



The impact of unemployment insurance taxes on wages

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Abstract

This paper examines the incidence of state unemployment insurance taxes on wages paid to workers in various demographic groups. The empirical work matches state level measures of unemployment insurance tax and benefit variables to data aggregated from the Current Population Survey on worker earnings for the period 1992 to 2002. Econometric evidence presented in the paper supports the paper's main hypothesis that UI tax rate structure has its greatest adverse impact on less mobile workers (prime age married women and young workers) and little impact on more mobile workers (prime age men).

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1. Introduction

In the United States there are two significant payroll taxes levied across all states—the Social Security payroll tax and the payroll tax that finances unemployment insurance (UI). The former is levied uniformly across employers and workers and has a relatively high taxable wage base.¹ Since the Social Security tax is uniform it is difficult to avoid. Moreover, the benefit (retirement income) that the tax finances is surely a benefit that the typical worker hopes to someday collect. Accordingly, the theory of payroll tax incidence makes a hands down case for 100% incidence of the Social Security payroll tax on workers.²

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¹ For example, maximum annual taxable earnings under Social Security in 2001 were \$80,400. See [Social Security Administration \(2001\)](#), Table 2.A.3, p. 87.

² This conclusion is more a point of deductive reasoning than based on a preponderance of empirical evidence. While empirical analyses of the incidence of the Social Security tax do exist (e.g., [Brittain \(1971\)](#) and [Hamermesh \(1979\)](#)), incidence is notoriously difficult to determine empirically due to the universal and uniform nature of the tax.

The basic structure of the unemployment insurance payroll tax, on the other hand, bears little resemblance to the social security tax. Social security taxes are administered at the federal level whereas unemployment insurance payroll taxes are administered by the states with federal supervision.³ The legal incidence of the Social Security tax is divided equally between employer and employee, whereas the unemployment insurance tax is levied solely on employers in all but three states.⁴ Average UI tax rates vary across the states. For example, in 1995 the average tax rate was 2.12% with a standard deviation of 1.12%. Moreover, because of experience rating, tax rates vary both over time and across firms. Finally, like Social Security, unemployment insurance taxes are levied only on a portion of worker wages (i.e., the taxable wage base), but unlike Social Security this ceiling is quite low. For example, in 1995 the median ceiling was \$9000, but ranged from \$7000 to \$25,500. This last point is important because, due to the relatively low value of the taxable wage base, variations across states and over time in the ceiling translate to *effective* change in the tax rate. Given that the unemployment insurance tax is structured far differently than the Social Security payroll tax, the question that naturally arises is, do these differences have implications for the incidence of the UI tax?

Empirical work on the incidence of the unemployment insurance tax is sparse. The most important published article on the topic appeared in the *Journal of Public Economics* by Anderson and Meyer (1997). Their primary interest was in estimating the incidence of the unemployment insurance tax at the firm and the industry level. They utilized firm-level data for the years 1978 to 1984 covering eight states (Georgia, Idaho, Louisiana, Missouri, New Mexico, Pennsylvania, South Carolina, and Washington).

The work I report on below has the potential to add value to the literature on several dimensions. First, both the traditional theoretical analysis of payroll tax incidence and the empirical work of Anderson and Meyer are silent about the issue of worker heterogeneity. Given the pronounced geographic variation in the structure of the UI tax, however, it seems reasonable that mobile workers will be able to avoid the tax, while geographically tied workers would bear much of the tax. The data I employ in the empirical work allow me to address this question whereas Anderson and Meyer's firm-level data precluded any assessment on this dimension. Second, I analyze separately the impact of both tax rate and of taxable wage base on the wage structure. Though these are distinct parameters of a state's UI tax structure, Anderson and Meyer combined them into a single tax variable in their empirical analysis. Finally, since my data span all fifty states and cover the years 1992 to 2002, the analysis has the potential to provide a comprehensive and up-to-date picture of the incidence of the unemployment insurance tax.

The paper is organized as follows. Section 2 outlines the conceptual and theoretical basis of the empirical work to follow. Section 3 discusses the data employed in the empirical analysis and a variety of econometric issues that must be addressed in order to properly determine the

³ The unemployment insurance system is overseen at the federal level. Employers are subject to a standard federal unemployment insurance tax of 6.2% on a taxable wage base of \$7000. Most all of this (with the exception of .8%) is credited back to a state as long as it has in place its own unemployment insurance system meeting a number of broad, federally established guidelines. All fifty states meet these guidelines and therefore unemployment insurance in the United States is a patchwork of fifty distinct state systems. (See Levine (1997) for a detailed discussion of unemployment insurance finance in the United States.)

⁴ Alaska, New Jersey, and Pennsylvania require modest employee contributions. Alaska's tax rate on employees is approximately half a percent of taxable wages (about 1/7 to 1/9 of the employer contribution depending on the phase of the business cycle). New Jersey levies a tax on employees of .425% on taxable wages. Pennsylvania charges a tax of .02 to .09% on all employee wages if the state's UI trust fund reaches an unacceptably low level. See <http://workforcesecurity.doleta.gov/unemploy/uifactsheet.asp>.

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