

North Carolina Businesses are Not Hindered by Unemployment Insurance Taxes

Among the justifications made by North Carolina General Assembly members in support of a plan to cut UI benefits deeply is that businesses are hindered in their job creation and overall growth by the costs associated with unemployment insurance taxes and that the state is at a disadvantage in attracting new businesses because of unemployment insurance taxes. A review of several important measures of unemployment taxes and research into business decision-making demonstrates that such claims are off base.

North Carolina has some of the lowest UI tax contributions and rates among states.

In 2013, the Tax Foundation ranked North Carolina's UI system as the 5th most favorable to business in the nation. Only Arizona, Oklahoma, Delaware and Louisiana scored higher.¹ Most of the states to which North Carolina is often compared by policymakers ranked far less favorable than North Carolina: Virginia (38th), South Carolina (33rd), Tennessee (26th), Georgia (25th), and Florida (10th).

These rankings confirm what we know from the United States Department of Labor data: North Carolina already has some of the lowest tax contributions and rates among the states. The average contribution per covered employee is \$336 in North Carolina, which ranks the state 30th nationally. Moreover, North Carolina ranks 42nd in its average tax rate on taxable wages at 2.22 percent. This rate is lower than the national average of 3.44 percent.²

Unemployment Insurance taxes have little impact on hiring decisions.

Businesses hire employees when they need new workers to meet rising demand for their products or services. A business that sees no need to hire new workers will not do so because of a UI tax cut.

Of course, businesses need to have enough after-tax revenue to hire, even when they see rising demand. But shifting the level of UI taxes will have too small of an impact on business costs to change the calculus for most businesses. All state and local taxes, including unemployment insurance taxes, paid by businesses represent just 1.8 percent of business costs.³ Unemployment insurance taxes represent 0.1% of total business costs.⁴

Let's look at the relative cost of unemployment insurance taxes for a business looking to hire an additional employee.

The Bureau of Labor Statistics releases each year the relative costs to employers of employee compensation. In September 2012, the survey found that legally required benefits—including social security, unemployment insurance and other programs—represented 8.2 percent of a compensation package offered by private

¹ Tax Foundation, 2013 State Business Climate Index: Unemployment Insurance Tax Component. Accessed at: <http://taxfoundation.org/article/2013-state-business-tax-climate-index-unemployment-insurance-tax-component>

The ranking is based on the statutory and effective tax schedules in place, which businesses are subject to unemployment insurance taxes and other unemployment insurance related charges.

² US Department of Labor, 2012 Second Quarter, Data Summary and US Department of Labor, 2011 Significant Measures of State Unemployment Insurance Systems.

³ Fisher, Peter S. February 2011. Corporate Taxes and State Economic Growth. Iowa Fiscal Partnership.

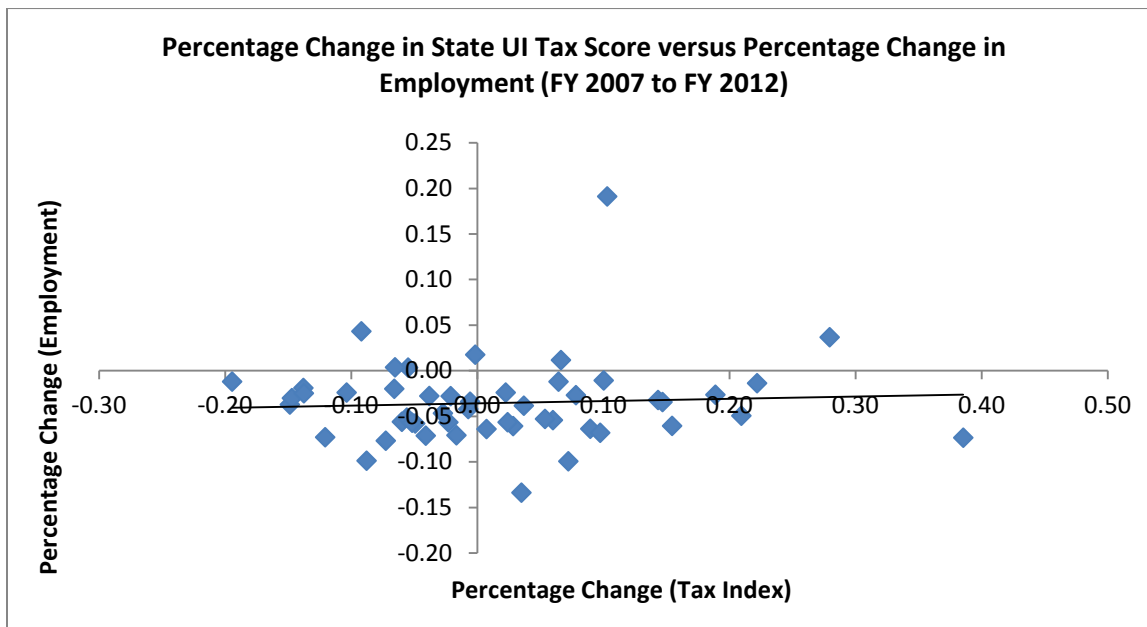
⁴ Author's calculation based on Fisher, 2011 methods and 2003 data from the Council on State Taxation and Internal Revenue Service data.

industry employers.⁵ Not surprisingly, wages and other benefits represented more than 90 percent of the cost of compensating an employee.

An employer in North Carolina at the lowest unemployment insurance tax rate of 0.06 percent would have low costs associated with unemployment insurance. To hire an additional worker at a salary of \$42,000, roughly the state's median wage, unemployment insurance would represent just \$12 each year. At the highest tax rate, 5.76 percent, the cost of unemployment insurance for an additional worker at that wage rate would be \$1203 each year. For these employers and the majority of employers in between, the additional cost of unemployment insurance is not likely to drive hiring decisions given the low cost relative to the total cost of adding an employee and the other factors that drive decisions to add employees, most importantly demand for the business' goods and services.

The graph finds that unemployment insurance tax rankings that would reward states for implementing policies that would reduce the contributions of employers and not put in place forward financing have done little to change the employment picture in states.⁶ The Congressional Budget Office has found that the portion of unemployment insurance taxes that distinguishes one tax climate or local labor market from another is passed on to workers in the form of reduced earnings.⁷

Policies that would reduce unemployment insurance taxes for employers and improve a state's Tax Foundation UI Tax Ranking are not correlated with changes in employment.



Source: Special Analysis by NELP, January 2012.

The economic literature confirms that during periods of economic weakness like today unemployment insurance *increases* employment, rather than decreasing it. As the non-partisan Congressional Budget

⁵ <http://www.bls.gov/news.release/ecec.nr0.htm>

⁶ To do well in the Tax Foundation rankings on unemployment insurance, a state must have low minimum and maximum tax rates, no surcharges, zero tax rates, and low wage bases in line with the federal minimum of \$7,000.

⁷ Congressional Budget Office, November 2012, Unemployment Insurance in the Wake of the Great Recession. http://www.cbo.gov/sites/default/files/cbofiles/attachments/11-28-UnemploymentInsurance_0.pdf

Office writes, unemployment insurance “adds to overall demand and raises employment over what it otherwise would have been during periods of economic weakness.”⁸

Benefit Cuts will Impact Businesses Too.

Deeply cutting unemployment insurance benefits would mean that unemployed workers would have less income to spend, further weakening demand for business products and services during economic downturns. That would hurt business profits, and would be more likely to lead businesses to *cut* jobs than add them.

Unemployment insurance temporarily and partially replaces an unemployed workers paycheck, a “wage-replacement” function that benefits both workers and businesses. As the effectiveness of wage replacement is reduced with cuts to benefit amounts, eligibility and duration, the potential of unemployment insurance to support businesses and stabilize demand in the economy is also reduced.

The benefit cuts in this proposal would reduce payouts by an estimated \$658 million each year, nearly half of the current benefits paid. The impact on the economy of fewer benefit payments, and thus less spending occurring at businesses, has been estimated as having a multiplier effect of 10 percent by the Congressional Budget Office and 55 percent by Mark Zandi of Moody’s Analytics.⁹ This would result in a decline in economic impact of between \$723 million and \$1 billion. That means a lot less money would flow to North Carolina businesses in the next few years. Though their taxes would be lower, businesses would see fewer customers coming through the door, hardly the sort of scenario that promotes job creation.

Summary

The unemployment insurance system does impact businesses but not in the way that is often claimed. The idea that the cost to business of adequate and stable financing of unemployment insurance is too burdensome is off-base. Unemployment insurance taxes in North Carolina ask employers to make a modest contribution in exchange for the benefit of having a stabilizing force in the economy when markets fail. Such contributions if further reduced will do little to spur additional hiring and encourage the growth that will address the state’s significant jobs deficit. Moreover, cuts to benefit amounts that would be required to pay for tax cuts for employers will reduce the ability of the system to stabilize the economy through its wage replacement function.

Unemployed,” November 17, 2010, <http://www.cbo.gov/ftpdocs/119xx/doc11960/11-17-UnemploymentInsurance.pdf>.⁹ Congressional Budget Office, November 2012, Unemployment Insurance in the Wake of the Recent Recession. Congress of the United States: Washington, DC and Zandi, Mark, February 2012. Bolstering the Economy: Helping American Families by Reauthorizing the Payroll Tax Cut and UI Benefits.
⁹ Congressional Budget Office, November 2012, Unemployment Insurance in the Wake of the Recent Recession. Congress of the United States: Washington, DC and Zandi, Mark, February 2012. Bolstering the Economy: Helping American Families by Reauthorizing the Payroll Tax Cut and UI Benefits.