Trends in Unemployment Insurance Financing

by RACHEL S. GALLAGHER*

The continuing adjustment of contribution rates to meet the benefit costs of the State-Federal unemployment insurance systems and to provide an adequate reserve has been of first importance in planning the financing of the programs. This article discusses trends in recent years in financing unemployment insurance.

IN planning unemployment insurance finances, the adjustment of income to the financial needs of the program should obviously be the first consideration. Under the Federal-State system such adjustment has been given first consideration in spite of the emphasis placed on experience rating as an incentive for the prevention of unemployment. Priority of consideration was given to solvency of the unemployment funds by the provision in the Social Security Act that no benefits could be paid within 2 years after the State assessed its first contributions, by the provisions in State laws making rate reduction contingent on the condition of the unemployment funds, and by the character of the experience-rating provisions.

Experience Rating and Adjustment of Income to Program Need

The original experience-rating provisions[1] were designed to adjust income to benefit cost automatically. The reserve-ratio and benefit-ratio systems were based on the theory that if each employer's contribution was adjusted to yield an excess above benefits the income and costs for the whole system would be kept in proper balance.

Under the reserve-ratio system the individual employer's reserve was automatically adjusted by alternating low rates with high rates as his reserve ratio rose and fell. Under the benefit-ratio system the rates were set to yield slightly more in revenue from each employer than the cost of benefits which had been paid his workers. Under the benefit-wage system the amount raised each year approximated the money spent for benefits and was apportioned among individual employers in accordance with the incidence of compensated unemployment among their workers. Under the compensable-separations system a specified State-wide yield was made possible by use of an array, under which the total pay roll is divided equally into a number of classes and each class assigned a specified rate. Adjustment of income to need in some of the pay-roll-decline systems was made by limiting State-wide reduction of contributions to an amount designated as surplus in the State fund.

War-Risk Insurance

To counteract rate reductions under the experience-rating provisions, 10 States[2] adopted war-risk insurance provisions in 1943 and 2 States[3] in 1945. During these years there was real concern over solvency; it was feared that contribution collections and the then existing reserves would not be sufficient to meet the cost of benefits growing out of postwar lay-offs.

The theory on which the war-risk tax was based was the antithesis of experience-rating theory as conceived and developed under the Federal-State unemployment insurance program. The war-risk provisions were based not on the hypothesis that past experience with unemployment constituted a measure of future risk but on the assumption that rapidly expanding pay rolls in establishments engaged in war work would inevitably result in lay-offs after the war. The provisions imposed additional taxes on employers whose pay rolls showed rapid expansion. A pay roll of a specified past period was used as the standard from which expansion was measured—most commonly, the pay roll for the calendar year 1940. The tax was imposed when the pay roll exceeded the base-year pay roll by a specified percentage. In Wisconsin, higher rates on increased pay rolls were considered so important that in 1945 the legislature adopted what was then considered a permanent amendment.[4] Beginning in 1947, 0.5 percent was added to an employer's contribution rate if his pay roll was $50,000 or more and if it had increased 20 percent over the preceding year's pay roll. The revenue raised by the war-risk provisions in the 12 States was

Table 1.—*Revenue collected under war-risk provisions, 1943–46* [1]

Year	Amount (in thousands)	As percent of contributions under experience-rating in States with war-risk provisions
1943	$32,549	18
1944	75,567	33
1945	67,844	32
1946	8,028	10

[1] War-risk provisions operative in 12 States in 1943, 1944, and 1945 and in only 5 States in 1946.

* Department of Labor, Bureau of Employment Security, Unemployment Insurance Service, Division of Legislation and Reference.

[1] For a description of experience-rating formulas see Rachel S. Gallagher, "State Differences in Unemployment Compensation Employer Taxes," *Social Security Bulletin,* October 1945. See also the second chapters of Bureau of Employment Security monographs, *Comparison of State Unemployment Insurance Laws as of October 1948* and *Comparison . . . as of September 1949.*

[2] Alabama, Florida, Illinois, Iowa, Maryland, Minnesota, Missouri, Ohio, Oklahoma, Wisconsin.

[3] Georgia and Kansas.

[4] Repealed as of January 1, 1948.

substantial. It represented 33 percent of contributions collected under the regular experience-rating provisions of those States in 1944 and 32 percent in 1945 (table 1).[5]

Income Under Experience-Rating Provisions

The revenue collected under the experience-rating provisions during the war years was also high. The high pay rolls continued throughout 1943 and 1944, and even in 1945 the declines were slight. While income was reduced well below what it would have been had it not been for experience rating, the increases in taxable pay roll during the war years resulted in sharp increases in contribution collections. The increases more than offset the rate reductions, and collections were far in excess of expenditures for benefits. The short-term character of unemployment insurance rights combined with the negligible compensable unemployment during these years meant that little was withdrawn from the funds. When benefits did begin to rise in the latter part of 1945 and in 1946, the reserves were far greater than any potential liability of the program or any foreseeable increase in liability.

Even over a span of 10 years the reduction in revenue under experience-rating provisions has not been sufficient to prevent an excessive accumulation of funds. An analysis[6] of the reduction in revenue resulting from the operation of State experience-rating provisions for the 10-year period 1939–48 "showed that, were it not for experience rating, employers would have paid an estimated $14.6 billion in unemployment insurance taxes on the basis of taxable wages amounting to $540 billion. Lower contribution rates resulting from experience rating, however, reduced the revenue yield by about $5.0 billion. This was offset, somewhat, by additional revenue of some $191 million realized in several States from special war-risk assessments. The total yield from employer taxes was, therefore, about $9.9 billion—a net reduction in revenue of about 32 percent."[7] Thus it became evident that the yield from existing experience-rating provisions was in excess of the needs of the program. Reserves continued at a high level, and additional cuts in revenue were justified.

Legislative Reductions

Legislative reduction in revenue had to take the form of reduced rates to individual employers because the additional credit provisions in section 1602 (a) of the Internal Revenue Code prevented the States from adopting a uniform rate for all employers that would yield income commensurate with the needs for reserves and benefit withdrawals. Because section 1602 (a) (1)[8] of the Federal Unemployment Tax Act is drafted in broad general terms, adjustment of rates has been possible under the experience-rating provisions of all pooled-fund laws. The more rigid standards in section **1602 (a) (3) make adjustment** in reserve-account States more difficult. Recognizing the necessity for greater freedom in making such adjustments than is possible under the standards for reserve accounts, all but two of the States[9] that originally had such accounts have abandoned them. They adopted laws of the pooled-fund type, thus availing themselves of the greater flexibility in financing that is permitted pooled-fund States. Recent changes from reserve account to pooled-fund laws by four States[10] were made in anticipation of greater tax reduction.

The involved character of recent experience-rating legislation emphasizes the difficulties inherent in trying to adjust contributions and costs on the basis of individual employers' experience. These difficulties arise partly from the intricacies of the existing contribution formulas for determining individual employers' rates. A uniform tax rate on pay rolls gives a formula with one constant (the tax rate) and one variable (the amount of pay roll) for the tax period to which the rate applies. In contrast, experience-rating formulas have variable factors only, and as a result financial planning is difficult. Under the simplest of all the formulas—the annual pay-roll declines with rates assigned by schedule—there are no constants and three variables: the percentage declines in pay roll from year to year, the rates based on those declines, and the fluctuating tax base to which the rates are applied. Under another simple formula, the benefit ratio (which uses the ratio of benefit payments to pay roll), both pay roll and benefits vary, and in turn the rates assigned on the basis of the relation between these two vary. Under the reserve-ratio system, the tax base, benefits, contributions, and the pay roll with which the reserve is compared are all variables.

Moreover, under different experience-rating formulas, like variables

---

[5] "Experience-Rating Operations in 1946," table 9, p. 10, *Social Security Bulletin*, October 1947.

[6] Unemployment Insurance Service, Division of Program Standards, *Quarterly Report—April–June 1949*.

[7] The $191 million war-risk assessments figure in the *Quarterly Report* differs from total in table 1, which is based on revised tax rates and taxable wages.

[8] The relevant parts of section 1602 (a) are as follows: "A taxpayer shall be allowed an additional credit under section 1601 (b) with respect to any reduced rate of contributions permitted by a State law, only if the Federal Security Administrator finds that under such law—

"(1) No reduced rate of contributions to a pooled fund or to a partially pooled account is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk during not less than the three consecutive years immediately preceding the computation date . . .

"(3) No reduced rate of contributions to a reserve account is permitted to a person (or group of persons) having individuals in his (or their) employ unless (A) compensation has been payable from such account throughout the year preceding the computation date, and (B) the balance of such account amounts to not less than five times the largest amount of compensation paid from such account within any one of the three years preceding such date, and (C) the balance of such account amounts to not less than 2½ per centum of that part of the pay roll or pay rolls for the three years preceding such date by which contributions to such account were measured, and (D) such contributions were payable to such account with respect to the three years preceding the computation date."

[9] Kentucky and North Carolina.

[10] Indiana and Wisconsin amendments making the changes from reserve accounts to pooled fund were adopted in 1945 and became effective in 1946; the Nebraska and South Dakota amendments became effective January 1, 1948.

produce dissimilar results. Under the reserve-ratio system, for example, it is to an employer's advantage if his reserve is high in relation to his pay roll. An increase in pay roll therefore tends to lower his reserve ratio and increase his rate. In contrast, under the benefit-ratio system, it is to an employer's advantage if the benefits paid to his workers are low in relation to his pay roll; an increase in his pay roll therefore tends to lower his rate.

Trends in Experience-Rating Legislation Since 1945

Within the framework of individual rates based on each employer's experience with unemployment, the States have made adjustments so that revenue will not be disproportionate to the needs of the program. The excessive accumulation of funds in the States' accounts in the unemployment trust fund has given impetus to the continuing drive to reduce contribution rates to the lowest possible point. The methods of tax reduction have taken many forms, including new types of experience-rating provisions and repeated changes in the elements of contribution formulas.

New Experience-Rating Laws

At the end of 1945, six[11] of the 51 jurisdictions with unemployment insurance laws had not yet adopted experience rating and continued to require all employers to pay a 2.7-percent rate in contributions. Experience rating was adopted in five of these jurisdictions in 1947 and in Mississippi, the sixth State, in 1948.

These six States had delayed the adoption of experience rating because of opposition to the experience-rating principle as applied to unemployment insurance, combined with the hope that Congress might pass legislation that would permit allowance for additional credit if a State law permitted a flat-rate reduction. Another reason was concern over the effect of rate reduction on the solvency of the funds. However, as high pay rolls brought in far more income than was needed to meet the cost of low benefit payments, concern over solvency declined. This high income, combined with growing demands for tax reduction by the employers, resulted in the adoption of experience rating.

Of the six States, five—Alaska, Mississippi, Rhode Island, Utah, and Washington—adopted formulas unrelated to the payment of benefits to individual workers. They avoid the frivolous contests over benefit payments that have sometimes developed under other experience-rating systems in which each employer has a definite interest in any benefit payment that may increase his tax rate. Experience-rating provisions in these States base the rates on percentage declines in pay roll from quarter to quarter or from year to year.

The provisions in Alaska, Mississippi, and Washington base the rates on the individual employers' experience with percentage declines in annual pay roll; the purpose of the experience-rating provisions in these States is more closely related to the adjustment of income to need than to giving an incentive to employers to prevent unemployment or to allocating benefit costs. The systems are designed on the theory that annual declines in pay roll reflect the curtailment of general business activity and that the greatest drains on the fund result from general business declines. Seasonal and incidental unemployment, some of which might be prevented by planning and ingenuity on the part of the individual employer, is not measured under these formulas. Both Alaska and Washington limited reduction in revenue to an amount which the legislatures felt the program could safely spare and still meet all potential obligations.

Mississippi and Rhode Island adjust revenue by varying rate schedules in accordance with the amount of the reserve in the fund. The rates in the Rhode Island schedules are assigned employers in accordance with their experience with quarterly pay-roll declines over a 3-year period. The quarterly declines reflect seasonal and irregular declines in employment as well as adverse changes in general business conditions.

The Utah experience-rating law, like the laws of Alaska, New York, and Washington, has a provision that automatically adjusts rate reduction to the surplus in the fund; however, the application of the provisions differs. The Utah law uses the same factors to measure unemployment risk as the New York experience-rating law of 1945. Rates for individual employers are determined on the basis of each employer's experience with three factors—declines in annual pay roll, declines in quarterly pay roll, and the number of years that the employer has been liable for contributions. On the basis of his experience with each of these factors, each employer is assigned a given number of points; his total points determine his rate classification. The rate assigned each class depends, in turn, on a number of factors, including the distribution among the classes of a "surplus" (as defined in the law) and the total taxable wages for all the employers whose experience factors place them in a given class. The rate for each class is the rate necessary to make up the difference between the amount of the surplus assigned to the class and the amount that would be collected on the pay rolls assigned to the class if contributions were collected at 2.7 percent.

The Montana law places emphasis on solvency in that it requires that rates be fixed to give an average yield of 1.8 percent. Three factors are used in measuring individual employers' experience with unemployment—average annual pay-roll declines, the number of years the employer has paid contributions, and the ratio of benefits to contributions. No employer is eligible for a rate of less than 2.7 percent if his average benefit costs in a 3-year period exceeded his average contributions in the same 3-year period.

Changes in Type of Experience-Rating Systems

Though New York amended its law in 1947 to change its experience-rating provisions radically, it retained the feature that automatically adjusts income to need—that is, the so-called distribution of credit certificates, which in total value are equivalent to

[11] Alaska, Mississippi, Montana, Rhode Island, Utah, Washington.

the "surplus"[12] in the fund. The basis for apportioning the certificates among employers, however, was changed by the substitution of "wages of compensated employees"[13] for annual pay-roll declines as one of the three factors used to measure unemployment risk. The other two factors are quarterly declines and the number of years the employer has paid contributions to the fund. As under the 1945 law, employers are given a number of points as a result of their experience with each of these factors, the points are totaled, and on the basis of the result each employer is assigned to a specified credit class.

The Pennsylvania Legislature in 1949 changed from a benefit-wage system of experience rating to a reserve-ratio system. The change was made in anticipation of the higher rates that would be imposed under the benefit-wage plan because of the effect of increasing benefit costs on the State factor. Those sponsoring the plan recognized that these additional costs should be met by the excess contributions collected during the years of high employment rather than by increasing future revenue by means of higher rates. The change to a reserve-ratio system of experience rating means that the rates of individual employers reflect contributions accumulated in earlier years. For this purpose all employers were given credit for a determined proportion of the balance in the reserve on August 31, 1945; the amount varied with the year that they became subject to the Pennsylvania law.

The Minnesota Legislature in 1949 made a change of a different type in its unemployment insurance law. Though the change involved no shift from the benefit-ratio system, it was nevertheless far reaching in its effect on rates. Before the law was amended, rates were assigned by arraying employers' pay rolls in the order of their benefit ratios. The total amount of State-wide pay roll was then divided into a number of equal classes and a rate specified for each class. While this system had the advantage of making it possible to approximate a given yield, it had the grave disadvantage of having the experience of employers affect the rates of their fellow employers. This interdependence led to dissatisfaction. The 1949 legislature therefore deleted the provision on arrays and substituted three fixed-rate schedules, effective at different fund levels, in which all employers whose benefit ratios fall within a specified range are assigned a specified rate. Under such schedules the experience of one employer is not affected by the experience of other employers. Moreover, with the schedule which is effective for any 1 year dependent on the financial condition of the fund, there is no need for aiming at a specified yield.

The Vermont Legislature deleted a provision that required employers to meet reserve requirements before they were eligible for rate reduction under the Unemployment Compensation Commission's regulations on rate determination. In its place a benefit-ratio system was incorporated that includes four rate schedules applicable at different fund levels.

Utah's legislature decided to retain its pay-roll decline system of experience rating and deleted a provision in its law that would have substituted a benefit-ratio system in 1950.

Rate Schedules and State Funds

The effort to adjust income to the needs of the program is indicated by the increasing number of States that provide two or more rate schedules, making the effective schedule for any tax period dependent on the condition of the fund. Obviously, schedules that provide low rates when the fund is high and higher rates when the fund is low make possible adjustment in revenue as the fund rises and falls. On March 1, 1945, 11 States had more than one schedule of varied rates.[14] At the close of the 1949 legislative sessions, there were 26 States[15] with fixed multiple schedules, incorporated in the law. An additional six States have the equivalent of an indefinite number of schedules. In four of these[16] the rates of the individual employer vary with the amount of surplus to be distributed from the fund. In Illinois the State experience factor is increased or decreased by 1 percent for every 4 percent that the State fund falls below or rises above specified levels. As a result the individual employers' rates are subject to an indefinite number of changes. Texas reduces all rates 0.1 percent for each $5 million that the fund exceeds $200 million and at the same time equals at least 8 percent of taxable wages. The number of fixed multiple schedules varies from 2 to 8.

Number of schedules	*Number of States*
1	19
2	9
3	8
4	3
5	4
6	1
8	1
Indefinite	6

Changes Within Schedules

There is a notable tendency toward lower rates under the more favorable schedules of the State laws and toward lowering the standard of experience which an employer must meet if he is to qualify for a given rate.

All but 11 States[17] reduced their

[12] Surplus is defined as "that amount by which the moneys in the fund as of the effective date, after subtracting the amount of credits previously established under this section and outstanding as valid on such date, exceed the lesser of nine hundred million dollars or three and one-half times the amount of contributions payable on the pay rolls reported by all employers on or before the effective date for the preceding completed calendar year, limited, however, to an amount not greater than sixty per centum of such contributions for such year."

[13] Wages of compensated employees (usually called benefit wages) are defined in the New York law as the wages paid by the employer "for the three base years corresponding to the three benefit years immediately preceding the computation date."

[14] See the *Bulletin*, May 1945, "Fund Protection Provisions in State Unemployment Compensation Laws," pp. 35–39.

[15] Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Iowa, Kansas, Maine, Massachusetts, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, North Dakota, Ohio, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, West Virginia, Wyoming.

[16] Alaska, New York, Utah, Washington.

[17] District of Columbia, Hawaii, Kentucky, Louisiana, Massachusetts, Michigan, Missouri, New Hampshire, New York, South Dakota, Wisconsin. (Illinois, Oregon, Texas, and Wyoming rates are not effective until January 1, 1950.)

minimum rates during the period 1945–49. In 1945, 5[18] of these 11 States had zero rates, and in New York, employers with credit certificates equal to or in excess of 2.7 percent of their taxable pay rolls did not pay any contributions. In 1949, four more States[19] had zero rates, and two others[20] granted credit certificates with the probability that some employers would not have to pay any contributions. At the end of 1945, only nine States had minimum rates of less than 0.5 percent; in 1949, 36

Table 2.—*Number of experience-rating States with specified minimum rates, 1945 and 1949*[1]

Minimum rate (percent)	Number of States	
	1945	1949
Total	45	51
0	[2] 6	[2] 12
0.1	1	7
0.135	1	0
0.2	0	5
0.25	0	4
0.27	1	0
0.3	0	7
0.35	0	1
0.5	13	7
0.7	3	0
0.9	7	3
1.0	9	2
1.1	0	1
1.2	1	0
1.3	0	1
1.5	3	0
Indefinite	0	1

[1] Includes rates for Illinois, Oregon, and Texas, which are not effective until Jan. 1, 1950.
[2] In Alaska, New York, and Washington an employer pays no contribution if his credit certificate is equal to or in excess of 2.7 percent of his taxable pay roll.

have minimum rates of less than 0.5 percent. In 1945 only the District of Columbia had a minimum rate of 0.1 percent; in 1949 there are seven States[21] with 0.1 minimum rates. In four States the minimum rate was reduced 100 percent—that is, to zero; there were reductions ranging from 70 to 96.29 percent in 11 States; from 50 to 70 percent in 15 States; and from 20 to 50 percent in 7 States (table 2).

In terms of revenue the percentage reductions in minimum rates are significant because the pay rolls of employers who are able to qualify for the low rates represent a high proportion of all employers. In 1947, for example, 60.5 percent of the employers whose rates were modified under experience-rating provisions were assigned rates of less than 1 percent.[22]

In some instances the standard necessary to qualify for the minimum was also reduced. In Kansas, for example, a 12-percent reserve was needed to qualify for a minimum rate of 0.7 percent in 1945; in 1949 a 10-percent reserve would qualify an employer for a minimum rate of 0.35 percent. In 1945, in New Hampshire a 15-percent reserve was necessary to qualify for a 0.5 minimum; in 1949 a reserve of 14 percent. In New Jersey, where the minimum rate was reduced from 0.9 to 0.3 percent, the qualifying reserve for the minimum was reduced from 10 to 9 percent. In other instances only those employers who had more than the minimum amount necessary to qualify for the old minimum were made eligible for the new minimum; in Iowa the minimum reserve of 10 percent that qualified an employer for a 0.9-percent rate stands as the qualifying reserve for the 0.9 rate, but two rates lower than 0.9 have been added to the schedules so that employers with a 12.5-percent reserve need pay only 0.45 percent and those with a 15-percent reserve are assigned zero rates.

In 1945, 16 States[23] of the 45 with experience-rating provisions had rates in excess of 2.7 percent. In 1949, with 51 experience-rating States, only 10 States[24] have rates in excess of 2.7 percent and in only 6 States[25] is the penalty rate effective in the most favorable schedule.

Another trend has been in the direction of increasing the number of rates in schedules so that there is a finer differentiation among employers with varying experience with unemployment. These numerous rate differentials with small intervals between them prevent slight variations in experience with unemployment from resulting in wide differences in rates and usually result in less marked differences in the year-to-year rates of the individual employer.

Montana, Oregon, and Wisconsin have recognized the hardship that may be caused by excessive rate increases. Montana, by regulation, protects employers from rate increases for a year's period; Oregon limits changes in rates from year to year to two steps in the rate schedule; and Wisconsin has placed a 1-percent limitation on the amount of the increase from one year to the next.

The extent of the trend toward a larger number of rates in schedules is indicated by the fact that in 1945, 17[26] of the 44 States with rate schedules[27] had fewer than six rates, including the standard rate of 2.7 percent and penalty rates. In 1949 there are only seven States[28] where the most favorable schedule has so few rates. In

Table 3.—*Number of experience-rating States with specified number of rates*[1] *found in most favorable schedules for rate reduction, 1945 and 1949*[2]

Number of rates	Number of States	
	1945	1949
3	2	0
4	8	2
5	7	5
6	11	8
7	6	8
8	2	2
9	4	5
10	0	6
11	0	3
12	2	2
13	2	2
14	0	0
15	0	3
16	0	1
33	0	1

[1] Including standard rate and penalty rate if any applicable in schedules.
[2] Represents 44 States in 1945, and 48 in 1949; Alaska, New York, and Washington have no fixed rate schedules.

[18] Hawaii, Kentucky, Missouri, South Dakota, Wisconsin.

[19] California, Colorado, Iowa, West Virginia.

[20] Alaska, Washington.

[21] District of Columbia, Florida, Indiana, Minnesota, Nevada, North Carolina, Texas.

[22] "Experience Rating Operations in 1947," *Social Security Bulletin*, August 1948, table 2, p. 6.

[23] Arizona, Colorado, Delaware, Illinois, Iowa, Michigan, Minnesota, Missouri, Nevada, New Jersey, New Mexico, Ohio, South Carolina, Tennessee, Wisconsin, Wyoming.

[24] Delaware, Iowa, Michigan, Minnesota, Missouri, New Jersey, New Mexico, Ohio, Texas, Wisconsin.

[25] Delaware, Iowa, Minnesota, and New Mexico with two or more schedules, and Michigan and Wisconsin with only one schedule.

[26] Arizona, Arkansas, California, Colorado, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Missouri, New Jersey, New Mexico, Oregon, Pennsylvania, Vermont, Virginia.

[27] New York had no fixed rate classes.

[28] Arizona, Hawaii, Idaho, Kansas, Kentucky, Montana, New Mexico.

1945 there were only four States[29] with 10 or more rates; in 1949 there are 18.[30] In 1945, two States[31] had as few as three rates and two[32] as many as 13. In 1949 no State has fewer than four rates, and seven States[33] have 13 or more (table 3).

Provisions that increase the credit side of an employer's experience-rating account.—Changes in rates and in the standards prerequisite to specified rates have not been the only approach to rate reduction. Provisions have been adopted to increase the amount of an employer's credit in his reserve account, and others to reduce the debit side of the account.

Under the reserve-ratio system of experience rating (if the schedules remain unchanged), a year inevitably arrives when an employer has a higher rate because the low rate at which he has been paying contributions has reduced his reserve. The benefits paid out may be small in amount, but replenishment must be at least equivalent to the withdrawals or the reserve ratio tends to decline if the pay roll does not decline. If the pay roll increases, the decline is more rapid. The decline in the reserve ratio may be offset or the ratio actually increased if the pay roll decreases. It was almost inevitable, therefore, that as reserve ratios began to increase, there would be demands from employers for changes in schedules to avoid a rise in rates. If the only action taken were to lower the requirements and the rates in the schedule, the rise in the rate would be only postponed. The lowered contribution rates and the lower requirements, in fact, make the shifts from a lower to a higher rate more frequent.

Examples of legislation to strengthen the credit side of the reserve-ratio formulas are found in the Pennsylvania amendment cited above, and in North Carolina's provisions for prorating current interest on the balance in the trust fund to employer-reserve accounts. Under this provision, interest is prorated to the individual reserve accounts in the same ratio that the credit balance in each individual employer's reserve account bears to the total of the credit balances in all such reserve accounts. North Carolina is a reserve-account State and must meet the reserve requirements in section 1602 (a) (3) of the Federal Unemployment Tax Act. Therefore, if North Carolina employers are to benefit from the fact that interest is available for benefit payments, the interest must be used to help them meet the requirements. Crediting interest to the individual employer's account is a practical solution, but it represents a change from emphasis on the individual employer's experience as the basis of rate reduction and an incentive to stabilization of employment to emphasis on adjustment of rates to need in the light of available funds. Another North Carolina amendment increases the reserve in each employer's experience-rating account by crediting it with a higher percentage of his contributions, and the partially pooled fund, from which benefits are paid if an employer's account is exhausted, with a lower percentage.

Voluntary contributions are another example of the device of strengthening the credit side of the ledger. Nineteen States have such provisions in contrast with 12 in 1945.[34] In 18 States with reserve-ratio formulas, the voluntary contribution increases the balance in the employer's reserve account, and this enables him to qualify for a lower rate. It is to an employer's advantage to make a voluntary contribution as long as the amount that he pays is less than what he saves because of his rate reduction. If an employer's reserve qualifies him for a 1.5-percent rate, by paying a voluntary contribution which is equivalent to 0.1 percent of his taxable pay roll he may be able to qualify for a 1-percent rate, thus reducing the actual rate of his tax from 1.5 to 1.1. In some instances the reward for a voluntary payment may be much greater. An employer with a large pay roll may have a reserve that misses the requirement for the next lower rate by a margin of a few dollars or even a few cents, so that the necessary voluntary payment will be only a small fraction of the amount saved in taxes.

The other State with voluntary contributions, Minnesota, has a benefit-ratio rather than a reserve-ratio formula. Its voluntary-contribution provision, as amended in 1949, allows employers to make voluntary payments to wipe out benefit charges against their accounts. It is to an employer's advantage to make such payments whenever the cancellation of the benefit charges would reduce his benefit ratio to a point where his tax rate would be low enough to make the tax, plus the voluntary contribution, less than the amount of tax he would have paid if he had not made the voluntary payment. The result is a modification of the character of unemployment insurance from a system under which all funds are pooled for the payment of benefits to a hybrid system under which contributions for the payment of some benefits are pooled while other contributions (made voluntarily) are earmarked for meeting the cost of benefits paid to the workers of those employers making the payments.

Reducing the debit side of the account.—Other amendments limit charges to an employer's account and thus decrease the debit side of the schedule. Omission of charges tends more and more to spread among all employers the burden of the cost of such benefits as are paid. Moreover, it modifies the principle of allocating the costs of the program to employers in accordance with the degree of their experience with unemployment by limiting allocation to only a portion of the costs. The failure to charge a high percentage of benefits may narrow allocation to a point at which the employer is not held responsible for anything but actual lay-

[29] Connecticut, Michigan, Minnesota, Ohio.

[30] Alabama, California, Colorado, Connecticut, Delaware, Georgia, Illinois, Maine, Maryland, Minnesota, New Jersey, North Carolina, North Dakota, Ohio, Pennsylvania, Texas, West Virginia, Wisconsin.

[31] Arkansas and Kentucky.

[32] Connecticut and Ohio.

[33] California, Connecticut, Delaware, Minnesota, Ohio, Pennsylvania, Tennessee.

[34] Colorado, Indiana, Iowa, Kentucky, Minnesota, Missouri, Nebraska, North Carolina, Ohio, South Carolina, South Dakota, and Wisconsin had adopted voluntary contributions by 1945; Arkansas, Hawaii, New Jersey, New Mexico, Oregon, Pennsylvania, and West Virginia adopted them after that year.

offs due to staff reduction because of lack of orders or other economic cause.

The charging omissions are varied in form. In most early laws there was only one type of provision for omitting charges, and it has been retained in 34 of the 46 States which make charges. These provisions stipulate that if the agency pays benefits and the determination is finally reversed on appeal, no charge shall be made to the employer's account. It is logically argued that the cost of such benefits is a general responsibility of the system rather than that of an individual employer.

The second most common type of charging omission has spread rapidly. Charges are omitted for benefits paid for unemployment following a period of disqualification for voluntary quit without good cause, discharge for misconduct, or refusal of suitable work. They are also omitted for benefits paid following a potentially disqualifying separation for which no disqualification was imposed for some reason such as good personal cause for the claimant's refusal of work or voluntary quit. The intent is to relieve employers of charges for unemployment due to circumstances, such as these, that are beyond their control, by means other than a claimant's disqualification for the duration of the unemployment or cancellation of wage credits. The provisions were initially advocated with the express purpose of relieving pressures for severe statutory disqualifications. They have relieved the pressure for legislation to some degree but seem to increase the incentive for an employer to contest benefit payments in the hope that the claimants will be disqualified so that there can be no charge to his account.

In 1945 only seven States [35] had very limited provisions of this type. In 1949, 26 [36] of the 46 [37] States which make charges have incorporated provisions that omit charges if the benefits were paid following a period of disqualification. Under 24 State laws, benefits paid following disqualification for voluntary leaving and discharge for misconduct are not charged. Six of the States that omit charges in both of these cases also omit charges when benefits are paid following a disqualification for refusal of suitable work. Omission of the charge is limited in Arkansas to benefits paid following a disqualification for discharge for misconduct, and in New Hampshire to those paid following a voluntary quit.

That the limitations on these charges result in substantial reductions in the debit side of an employer's ledger is apparent from the percentage of claimants with wage credits who are disqualified under the law. For the quarter ended December 1948, for example, 231,295 new claims representing 20.2 percent of the total with sufficient wage credits were disqualified for benefits; 30.7 percent of these disqualifications were for voluntary quit, and 0.9 percent for discharge for misconduct.[38] Since these percentages are national averages, in some States the percentages were much higher.

Another instance of limitation on the charging of benefits is found in the California provision that omits charges for benefits paid to a worker for more than 18 weeks of unemployment. When the maximum duration in California was increased to 26 weeks the charges for the last 8 weeks were omitted. This, too, represents a trend toward the theory of joint responsibility for unemployment as opposed to the theory of individual responsibility. It is assumed that after 18 weeks a worker's unemployment is due to the general condition of the labor market.

Compensable unemployment of short duration is sometimes ignored under charging provisions in benefit-wage formulas. Five of the eight benefit-wage States ignore the first week or weeks of compensable unemployment when charging employers. New York does not charge until the worker has received at least four times his weekly benefit amount, Illinois until he has received three times his weekly benefit amount, Virginia until the claimant has had benefits for 2 weeks, Alabama and Texas until he has had 1 week's benefits. This delay in charging means that short-time unemployment is ignored for purposes of determining the individual employer's rate. The cost of short-term unemployment is borne jointly by all employers.

Alabama and Delaware limit benefit-wage charges in another way; if an employer reemploys a worker after benefit wages due to that worker's unemployment have been charged to the employer's record, he may receive cent, and 25 percent of the charge if the worker has received not more than 25 percent of his maximum benefits, 50 percent of the charge if the worker has received more than 25 percent but not more than 50 percent, and 25 percent of the charge if the worker has received more than 50 percent but not more than 75 percent of his maximum benefits.

Several States do not charge benefits paid to a claimant if the employer has given him only casual or short-time employment. Benefits are not charged in Maine unless the employer has employed the claimant during at least 5 consecutive weeks; in Connecticut, for 4 weeks during the 8-week period preceding the claimant's separation; in Missouri, for 3 weeks or 1 month if paid on a monthly basis; and in West Virginia, for 3 consecutive weeks. In Minnesota any employer who has paid a worker less than the minimum qualifying wage of $300 is not charged unless there is work available for the worker and the employer separated him to avoid charges. In Florida no charge is made unless the employer has paid the worker at least $15 in wages; in New Hampshire, the worker's weekly benefit amount plus $3.

Thirteen States do not charge benefits based on wage credits earned in more than one State. The theory is that if the worker did not earn enough in either State A or B to qualify but did qualify on the basis of the combined wage credits from the two

(*Continued on page 20*)

[35] Connecticut, Delaware, Indiana, Maine, Minnesota, New Hampshire, West Virginia.

[36] Alabama, Arkansas, California, Colorado, Florida, Hawaii, Idaho, Kentucky, Maryland, Massachusetts, Nebraska, New Mexico, North Carolina, North Dakota, Oregon, South Carolina, South Dakota, Tennessee, and Texas adopted provisions after 1945.

[37] No charges are made in Alaska, Mississippi, Rhode Island, Utah, and Washington.

[38] *Employment Security Activities*, March 1949, appendix table D-4, p. 33.

859003—49——2

in the instances in which a worker's periods of covered employment have been intermingled with periods of noncovered employment for which he received no wage credits.

In nearly all States the average amount of supplementary assistance in 1948 was found to be well above the average amount of the insurance benefit to the same persons. Insurance benefits would have to be more than doubled to reduce materially the need for supplementary assistance. Increase in the maximum benefit payable on a single wage record, so that larger families will receive amounts as nearly commensurate with their needs as the smaller families, would considerably reduce the burden on the aid to dependent children program, since the record shows that it is the larger families among the survivor beneficiaries who are most apt to receive assistance. Because a benefit formula must be set to meet the requirements of the greatest number of potential beneficiaries, benefits would doubtless continue to be inadequate for the largest survivor families if the parent's average monthly wage had been low. Benefits will probably be inadequate also for some retired persons with unusual medical expenses.

Extension of old-age and survivors insurance to include workers in employments not presently covered, especially if coverage is extended to agricultural employment, would go far to shift part of the burden of support of those who are too old or too young to work for a living from public assistance to the insurance program. Reduction of the assistance costs in agricultural States with relatively small tax resources would help to release funds for more adequate assistance to the persons who would still need it and for other State services.

Periods of illness have the same effect as periods of noncovered employment in reducing insurance benefits or making it impossible to qualify for benefits. Provision of insurance benefits for disability could substantially reduce the need for public assistance.

UNEMPLOYMENT INSURANCE FINANCING

(*Continued from page 9*)

States no employer should be held responsible for unemployment which, but for the combination, would not have been compensated.

Transfers of Experience

Most of the amendments in the experience-rating provisions have been designed to reduce rates generally for all employers. Transfer provisions are designed to give a successor employer any advantages in terms of rate reduction that the predecessor employer from whom he acquired a business may have had. The demand that the successor be allowed to make use of his predecessor's experience record as a basis for his rate determination grew out of the requirement in pooled-fund States that rates must be based on a minimum of 3 years' experience and in reserve-account States that before an employer's rate can be reduced he must have accumulated enough in his reserve account to meet the standards in section 1602 (a) (3) of the Internal Revenue Code. Legislation in recent years has been marked by the general extension of transfer provisions making the conditions under which experience-rating records are transferred less and less restrictive.

In 1945, all but one [39] of the 45 States with experience rating had transfer provisions. In 1949 all the 51 State laws include provision for transfers.

In 1945 only three [40] of the States made provision for partial transfers. The others limited transfers to those situations in which the successor acquired all or substantially all of his predecessor's business. In 1949, 19 States [41] provide for partial as well as total transfers—that is, the laws provide for the transfer of only a part of the experience-rating record when only a portion of a business is acquired by a successor employer. The other 32 States still limit the transfer provisions to instances in which the acquisition includes all or substantially all of the predecessor's business.

In 1945 in only 15 States [42] was the transfer of the record mandatory if the transfer of the business came within the terms of the provision; in 6 States [43] the transfer was not made without the consent of both predecessor and successor; in 3 [44] the consent of the successor alone was needed; and in 1,[45] the consent of the predecessor. In 14 States [46] the transfers could be made at the discretion of the agency. In 1949 a higher proportion of States make statutory provision for the mandatory transfer of the record in case of the business transfer. In 35 States [47] the record must be transferred if the successor acquires the total business and in 8 States [48] if he acquires a portion of the business.

[39] Idaho.

[40] Indiana, Pennsylvania, Wisconsin.

[41] California, the District of Columbia, Florida, Indiana, Kansas, Louisiana, Maryland, Montana, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, Rhode Island, Texas, Utah, Virginia, Washington, Wisconsin.

[42] Arkansas, California, Colorado, Georgia, Illinois, Iowa, Kentucky, Maine, Massachusetts, Missouri, Nebraska, New Hampshire, New Jersey, Oregon, South Carolina.

[43] Hawaii, North Carolina, Pennsylvania, South Dakota, Virginia, Wyoming.

[44] Arizona, the District of Columbia, Kansas.

[45] Florida.

[46] Connecticut, Delaware, Indiana, Louisiana, Maryland, Michigan, Minnesota, New Mexico, North Dakota, Ohio, Oklahoma, Texas, Vermont, Wisconsin.

[47] Alabama, Alaska, Arizona, Arkansas, California, Colorado, the District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming.

[48] California, the District of Columbia, Indiana, Louisiana, Maryland, Utah, Washington, Wisconsin.