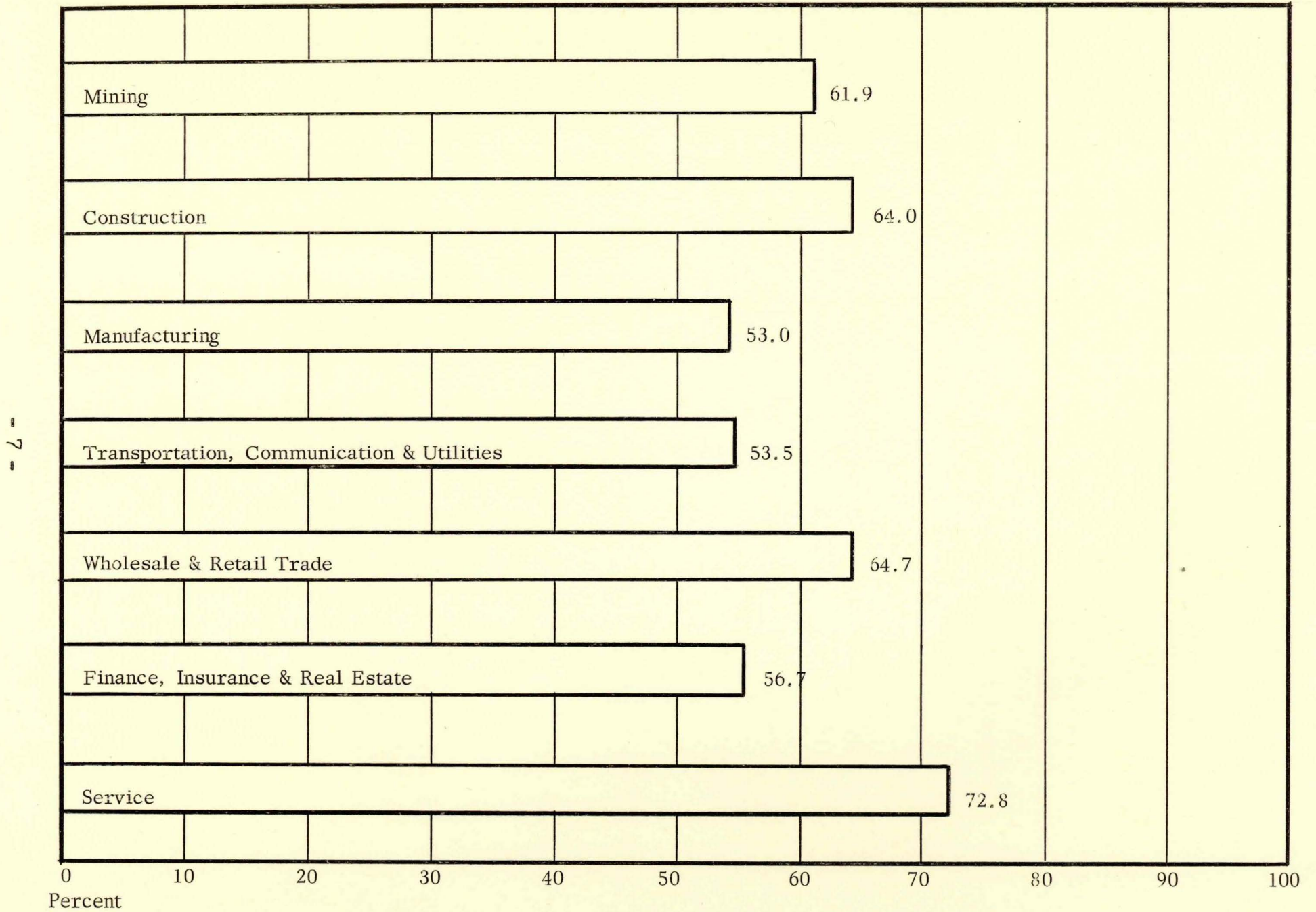
ALL MAJOR INDUSTRIES ARE PAYING TAX ON ONLY ONE-HALF TO THREE-FOURTHS OF THEIR WAGES.

THERE IS CONSIDERABLE VARIATION IN THE PERCENTAGE OF WAGES TAXABLE AMONG MAJOR INDUSTRIES.

OF THE TOTAL WAGES IN MANUFACTURING, 53 PER CENT ARE TAXABLE.

OF THE TOTAL WAGES IN SERVICE, 73 PER CENT ARE TAXABLE.

Taxable Wages as Percent of Total Wages by Industry Division: Iowa 1963



THERE IS A WIDE DIFFERENCE IN THE PROPORTION OF PAYROLL WHICH IS TAXED EVEN WITHIN MAJOR INDUSTRIES.

IN THE MANUFACTURING INDUSTRY GROUP, FOR EXAMPLE, RUBBER AND PLASTIC PRODUCTS AND THE PRIMARY METAL INDUSTRY PAYS TAX ON ONLY 47 PER CENT OF THEIR PAYROLL, WHILE APPAREL AND OTHER KINDRED PRODUCTS PAYS TAX ON 79 PER CENT OF THEIR PAYROLL.

Taxable Wages as Percent of Total Wages for Specified Manufacturing Industries: Iowa 1963

- 6 -

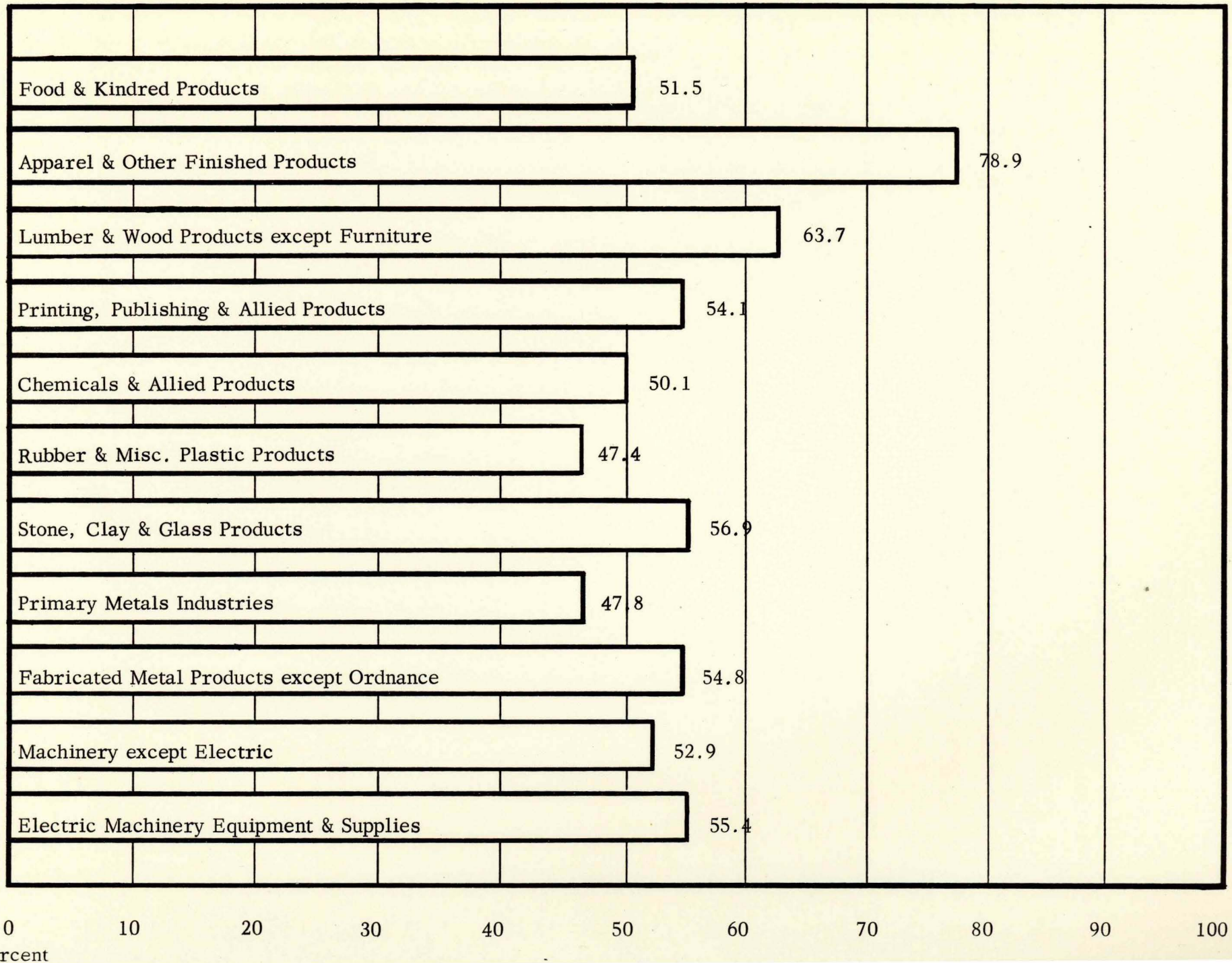


Table II - Average Annual Wage in Major Industry Groups
and Per cent Taxable

Industry	Average Annual Wage			Per cent Taxable		
	1940-45	1950-55	1960-63	1940-45	1950-55	1960-63
All industries	\$1,645	\$3,381	\$4,655	93.1	76.4	60.6
Mining	1,382	3,540	5,231	98.3	80.9	65.1
Construction	1,983	4,145	5,536	95.3	78.9	66.6
Manufacturing	1,864	3,787	5,649	93.6	75.0	54.9
Transportation	1,574	3,412	5,278	96.2	77.2	56.6
Trade	1,384	2,968	3,713	91.5	76.2	66.6
Finance	1,871	3,388	4,754	84.5	70.6	58.4
Service	1,052	2,205	2,855	94.4	83.0	74.1

II. Estimating the Effect on Taxable Wages When the Total Base Is Increased

A. The Overall Effect

Table III indicates that raising the taxable wage base to \$3,600 would increase taxable wages by 14.4 per cent. A \$4,200 base would increase taxable wages by 28.0 per cent, while a \$4,800 base would provide 38.8 per cent more in taxable wages.

B. The Effect on Major Industries

On an industrial basis, the largest increase in taxable wages will be in those industries that have the smallest proportion of their wages taxed under the \$3,000 tax base. Table IV shows the effect on major industrial groups when the tax base is raised to \$3,600. These estimates are based on the assumption that there has been no significant difference in the rate of wage change within each of the industries. The greatest percentage of increase in taxable wages, as shown by the table, occurs in manufacturing with an increase of 16.8 per cent and transportation, communications and public utilities with an increase of 15.7 per cent. Table V shows the industrial effect in dollars. The taxable payroll for all industries totaled \$1,300,805,000 under the \$3,000 base in 1963. If the tax base had been increased to \$3,600 the taxable payroll would have totaled \$1,488,120,920 or an increase of nearly \$187,316,000.

Table III - Estimated Increase in Taxable Wages Under Various Tax Bases

Tax Base	Ratio of Taxable to Total Wages in 1963	Estimated Increase in Taxable Wages Over Actual
\$3,000	.582	---
3,600	.666	14.4
4,200	.745	28.0
4,800	.808	38.8

Table IV - Estimated Increase in Taxable Wages When the Tax Base Is Raised to \$3,600 for Major Industry Groups

Industry	Ratio of Taxable to Total Wages in 1963 Under \$3,000 Base	Estimated Ratio of Taxable to Total Wages in 1963 Under \$3,600 Base	Estimated Per cent Increase
All industries	.582	.666	14.4
Agriculture	.723	.775	7.2
Mining	.619	.715	15.5
Construction	.640	.724	13.1
Manufacturing	.530	.619	16.8
Transportation, comm. & public utilities	.535	.619	15.7
Trade	.647	.730	12.8
Finance, insurance & real estate	.567	.634	11.8
Service	.728	.790	8.5

Table V - By Industry Effect of an Increase in the Tax Base to \$3,600:
 Calendar Year 1963

Industry	Taxable Payroll \$3,000 Base	Taxable Payroll \$3,600 Base	Per cent Increase
All industries <u>1/</u>	\$1,300,805,000	\$1,488,120,920	14.4
Agriculture	5,586,644	5,988,882	7.2
Mining	10,197,000	11,777,535	15.5
Construction	106,467,000	120,414,177	13.1
Manufacturing	553,310,000	646,266,080	16.8
Transportation	97,210,000	112,471,970	15.7
Trade	364,607,000	411,276,696	12.8
Finance	81,340,000	90,938,120	11.8
Service	82,087,000	89,064,395	8.5

1/ The totals for each major industrial group may not add to the total for all industries because of rounding.

C. The Effect on Unrated Employers

To be eligible for a rate reduction in Iowa, newly covered employers must have at least three years of experience under the Iowa Unemployment Security Law. The purpose of this requirement, as originally enacted, was to give the employer a chance to build up his reserve and to evaluate his unemployment experience before granting him a reduced rate. Increasing the taxable wage base would also increase proportionately the amount of contributions paid by these newly liable employers and should therefore permit a reduction in his waiting period requirement. Thirty-three states have already provided for an experience requirement of less than three years. A reduction of this sort might be of some value in attracting new employers to the state of Iowa.

D. The Effect on Negative Balance Employers

Increasing the tax base would require "negative balance" employers, that is those employers who have had more benefits charged to their accounts than they have paid into the fund in contributions, to pay a larger proportion of the cost of their unemployment. The negative balance of rated accounts has been increasing at slightly more than \$2 million a year since 1961. The negative balance employers are all taxed at the maximum rate of 2.7 per cent. The table below shows all accounts, amount of taxable payroll, and amount of account balances for negative and credit balance accounts.

Table VI - All Accounts: Number, Amount of Taxable Payroll, and Amount of Account Balance

Accounts	Number	Amount of Taxable Payroll Year Ended 9/30/63	Amount of Balance
Negative balances	2,024	90,177,617	-15,058,479
Rated	1,623	84,346,048	-14,420,132
Unrated	401	5,831,569	-638,347
Credit balances	20,713	1,203,420,888	101,829,481
Rated	17,257	1,143,466,556	98,670,586
Unrated	3,456	59,954,332	3,158,895

The total taxable payroll of all negative balance employers amounted to approximately \$90 million for the year ended September 30, 1963. This represents approximately 7 per cent of the state's total taxable payroll. If we assume that increasing the tax base will have the same effect on the taxable payroll of negative balance employers as on all employers, increasing the tax base to \$4,800 would increase taxable wages by 38.8 per cent. This would have resulted in a taxable payroll of \$125,167,000 for negative balance employers. As such employers pay contributions at the maximum rate of 2.7 per cent, this would result in an additional \$945,000 in contributions from this group toward their benefit costs and would allow a proportionate reduction in contributions required from other rated employers.

Table VII - All Accounts with a Negative Balance Distributed by Industry,
Amount of Negative Balance, and Taxable Wages: Iowa 1963

Industry	Number of Accounts	Negative Balance		Taxable Wages	
		Amount (000)	%	Amount (000)	%
Total	1,978	15,080	100.0	90,040	100.0
Agriculture, forestry & fisheries	24	51	.3	324	.4
Mining	77	1,418	9.4	5,064	5.6
Mining & quarrying of non-metallic minerals	59	789	5.2	4,727	5.2
Bituminous coal & lignite mining	14	622	4.1	276	.3
Other	4	7	.1	61	.1
Contract construction	1,079	7,567	50.2	43,375	48.2
Construction other than building	327	5,205	34.5	20,716	23.0
Building construction	319	1,516	10.1	16,181	18.0
Special trade	433	846	5.6	6,478	7.2
Manufacturing	233	4,335	28.8	29,030	32.2
Food & kindred products	39	1,945	12.9	4,772	5.3
Apparel & other finished products	23	508	3.4	3,639	4.0
Machinery, except elec.	21	450	3.0	6,804	7.6
Stone, clay & glass prod.	59	428	2.8	5,268	5.8
Other	91	1,004	6.7	8,547	9.5
Transportation, communication & public utilities	98	175	1.2	1,686	1.8
Wholesale & retail trade	328	1,108	7.3	6,642	7.4
Wholesale trade	103	573	3.8	3,172	3.5
Other	225	535	3.5	3,470	3.9
Finance, insurance & real estate	18	33	.2	240	.3
Service	121	393	2.6	3,689	4.1
Miscellaneous business service	3	115	.8	1,784	2.0
Other	118	278	1.8	1,905	2.1

Table VIII - Rated Accounts with a Negative Balance Distributed by Industry, Amount of Negative Balance, and Taxable Wages: Iowa 1963

Industry	Number of Accounts	Negative Balance		Taxable Wages (000)
		Amount (000)	Per cent of Total	
Total	1,655	14,555	100.0	84,264
Agriculture, forestry, & fisheries	15	48	.3	285
Mining	73	1,411	9.7	5,003
Mining & quarrying of non-metallic minerals	59	789	5.4	4,727
Bituminous coal & lignite mining	14	622	4.3	276
Contract construction	851	7,213	49.6	40,043
Construction other than building	267	5,060	34.8	19,527
Building construction	268	1,396	9.6	14,688
Special trade	316	757	5.2	5,828
Manufacturing	219	4,328	29.7	28,915
Food & kindred products	39	1,945	13.4	4,772
Apparel & other finished products	23	508	3.5	3,639
Machinery, except electric	21	450	3.1	6,804
Stone, clay & glass products	59	428	2.9	5,268
Other	77	997	6.8	8,432
Transportation, communication & public utilities	87	169	1.2	1,653
Wholesale & retail trade	288	1,081	7.4	6,337
Wholesale trade	103	573	3.9	3,172
Other	185	508	3.5	3,165
Finance, insurance & real estate	15	33	.2	210
Service	107	272	1.9	1,828

Table IX - Unrated Accounts with a Negative Balance Distributed by
 Industry, Amount of Negative Balance, and Taxable Wages:
 Iowa 1963

Industry	Number of Accounts	Negative Balance		Taxable Wages (000)
		Amount (000)	Per cent of Total	
Total	323	525	100.0	5,776
Agriculture, forestry & fisheries	9	3	.6	39
Mining	4	7	1.3	61
Contract construction	228	354	67.4	3,332
Construction other than building	60	145	27.6	1,189
Building construction	51	120	22.9	1,493
Special trade	117	89	16.9	650
Manufacturing	14	7	1.3	115
Transportation, communication & public utilities	11	6	1.1	33
Wholesale & retail trade	40	27	5.2	305
Finance, insurance & real estate	3	1/		30
Service	14	121	23.1	1,861
Miscellaneous business service	3	115	21.9	1,784
Other	11	6	1.2	77

1/ Less than \$400

III. Adjusting Iowa's Tax Rate to Offset an Increase in the Taxable Wage Base

Most state laws have in effect a system of experience rating by which individual employers contribution rates are varied from the standard rate on the basis of their experience with unemployment risk. The Iowa law uses a system known as the "reserve-ratio" formula. The system is essentially cost accounting. On each employer's record are entered the amount of his payroll, his contributions, and the benefits paid to his workers. The benefits are subtracted from the contributions and the resulting balance is divided by the average annual payroll to determine the experience factor. The balance carried forward each year under the reserve-ratio plan is the difference between the employer's total contributions and the total benefits received by his workers.

As indicated in the "Foreword", the Iowa Unemployment Trust Fund is in a very favorable financial position. A new tax rate schedule to maintain the fund at the desired level might be considered if an increase in the taxable wage base was made. Employers with negative balances and newly liable employers, not yet eligible for a reduction could still be taxed at a rate of 2.7 per cent under the adopted schedule.

Table X shows the eligible accounts and related data by the experience factor and rate for the payroll year ending September 30, 1963. Over 22,500 employers were liable under the Iowa Unemployment Insurance Law for the 1963 taxable payroll year. The law is applicable to employers of four or more workers on at least one day in each of 20 weeks during the calendar year. The Iowa law provides that all accounts with an experience factor of 10 or

over shall have a zero rate. Sixty-six per cent of the total number of accounts had a contribution rate of 0.45 or less, nearly 45 per cent were at a zero rate. These zero rate accounts represented approximately \$314 million in taxable wages in 1963.

Inherent in the unemployment system are certain "costs" which of necessity are financed by the system as a whole. These costs include benefits not charged to any employer's individual account, and benefits charged to employers who are currently taxed at the maximum rate, but whose account is overdrawn (benefits charged exceed contributions paid). All but five states, other than Iowa, with similar experience rating provisions have decided that all employers should be required to contribute something to the fund and have accordingly established their minimum rate at one-tenth of one per cent or higher.

Table X - Eligible Accounts; Number and Related Data by Experience
Factor and Rate: Iowa 1963

Experience Factor	Rate	Number	Taxable Payroll (000)	Balance (000)
30.0 & over	0.00	647	10,367	7,849
25.0	0.00	300	5,403	1,586
20.0	0.00	587	16,590	3,884
19.0	0.00	187	5,819	1,173
18.0	0.00	214	7,380	1,398
17.0	0.00	260	7,643	1,341
16.0	0.00	315	9,691	1,617
15.0	0.00	420	18,396	2,917
14.0	0.00	522	17,132	2,499
13.0	0.00	748	27,622	3,776
12.0	0.00	1,026	37,632	4,750
11.0	0.00	1,443	52,628	6,032
10.0	0.00	1,883	97,631	10,446
9.5	0.05	908	52,894	5,123
9.0	0.10	873	68,526	6,260
8.5	0.15	773	38,227	3,312
8.0	0.20	764	45,225	3,651
7.5	0.25	722	61,359	4,819
7.0	0.30	640	56,307	3,990
6.5	0.35	633	57,514	3,725
6.0	0.40	576	66,423	4,023
5.5	0.45	516	34,202	1,912
5.0	0.50	477	79,099	3,862
4.5	0.65	460	68,966	2,948
4.0	0.80	327	60,806	2,414
3.5	0.95	242	31,973	1,160
3.0	2.20	180	13,775	443
2.5	2.50	155	10,208	287
2.0	2.70	123	50,741	1,065
1.5	2.70	96	15,632	269
1.0	2.70	83	6,239	83
0.5	2.70	79	6,773	46
0.0	2.70	78	4,644	10
Negative balance	2.70	1,623	84,346	-14,420

Source: ES-204

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