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Unemployment Insurance Financing As A Uniform Payroll Tax

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In the United States, unemployment insurance has an unusual feature—it is financed by taxes on firms. Suppose a worker is laid off by a firm, and collect unemployment benefits. Part of these unemployment benefits are subsequently charged to the firm, a system known as "experience rating". This short paper investigates the consequences of unemployment insurance financing for employment. We use a simple model to argue that UI taxes have two components. The first component is a firing tax, levied on firms that layoff workers. The second component is a uniform payroll tax, levied on all firms regardless of whether they lay off workers. We provide descriptive statistics about the uniform payroll tax. The uniform tax is large, roughly 1/3 to 1/2 of overall UI taxes. The uniform tax rises substantially during recessions, though the size of the increase has fallen over time as the wage base for UI has fallen. There is much heterogeneity across states. In particular, states with poorly funded UI systems tend to increase UI taxes by more during recessions. Our results suggest that the current structure of UI financing in the United States tends to increase unemployment during recessions. UI financing leads to higher payroll taxes for all firms during recessions, regardless of whether they fire workers.