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UNEMPLOYMENT INSURANCE

States' Tax Financing Systems Allow Costs to Be Shared among Industries

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Highlights

Highlights of GAO-06-769, a report to the Chairman, Subcommittee on Human Resources, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

In 2006, the Unemployment Insurance (UI) program is expected to collect over $37 billion in taxes from employers to pay $34 billion in benefits to unemployed workers. Under state UI programs, employers' tax contributions are experience-rated—that is, they reflect the extent to which they laid off workers who then collected benefits. To examine the equity of this system, we met with officials from five states, reviewed prior studies, and examined state data to determine (1) how states ensure that employers pay UI taxes based on their experience with unemployment, and the aspects of state unemployment insurance systems that limit experience rating; (2) the extent to which employers pay unemployment insurance taxes commensurate with unemployment benefits paid to their former employees; and how this varies by industry; and (3) steps states could take to increase the degree of experience rating.

We provided a draft of this report to the Department of Labor (Labor) for its review. Overall, Labor agreed with our findings.

www.gao.gov/cgi-bin/getrpt?GAO-06-769.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Sigurd R. Nilsen at (202) 512-7215 or nilsens@gao.gov.

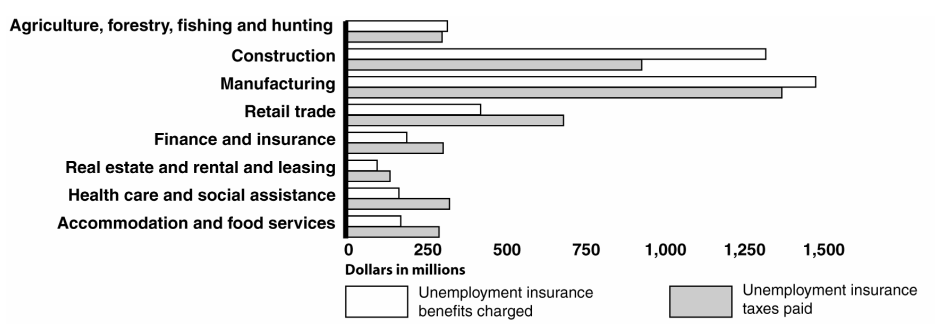
What GAO Found

All state Unemployment Insurance-financing systems are experience-rated, but several aspects of these systems limit the connection between an employer's tax contributions and the employer's experience with unemployment. For example, a state's maximum tax rate limits the size of an employer's tax payment, regardless of the costs an employer may have imposed on the system. Similarly, a minimum tax rate ensures that an employer's tax rate will not drop below a specified floor, no matter how much its experience rating improves. Other aspects of state systems allow the cost of some benefits to be charged to all employers rather than to a single employer. These shared costs include, for example, benefits paid to unemployed workers of a firm that has gone out of business. When the cost of benefits is shared in this way, it reduces experience rating and imposes additional costs on all employers.

A series of studies that examine experience rating in state UI systems show that a number of industries used more in benefits than they paid in taxes to finance the system. Certain industries, such as construction and agriculture, forestry, and fisheries, as a whole, consistently received such subsidies, while other industries, such as finance, insurance, and real estate tended to pay subsidies. Newer firms that are not yet experience-rated, regardless of industry, also tend to pay subsidies. Our analysis of more recent data from three states found a similar pattern of subsidies.

States could increase experience rating and reduce subsidies by adjusting aspects of the unemployment insurance tax structure, such as the maximum tax rate. However, each of these adjustments has trade-offs that would have to be considered by a state because the adjustments would raise costs for some employers or reduce costs for others. In addition, such adjustments would have to be evaluated based on the implications for other policy objectives established for a state's unemployment insurance program.

Unemployment Insurance Benefits Charged and Taxes Paid by Selected Industries in Washington State from 1999 to 2004



Source: GAO analysis of data from the Washington State Employment Security Department.