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PAYROLL TAXES: ECONOMIC EFFECTS AND LEGISLATIVE  
PROPOSALS

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## PAYROLL TAXES: ECONOMIC EFFECTS AND LEGISLATIVE PROPOSALS

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## Payroll Taxes: Economic Effects and Legislative Proposals

### Summary

The steep climb in federal payroll tax receipts during the past 20 years represents a largely unrecognized major shift in U.S. tax policy. These taxes, paid by employers and employees, finance a series of federal and state employee benefit programs including social security, unemployment insurance and workmen's compensation. The sharp growth in such taxes has resulted from a series of program changes requiring additional financing such as extending coverage to new sectors of the economy, raising benefit levels on existing programs, and introducing new types of benefits.

Although a tax on payroll represents a logical source of revenue for employment related benefits, the tax as presently applied is extremely regressive and places a heavy burden on low-income wage earners. Over the most recent decade the increase in the payroll tax contrasts sharply with the Congressional effort to lighten the income tax burden on low income families. Looking to the future, a number of legislative proposals now before Congress, most notably comprehensive health insurance, would add substantially to the present burden of payroll taxes.

Several approaches have been suggested to reconcile the continuing necessity for payroll taxes with the desirability of reducing their burden on low-income families. One approach, embodied in bills by Congressman James Burke and others, is to lower the social security tax rate and introduce general revenue financing. Other approaches by Senators Russell Long and Gaylord Nelson would provide payroll tax relief limited to low-wage workers. Senator Long's "work bonus" proposal, adopted by the Senate in November 1973, would refund low-income families with children social security taxes paid by both the employee and his employer. Senator Nelson's proposal would introduce the income tax technique of a personal exemption and a low-income allowance applying to the employee's share of the social security payroll tax. Such proposals will most likely command increasing attention in the debates over tax relief and tax reform.



Introduction

A payroll tax, whether levied on the individual employer or on the employee, represents a method of forcing the employment relationship to bear the cost of benefit programs which grow out of that relationship. Thus payroll taxes are viewed as the major source of revenue for all employment-related programs. (Medicare is the exception since the program benefits are available regardless of an individual's previous work experience.)

In fact, the basic rationale of a payroll tax has been applied with certain modifications in the private sector by both employers and employees. In numerous collective bargaining arrangements, for example, particularly where one union is bargaining with many employers, payroll based contributions by employers (sometimes together with contributions by employees) finance programs for health insurance, pensions, safety measures, apprenticeship training and employee savings.

The rise in payroll taxes, the economic issues posed by this development, and current proposals regarding these taxes are the central questions explored by this report. Discussion centers on taxes levied on wages and salaries in the private economy, thus excluding consideration of 1) payroll taxes under benefit programs for employees of federal, state, or local government, and 2) taxes paid on earnings by the self-employed under social security or other benefit programs.

An appendix provides brief descriptions of the financing methods utilized under major current programs supported by payroll taxes and payments, as well as a summary of proposals for future changes.



Origin and Growth of Payroll Taxes

Federal payroll taxes had their origin in the enactment of the Social Security Act in 1935. Such taxes were selected as the sole source of revenues for the new retirement benefit system not only because such taxes represent a fruitful source of funds, but also because such joint employer-employee financing would bring the retirement program closer to the concept of an "insurance system" with the individual worker contributing half the funds which eventually would yield his own retirement benefit.

An additional value that resulted from this method of financing was the continued active interest of both employers and employees in the workings of the Social Security system. The close tie between financing and benefits meant that employer or employee recommendations for more liberal benefits would also involve companion proposals for financing any proposed benefit increase.

The imposition of the initial 3% tax in the Social Security legislation almost immediately gave payroll taxes a major role in the limited federal tax system of the 1930's. In fact, in 1940 such taxes formed close to 25% of total tax receipts. With the coming of World War II, however, and the accompanying vast expansion in income and excise taxes, the total federal revenue collected under payroll taxes, although continuing to expand, occupied a more minor role in the nation's tax system. The post World War II period saw the start of long period of expansion in payroll taxes. From 1946 to 1974, these taxes have risen more than twenty-fold from \$3 billion to an estimated \$78 billion and, from 7% of federal tax receipts to an expected 29% (Table 1).



Payroll taxes also play a prominent role in financing other employee welfare programs, both federal and state. Particularly important are the federal-state unemployment insurance program and workmen's compensation, an entirely state-operated system. The unemployment insurance program originated along with the Social Security system in 1935 while workmen's compensation statutes in the states date back to a considerably earlier period in the nation's history. In both cases tax receipts have expanded slowly throughout the years, but the growth has been far less spectacular than for the Social Security system.

In addition, payroll taxes are utilized in a separate social insurance program for the railroad industry (retirement, disability, unemployment insurance, and cash sickness benefits). Here the pattern of tax collections differs because the decline in railroad employment has meant declining receipts from the payroll tax even though tax rates have been increased quite substantially, at one time reaching over 10% of wages or salaries for both employers and employees.

#### Operation of Payroll Taxes and Payments

Although the individual benefit programs all rely on payrolls as a source of revenue, the share of revenue raised by employer and employee payroll taxes differs among them. For example, only the federal social security program is financed by taxes which are levied equally on the employer and employee. In the unemployment insurance program there is no federal tax on employee earnings and only three states levy such a tax. The workmen's compensation program is operated on an insurance basis with only the employer paying the cost of the insurance but since the premium is expressed as a percent of payroll, it has the essential characteristics of a payroll tax.



For both the social security and unemployment insurance systems, the tax is set as a percent of covered payroll up to a maximum wage base. In 1974 the Social Security tax rate is 5.85 percent, to be paid by each employer and employee on the individual worker's first \$13,200 of earnings. For the unemployment insurance system, the taxable wage base is \$4,200 for all except five states which have set higher levels and the individual employer's tax rate varies with the unemployment experience of his employees. Under workmen's compensation the insurance premium is normally based on total wages and the rate varies with the employer's exposure to occupational hazards in his particular industry as well as his experience rating under the law.

#### Current Importance of Payroll Taxes

The increasing role of payroll taxes in the economy as a whole can best be viewed in relation to total wages and salaries. In 1950, payroll taxes represented only 4% of wage and salary income, but by 1972, this proportion has risen to over 11% with the employer share more than 6%. The federal Social Security program by itself takes 8%, while the Federal and State unemployment insurance programs and State workmen's compensation programs each take more than 1% (Tables 2-4).

Although current payroll taxes represent over 11% of wage and salary income, this average obscures the considerable variations among employers in different sectors of the economy. Although the federal social security tax is relatively uniform, the experience rating system utilized for both unemployment insurance and workmen's compensation necessarily involves considerable variation in effective tax rates among employers in different industries. In



general, it can be said that the burden of payroll taxes will fall lightest among firms with relatively high wage or high salaried employees in stable industries with low exposure to occupational hazards. On the other hand, the burden of payroll taxes will be highest among firms in relatively low-paying industries with unstable employment (such as construction) and in industries with a high incidence of industrial accidents.

Although the growth in U.S. payroll taxes is impressive, this country's reliance on payroll taxes is still not as large as a number of European countries (Table 5). In Belgium, France, Germany and the Netherlands, for example, payroll tax receipts amount to a quarter or more of total wages and salaries. These figures reflect broader benefit programs than the U.S., including national health insurance, family allowances, and a more generous retirement system. On the other hand, both Canada and Japan are less dependent on payroll taxes than the U.S. although the Canadian figures are somewhat deceptive since they refer only to programs financed by the national government and not by the provinces. In Canada, it should be noted, the basic national pension program is financed from general revenue. In Japan the general level of social programs, particularly retirement, is at a considerably lower level than in the U.S.

#### Economic Issues

The effectiveness of the payroll tax as a device for raising money cannot be faulted. However, economists have raised a number of issues regarding the manner in which the payroll tax is being utilized in current federal programs. Two specific issues are worthy of further attention.



Regressive Character of Payroll Tax. There can be no doubt that the payroll tax as it is currently utilized is regressive. The higher the earnings of any individual, the less the burden of the payroll tax. This follows not because the payroll tax rate varies with income but rather because of the operation of the maximum taxable earnings base in the social security and unemployment insurance programs. For example, under social security, the tax applies only to the first \$13,200 of wages and salaries for any one individual. Any person whose earnings fall below this amount pays a straight 5.85% to the U.S. Treasury and his employer contributes a similar amount. Above this amount, however, there is no tax so that an individual with a salary, for example of \$25,000 has to pay at a rate of only 3.1%. Moreover, because the tax applies to each individual worker, a working wife's earnings are taxed regardless of her husband's income.

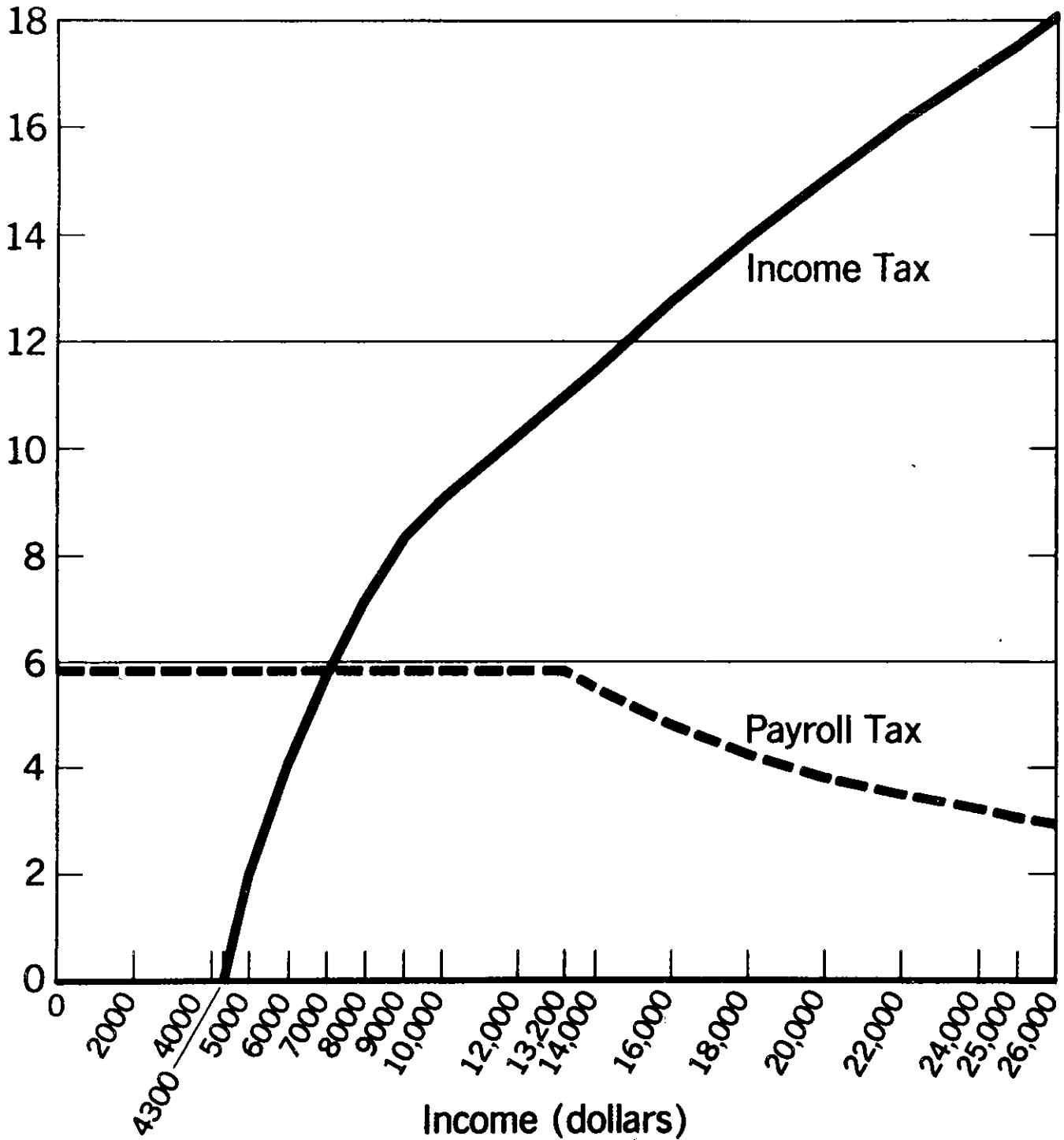
The regressive effect of the payroll tax contrasts sharply with the individual income tax. Low income families pay little or no income tax by virtue of the personal exemption and the special low income allowance but the payroll tax is applied from their first dollar of wage income. In fact, not until the wage income of a four-person family is more than \$7,000 does it pay more in income tax than it pays in payroll tax (Table 6 and Chart 1). The contrast between the payroll and income tax is particularly sharp for a family at the low income or "poverty" level. In effect, over the past 10 years the payroll tax has more than doubled, offsetting efforts by Congress to lighten the income tax load for these families (Table 7 and Chart 2).

The response of those supporting the present tax arrangement is not to deny the regressive character of the payroll tax but to argue that the social security system as a whole, considering the structure of benefits as well as



# Tax Rates Paid by Family of Four, 1974 (Wage Income Only)

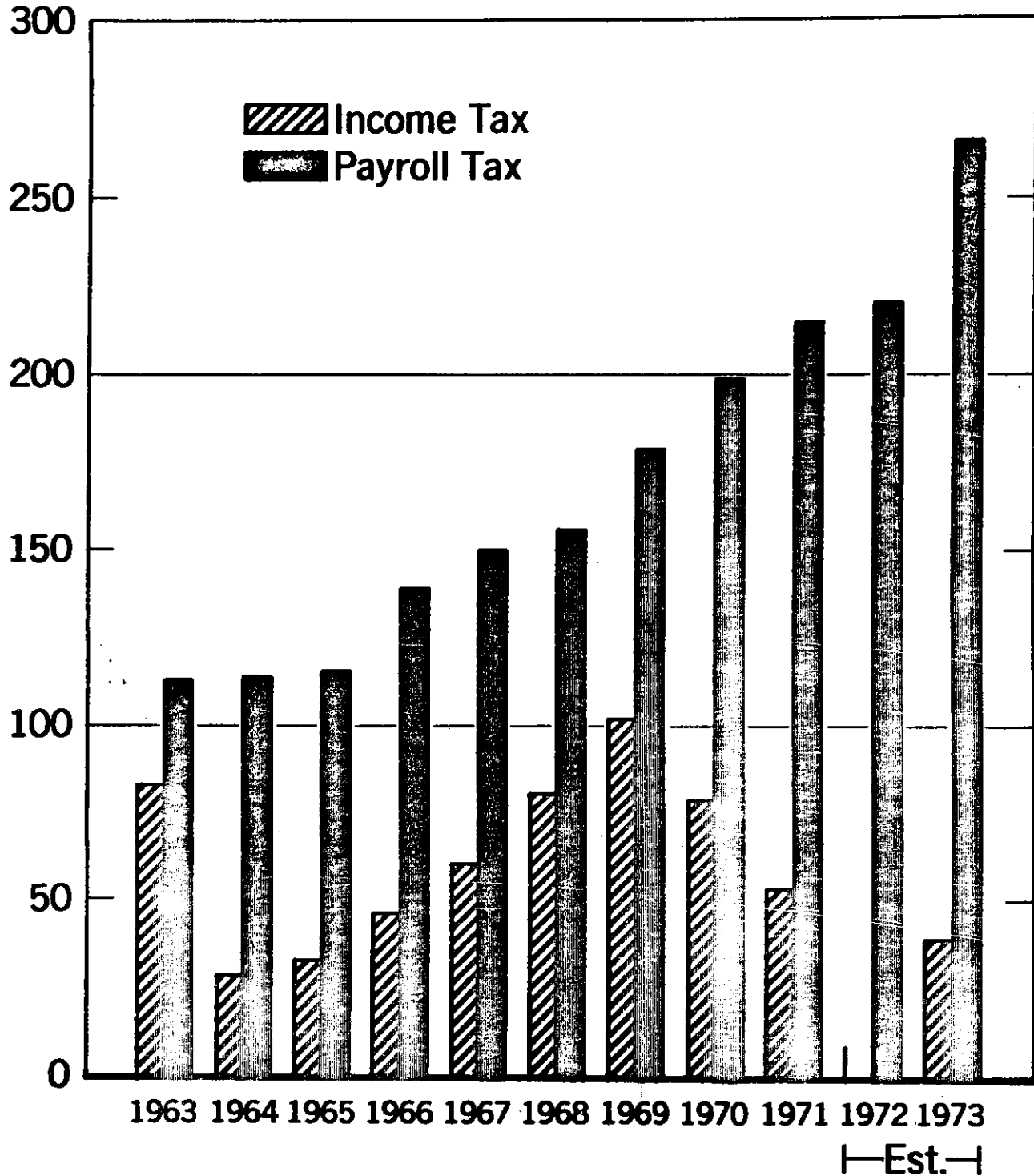
Percent of Income





# Taxes Paid by Family of Four At Low Income or "Poverty" Level, 1963 - 1973

Dollars





taxes, is not regressive. They point to the minimum benefit and to the benefit structure which is weighted in favor of lower wage earners. Robert J. Myers, formerly Chief Actuary, Social Security Administration points out that:

"When both sides of the coin are considered--both benefits and taxes--Social Security is definitely not regressive. Looking merely at the tax side is playing ostrich. The benefits are heavily weighted in favor of the low-paid workers. Thus, for example, the primary benefit (payable to a retired worker aged 65 at time of retirement or to a disabled worker) is 64.4 percent of average monthly wage (as defined in the Social Security Act) for a \$300 per month worker, but only 40.4 percent for the \$1,000 individual." 1/

It is certainly true that benefits are weighted toward the lower-income workers, but the taxes paid by today's lower income worker are supporting, not his own future benefit many years away, but the current benefits paid to the current elderly. The benefits may be weighted toward the lower-income elderly for social reasons (perhaps this is no longer necessary with the advent of the Supplementary Security Income program), but it is still pertinent to ask whether the benefit system should be financed by so regressive a tax.

Who Pays the Payroll Tax? The payroll tax is nominally paid equally by the employee and the employer. To most employees it appears that only the portion of the tax which he pays affects his take-home pay. However, a number of economists who have studied this question have concluded that the employee is also the ultimate payer of the tax levied on the employer.

For example, Milton Friedman, the noted University of Chicago economist has written:

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1/ Tax Foundations's Tax Review, Social Security Taxes: Regressivity and Subsidies, December 1973, Vol. XXXIV, No. 12, p. 47.



[The total tax for social security] includes what is euphemistically called a "contribution by the employer." Again, this is mislabeling. It is no contribution by the employer; it is a compulsory tax and it isn't paid by the employer; it is, in effect, paid by the wage earner. It is part of his wages that is sent to Washington instead of going to him. The form, the name, doesn't change the substance. 1/

In a similar vein, John A. Brittain, Brookings Institute, who has completed the most comprehensive study of the payroll tax, concludes as follows:

It is difficult to conceive any difference between the employer and employee taxes other than their labels. The employer views his share of the tax as no less a part of his total labor costs than the portion of wages and salaries he withholds for the employee tax. From the viewpoint of the employee, there should thus be no distinction between those parts of his total compensation that are withheld as employer and employee tax. From that perspective, the employee is paying both parts of the payroll tax. This proposition is supported empirically in the study by means of an intercountry analysis showing a tradeoff between the payroll tax and the basic wage. 2/

In other words, were the payroll tax to be repealed, the employee would not only find that his take home pay had automatically increased by the amount of the tax he had been paying, but also that he (or his union) would be able to bargain for an increase in his wages equal to the tax his employer had been paying.

Some economists dispute this view of who ultimately pays the cost of the employer's share of the payroll tax. These economists argue that a strong union will be able to obtain a wage level independent of the employer's share of any payroll tax. In such situations the firms will try to pass

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1/ Milton Friedman, "Transfer Payments and the Social Security System" Conference Board Record, September 1965, p. 8.

2/ John A. Brittain, "The Payroll Tax for Social Security", Highlights, Brookings Research Report 132, p. 4.



along their increased payroll costs to the consumer in the form of higher prices. Thus, these economists argue, at least some of the cost of the employer's share of payroll taxes is borne by consumers rather than by the employees concerned.

This issue can never be settled with any finality. However, it seems clear that economists generally believe that the largest share of the burden for the employer's payroll taxes is ultimately borne by the worker. If this is true, the regressivity of the payroll tax operates with even greater force against the lower wage workers.

#### Future of the Payroll Tax

What is likely to happen to payroll taxes in the future? A review of legislative proposals currently before the Congress indicates that a major further addition to the payroll tax burden is quite likely.

The following program changes now before the Congress (discussed in greater detail in Appendix) would affect payroll tax levels.

Social Security: Specific increases are scheduled for the payroll tax rate in future years. From the present 11.7% it would rise to 12.1% in 1978 and 12.6% in 1981 with further increases in 1986 and 2011. An increase in the wage base to \$14,100 is scheduled for 1975. Beyond this, future increases, although not specified, are scheduled to occur periodically to finance increases in the level of benefits which are tied to changes in the average wages of those covered by the law.

Unemployment Insurance: A number of proposals have been made to improve the unemployment insurance system. The Administration has proposed, for example, changes in the law that would assure each full-time worker un-



employment benefits equal to half his weekly wage up to a maximum of two-thirds of the average State-wide wage for covered workers.

Any major improvement in benefit structure, of course, will involve an increase in costs. The Administration has estimated that its proposed new benefit standard would involve cost increases ranging from zero in four states up to a high of over 25% in two states, with the average for the country as a whole at 12 percent. Enactment of any more liberal proposal such as that proposed by organized labor would, of course, mean an even greater increase in costs. Presumably such cost increases would be reflected in higher effective tax rates (operating through the experience rating system) or perhaps legislated changes involving, for example, an increase in the maximum wages taxed.

Workmen's Compensation: An effort is under way to change the entire structure of the workmen's compensation system by requiring that the State laws conform to a set of Federal standards, somewhat similar to the system in effect for unemployment insurance. The major bill in this field (S. 2008) calls for each state's law to meet a set of Federal standards effective January 1975, or else the State's employees would be covered by the provisions of the federal Longshore and Harbor Workers' Compensation Act. Although no official cost estimates resulting from this proposed legislation have been made available, it is fair to say that the bill would involve major increases in costs, varying by State, depending on each State's current provisions.



Health Insurance: A review of ten proposed comprehensive health insurance plans indicates that although many of them would involve contributions from general federal revenues, the major part of the financing would come from either a payroll tax to be paid by employers and employees or by insurance premiums also to be jointly paid. Several proposals specifically provide for a payroll tax including the original Kennedy-Griffiths proposal (1% on employees, 3.5% on employers) and the more recent Mills-Kennedy proposal (1% on employees, 3% on employers). Three major bills accentuating a private insurance system, including the Administration plan as well as plans supported by the American Hospital Association and the health insurance carriers, would require payment of insurance premiums largely (75% or more) by employers. The more limited proposals for catastrophic insurance naturally require less extensive financing with the more prominent of these, the Long-Ribicoff proposal, setting a payroll tax rate of 0.3% for both employees and employers. In all cases, the present payroll tax to finance Medicare would continue.

#### Issues Before Congress

Thus the role of payroll taxes is quite likely to increase in the near future. The result could well be that such taxes could rise to a point where they presented more than one-third of all federal revenues and 15-20% of total wages and salaries in the private economy.

Such a prospect raises two basic legislative issues:

1. Is it necessary to rely so completely on payroll taxes to finance the nation's employee benefit programs?
2. Should the character of the payroll tax be changed to reduce the burden on holders of low-wage jobs?



On the first question it is possible to conceive revised statutory arrangements that would shift the financing of such programs as social security away from payroll taxes partially or completely to general revenues. On the other hand, the logic of utilizing payrolls as a source of income for employment-related benefit programs is irrefutable. In effect it states that the basic costs shall be borne by the economic processes from which the risks arise that the benefit programs are designed to protect against.

However, this logic does not apply with the same force to the current Medicare program or to various proposals for a comprehensive health insurance program. Medicare benefits are available to all elderly, regardless of their previous employment experience and many of the health proposals would cover all citizens regardless of their employment status. Under such circumstances it might be more defensible to provide at least partial financing for these programs through general revenues.

With respect to the on-going Social Security program, some advocates have argued that costs should be equally shared among employers, employees, and general revenues. One argument offered in support of such a change is that certain elements in the program, e.g., weighting the benefit formula in favor of the lower-wage workers, should be borne by all taxpayers, rather than simply employers and employees. A major proponent of this viewpoint is Congressman James Burke who along with approximately 100 other sponsors has introduced recent legislation (H.R. 12489, H.R. 12829, H.R. 12947, H.R. 13190, and H.R. 13384) that would place social security financing on this three-way basis. Senator William Hathaway has introduced similar legislation in the Senate. To provide general revenue financing on this scale would require an increase in other tax rates or reduction in funding for other programs.



A second approach to the issues presented here is to continue the current reliance on payroll tax but to inject certain modifications that would lighten the tax burden on those holding low-wage jobs. Two major proposals to gain this objective have been advanced, one by Senator Russell Long and the other by Senator Gaylord Nelson and Congressman John F. Seiberling.

Under Senator Long's "work bonus" proposal, low-income families with children would receive an income tax refund roughly equivalent to the social security taxes previously paid by them and their employers. The refund would be available only to families with annual incomes less than \$5,600 a year. Families whose annual income fell below \$4,000 would receive close to a full refund of all social security taxes while a partial refund would be applicable when annual income reached between \$4,000 and \$5,600.

The refund would be made from general revenues based on information furnished on the family's annual income tax form, although refunds would be made in all cases, even if the family had little or no income tax liability. Arrangements would be made for families to obtain their refund in advance in quarterly installments. Senator Long's proposal was included in the Senate amendments to H.R. 3153, an omnibus Social Security bill, which the Senate passed on November 30, 1973, but the Long amendment was later dropped in conference with the House.

The proposal by Senator Nelson and Congressman Seiberling (H.R. 8157) would incorporate into the employees' portion of the social security payroll tax the personal exemption and low income allowance that are presently included in the income tax. According to their proposal, each employee would be entitled to a personal exemption of \$750 for himself and each additional



member of the family. In addition, each family would be entitled to a low-income allowance of \$1,300. Benefits from these provisions would be confined to relatively low-wage earners by requiring that they be phased out dollar for dollar as earnings rise beyond the value of the exemptions plus the low-income allowance.

Currently, under this proposal, a family of four would be entitled to \$3,000 in personal exemptions plus \$13,00 as a low-income allowance. Thus families with wage income up to \$4,300 would be relieved of any employee payroll tax liability. From \$4,300 to \$8,600 such a family would be liable for some tax but for a lesser amount than at present. Above \$8,600, there would be no reduction from the present schedule.

It has been estimated that this proposal would cost the Treasury about \$4 billion annually in revenue from the current \$50 billion now being received under the payroll tax. This, of course, could be offset in one form or another by changes in the tax rates paid by employers or employees generally or by other changes in the Internal Revenue Code. Congressman Seiberling's bill would reimburse the various Social Security Trust Funds from general revenues for the loss in revenue resulting in this bill.

The major differences between the Nelson and Long approaches are the following:

- 1) The Nelson approach operates by relieving the individual worker of paying his social security tax as wages are earned while the Long approach operates by providing a refund after such taxes have been paid. Thus the Nelson approach would reduce the flow of funds into the Social Security Trust Fund while the Long approach would affect only general revenues.



2) The Nelson approach would apply to all families and single persons, while the Long approach would apply only to families with children.

3) The Nelson approach provides a personal exemption and low-income allowance to the employee's share of the social security tax; the Long approach would provide a rate of refund covering both the employee's and the employer's share of the social security tax.

4) For a four-person family, the Nelson approach would relieve the individual of any employee social security tax until wage earnings reached \$4,300 and a partial tax would be paid on earnings between \$4,300 and \$8,600; the Long approach would provide a full refund on earnings up to \$4,000 with a partial refund on earnings between \$4,000 and \$5,600.



Federal Budget Receipts

Fiscal Year	Total Receipts	Social Insurance Taxes and Contri- butions	Percent of Total
<u>Actual</u>	(Billions of Dollars)	(Billions of Dollars)	
1940	6.9	1.7	24.6
1946	43.5	3.1	7.1
1950	40.9	4.4	10.8
1955	65.5	7.9	12.1
1960	92.5	14.7	15.9
1965	116.8	22.0	18.8
1966	130.9	25.6	20.0
1967	149.6	33.3	22.3
1968	153.7	34.6	22.5
1969	187.8	39.9	21.2
1970	193.7	45.3	23.4
1971	188.4	48.6	25.8
1972	208.6	53.9	25.8
1973	232.2	64.5	27.8
<u>ESTIMATED</u>			
1974	270.0	77.9	28.9
1975	295.0	85.6	29.0

Source: Budget of the U.S. and supporting data.



EMPLOYEE PAYROLL TAXES, PRIVATE ECONOMY, 1940-72  
(Millions of Dollars)

Year	Old Age, Survivors, Disability and Hospital Insurance <sup>1/</sup>	State Unemployment Insurance	Railroad Retirement Insurance	Cash Sickness Compensation Funds	Total
1940	--	67	50	--	117
1945	79	295	1,030	4	1,408
1950	--	371	474	51	896
1955	2,825	14	308	63	3,210
1960	5,650	14	297	102	6,063
1965	8,391	20	326	252	8,989
1966	11,034	21	375	275	11,705
1967	11,865	22	399	285	12,571
1968	13,188	25	445	308	13,966
1969	15,781	27	474	343	16,625
1970	16,450	38	437	337	17,262
1971	18,463	20	450	352	19,285
1972	20,933	25	499	412	21,869

Note: Data is for calendar years, not fiscal years as in Table 1.

<sup>1/</sup> Includes receipts from covered public employment, including military, state, and local government, not available separately.



EMPLOYER PAYROLL TAXES AND PAYMENTS, PRIVATE ECONOMY, 1940-72  
(Millions of Dollars)

Year	Old Age, Survivors, Disability and Hospi- tal Insurance <sup>1/</sup>	State Unemployment Insurance	Federal Un- employment Tax	Railroad Retirement Insurance	Railroad Un- employment Insurance	Cash Sickness Compensation Funds	Workmen's Compensation Payments	Total
1940	329	813	98	67	67	--	421	1,795
1945	630	1,011	174	140	130	--	726*	2,811
1950	1,308	1,217	232	282	24	7	1,013	4,083
1955	2,825	1,221	304	308	25	5	1,532	6,220
1960	5,650	2,300	358	297	165	8	2,055	10,833
1965	8,391	3,077	573	326	149	9	2,908	15,433
1966	11,022	3,015	623	375	146	11	3,279	18,471
1967	11,853	2,614	641	399	141	12	3,656	19,316
1968	13,177	2,536	681	445	136	14	4,027	21,016
1969	15,767	2,529	721	500	131	19	4,441	24,108
1970	16,436	2,494	860	518	128	27	4,882	25,345
1971	18,446	2,707	862	536	123	38	5,168	27,880
1972	20,916	4,185	1,196	568	119	45	5,759	32,788

\*1946 figure, 1945 not available.

Note: Data is for calendar years, not fiscal years as in Table 1.

<sup>1/</sup> Includes receipts from covered public employment, including military, state, and local government, not available separately.



BURDEN OF EMPLOYER AND EMPLOYEE PAYROLL TAXES, PRIVATE ECONOMY, 1940-72  
(Millions of Dollars)

Year	Payroll Taxes and Payments			Private Wages and Salaries	Percent Payroll Taxes to Wages and Salaries
	by Employers	by Employees	Total		
1940	1,795	117	1,912	41,393	4.6
1945	2,811	1,408	4,219	82,580	5.1
1950	4,083	896	4,979	124,390	4.0
1955	6,220	3,210	9,430	175,074	5.4
1960	10,833	6,063	16,896	222,108	7.6
1965	15,433	8,989	24,422	289,145	8.4
1966	18,471	11,705	30,176	316,801	9.5
1967	19,316	12,571	31,887	337,322	9.5
1968	21,016	13,966	34,982	369,168	9.5
1969	24,108	16,625	40,733	405,568	10.0
1970	25,345	17,262	42,607	426,875	10.0
1971	27,880	19,285	47,165	449,711	10.5
1972	32,788	21,869	54,657	493,276	11.1



BURDEN OF PAYROLL TAXES IN VARIOUS COUNTRIES, 1971

Country	Monetary Unit	Social Security Contributions			Other Payroll Taxes	Total Payroll Taxes	Total Wages and Salaries	Payroll Taxes As Percent of Wages and Salaries
		Employees	By Employers	Total				
Belgium	Millions Francs	38,549	101,309	139,858	---	139,858	576,800	24.2
Canada	Millions Canadian \$	n.a.	n.a.	2,463	99	2,562	49,354	5.2
France	Millions Francs	23,236	193,880	127,116	2,596	129,712	332,860	39.0
Germany	Millions Deutsche Marks	34,810	53,030	87,840	1,805	89,645	345,000	26.0
Japan	Billions Yen	1,197	1,635	2,832	---	2,832	34,729	8.2
Netherlands	Millions Guilders	9,244	8,927	18,171	---	18,171	59,030	30.8
Sweden	Millions Kronor	3,253	9,847	13,100	1,691	14,791	97,712	15.1
U.K.	Millions Pounds Sterling	1,266	1,454	2,720	554	3,274	30,512	10.7
U.S.	Millions U.S. Dollars	25,030	33,308	58,338	---	58,338	551,501	10.6

Note: Taxes exclude any payments by self-employed but include payments by governments and government employees.

Sources: Organization for Economic Cooperation and Development, "Revenue Statistics of OECD Member Countries, 1965-71"; OECD, "National Accounts of OECD Countries, 1960-71".



## Taxes Paid by Family of Four, 1974

(Wage Income Only)

Income (Dollars)	Employees' Income Tax		Employees' Payroll Tax		Total Taxes	
	Amount <sup>1/</sup>	Percent of Income	Amount	Percent of Income	Amount	Percent of Income
4,000	\$ 0	0.0	\$234	5.85	\$ 234	5.85
6,000	249	4.15	351	5.85	600	10.00
8,000	573	7.16	468	5.85	1,041	13.01
10,000	905	9.05	585	5.85	1,490	14.90
12,000	1,228	10.23	702	5.85	1,930	16.08
14,000	1,600	11.43	772.20	5.52	2,372.20	16.94
16,000	2,040	12.75	772.20	4.83	2,812.20	17.58
20,000	3,010	15.05	772.20	3.86	3,782.20	18.96
25,000	4,380	17.52	772.20	3.09	5,152.20	20.61

<sup>1/</sup> For purposes of calculating Federal income tax liability, the taxpayer is assumed to claim four dependents, to claim either the low income allowance or the standard deduction, and to file a joint return.



Table 7

## Taxes Paid by Family of Four at Low Income or "Poverty" Level

1963 - 1973

Year	Low Income Level	Income Tax <sup>1/</sup>	Payroll Tax	Total Tax	
				Amount	Percent of Income
1963	\$3,128	\$ 83.00	\$113.39	\$196.39	6.3
1964	3,169	28.00	114.87	142.87	4.5
1965	3,223	32.00	116.83	148.83	4.6
1966	3,317	46.00	139.31	185.31	5.6
1967	3,410	60.00	150.04	210.04	6.2
1968	3,553	81.00	156.33	237.33	6.7
1969	3,743	102.00	179.66	281.66	7.5
1970	3,968	79.00	190.46	269.46	6.8
1971	4,137	53.00	215.12	268.12	6.5
1972	4,275	0.00	222.30	222.30	5.2
1973	4,550 <sup>2/</sup>	39.00	266.18	305.18	6.7

<sup>1/</sup> Calculated by use of Tax Tables.<sup>2/</sup> Estimated.



Social Security

Since its origin in 1935, the nation's Social Security System has expanded from a limited arrangement focusing on retirement benefits for the individual worker to a far more comprehensive system with broader coverage and additional benefits. Major changes over the years have been the addition of benefits to workers' dependents and survivors in 1939, a substantial broadening of coverage in 1950, the addition of benefits for permanently disabled workers in 1956, the lowering of age at which retirement benefits are payable from 65 to 62 for women in 1966 and five years later for men, the addition of health insurance benefits for retirees in 1965, and a series of benefit level increases at various times during this period, but especially during the past eight years.

From its beginning the system has been financed exclusively by a payroll tax applied equally to employers and employees as well as a separate tax on self-employment earnings. The expansion in the system has been financed by a continuing rise both in the rate of tax and the earnings base to which the tax is applied. In particular, important increases have occurred during the past ten years as indicated by the following table.



Year	Maximum Taxable Base	Tax Rate (percent)	
		Combined Employer- Employee	Employer or Employee Alone
1937-1949	\$ 3,000	2.0	1.0
1950	3,000	3.0	1.5
1951-1953	3,600	3.0	1.5
1954	3,600	4.0	2.0
1955-1956	4,200	4.0	2.0
1957-1958	4,200	4.5	2.25
1959	4,800	5.0	2.5
1960-1961	4,800	6.0	3.0
1962	4,800	6.25	3.125
1963-1965	4,800	7.25	3.625
1966	6,600	8.4	4.2
1967	6,600	8.8	4.4
1968	7,800	8.8	4.4
1969-1970	7,800	9.6	4.8
1971	7,800	10.4	5.2
1972	9,000	10.4	5.2
1973	10,800	11.7	5.85
1974	13,200	11.7	5.85



Proposed Changes

Because of the need for advance planning to finance the expected increase in benefits as a larger proportion of the population becomes eligible for benefits, the social security legislation currently in effect provides a firm schedule for changes in both the amount of the wage base and the rate of taxation. Specific increases are scheduled for the tax rate in future years. From the present 11.7% it would rise to 12.1% in 1978 and 12.6% in 1981 with further increases in 1986 and 2011. An increase in the wage base to \$14,100 is scheduled for 1975. Beyond this, future increases are not specified but along with similar increases in the level of benefits, would be set to parallel increases in average wages of those covered by the law. With a generally rising level of wages, the wage base would be adjusted annually.



Unemployment Insurance

The basic source of funds for financing the nation's unemployment insurance program is a joint Federal-State tax system under which employers may credit toward the federal payroll tax the contributions which they make under an approved State tax system. Employers may also credit any savings on the State tax under an approved experienced rating plan. There is no Federal tax levied on employees although there is such a tax in a few of the states.

All employers covered by the Federal Unemployment Tax Act are charged a tax of 3.2 percent on the first \$4,200 of each worker's wages. Employers who are also subject to an approved State law may offset 2.7 percent of payrolls by taxes and experience rating credits under the State law. Since all States have approved laws, the remainder of the tax, or 0.5 percent of taxable wages, is paid to the Federal Government. This tax is used to pay the administrative expenses of Federal and State unemployment insurance and employment service agencies, the Federal share of the Federal-State extended unemployment compensation program, and for interest, free loans to states with depleted benefit reserves.

All the States finance unemployment benefits mainly by contributions from subject employers on the wages of their covered workers; in addition, three States (Alabama, Alaska, New Jersey) collect employee contributions. The funds collected are held for the States in the unemployment trust fund in the U.S. Treasury, and interest is credited to the State accounts.

In most States the standard rate--the rate required of employers until they are qualified for a rate based on their experience--is 2.7 percent, the maximum allowable credit against the Federal tax. Similarly, in most States,



the employer's contribution, like the Federal tax, is based on the first \$4,200 paid to (or earned by) a worker within a calendar year, but five States (Hawaii, Minnesota, North Dakota, Oregon and Washington) have provision for a higher wage base.

All States have in effect some system of experience rating by which the individual employer's contribution varies from the standard rate according to his experience with the risk of unemployment. The experience-rating provisions of State laws vary greatly, and the number of variations has tended to increase with each legislative year.

As a result of the many variables in State taxable wage base and tax rates, benefit formulas and economic conditions, actual tax rates vary greatly among the States. In 1972 the average tax rate for all the States was 1.70% of taxable wages, ranging from a high of 3.24% in Massachusetts to a low of .41% in Virginia, both on a taxable wage base of \$4,200. Tax rates as a percentage of total wages ranged from a high of 2.08% in Puerto Rico to .23% in Virginia.

#### Proposed Changes

A number of proposals have been made to improve the unemployment insurance system. The Administration has proposed, for example, changes in the law that would assure each full-time worker unemployment benefits equal to half his weekly wage up to a maximum of two-thirds of the average State-wide wage for covered workers. The Administration has also suggested broader coverage for farm workers as well as a temporary system for extended benefits for individuals whose unemployment extends beyond the period for receipt of normal benefits.



Hearings on the Administration's proposed changes as well as on other proposals by organized labor and other groups have been held by the House Ways and Means Committee (April 22 and 23) and Senate Finance Committee April 2.

Any major improvement in benefit structure, of course, will involve an increase in costs. The Administration has made available a listing of estimated cost increases for each State if its proposed new benefit standard should go into effect. The cost increases range from zero in four states up to a high of over 25% in two states, with the average for the country as a whole at 12 percent. Enactment of any more liberal proposal such as that proposed by organized labor would, of course, mean an even greater increase in costs. Presumably such cost increases would be reflected in higher effective tax rates (operating through the experience rating system) or perhaps legislated changes involving, for example, an increase in the maximum wages taxed.



Workmen's Compensation

Workmen's compensation is an employer paid, state-operated insurance program in which employers normally pay insurance premiums for protecting their employees against the loss of pay resulting from on-the-job accidents. A Federal statute, the Longshoremen's and Harbor Workers' Compensation Act, applies to on-the-job accidents in the longshore and maritime industries and serves as well as the workmen's compensation law for the District of Columbia.

Employers can pay for the cost of workmen's compensation in several ways. In most States, if the employer has sufficient payroll and a satisfactory record of paying past claims, he may self-insure the risks of industrial accidents. Alternatively, the employer may purchase insurance, usually from private insurance companies and often from an insurance fund operated by the State.

Essentially, the payment of compensation insurance premiums by employers is equivalent to a payroll tax. The premium is set in terms of a rate on wages and salaries up to a maximum per employee. Moreover, although the rates under workmen's compensation vary by type of industry, an element not present in either unemployment insurance or OASDI, the premium for individual employers is experience-rated in a fashion similar to the state unemployment insurance system. In general, the payment of workmen's compensation is considered by economists the equivalent of a payroll tax.

In 1972 an estimate of \$5,759 million was spent by employers to insure or self-insure their risks under workmen's compensation, 11 percent or \$583 million higher than the amount estimated for 1971. The 1972 total consists



of (1) \$4,181 million in premiums paid to private carriers; (2) \$1,048 million in premiums paid to State funds (for the Federal employees' program these premiums are the sum of the benefit payments and the costs of the administrative agency); and (3) \$530 million as the cost of self-insurance (benefits paid by self-insurers, with the total increased by 5 to 10 percent to allow for administrative costs). As a percent of covered payroll, Workmen's Compensation costs have risen slowly over the past 20 years, from slightly less than 1% of payroll to the 1972 level of 1.16% of payroll.

#### Proposed Changes

An effort is under way to change the entire structure of the workmen's compensation system by requiring that the State laws conform to a set of Federal standards, somewhat similar to the system in effect for unemployment insurance. This effort grows out of a special study of the network of State statutes in this field undertaken by a special presidentially-appointed National Commission on State Workmen's Compensation Law. The Commission's report, issued in 1972 called for such standards to be introduced with the states being given a three year period to conform to the new standards. The major bill in this field, S. 2008 (Senators Williams and Javits) calls for each state's law to meet a set of Federal standards effective January 1975, or else the State's employees would be covered by the provisions of the Longshore and Harbor Workers' Compensation Act. Field hearings on the Williams-Javits bill have been held by the Senate Labor Committee. Although no official cost estimates resulting from this proposed legislation have been made available, it is fair to say that the bill would involve major increases in costs, varying by State, perhaps in the range of 10-25%.



### Health Insurance

The U.S. does not have any system of comprehensive health insurance. The Social Security system does include a health insurance program for the elderly (Medicare), originally adopted in 1965. The program provides hospital and medical insurance protection for over 23 million people--those 65 and older, people under age 65 who have been receiving cash benefits under the social security or railroad retirement programs because they are disabled, and certain chronic kidney disease patients under 65. Included in the program are in-patient hospital services, post hospital extended care, physicians' and surgeons' services and certain other medical and health services.

The program is financed by earmarking part of the payroll tax under the Social Security Act. For 1974 the rate is 0.90% of payroll to be paid up to the tax base by each employee and his employer.

### Proposed Changes

A number of proposals for a more comprehensive health insurance system covering essentially the entire U.S. population are currently being considered by the Congress. In general, these would provide a broad program for insuring the cost of hospital care, physicians' and surgeons' fees, related medical services, and prescription drugs. A few proposals reject the comprehensive approach and provide instead for a system of insurance for catastrophic illness requiring especially heavy medical expenses.

A review of ten proposed plans listed in a report by the House Ways and Means Committee indicates that although many of them would involve contributions from general federal revenues, the major part of the financing would come from either a payroll tax to be paid by employers and employees or by insurance premiums also to be jointly paid. In most cases the bills provide



only limited financing by the employee, especially low-income employees. Several proposals specifically provide for a payroll tax including the original Kennedy-Griffiths proposal (1% on employees, 3.5% on employers) and the more recent Mills-Kennedy proposal (1% on employees, 3% on employers). Three major bills accentuating a private insurance system, including the Administration plan as well as plans supported by the American Hospital Association and the health insurance carriers, would require payment of insurance premiums largely (75% or more) by employers. The more limited proposals for catastrophic insurance naturally require less extensive financing with the more prominent of these, the Long-Ribicoff proposal, setting a payroll tax rate of 0.3% for both employees and employers. In all cases, the present payroll tax to finance Medicare would continue.

Since many employers are already contributing all or a major portion of the cost of their employees' health insurance, the proposed financing arrangements do not necessarily represent an added cost burden for all employers. Since the health insurance coverage, however, will be greater in many instances than present plans, some net increase in cost is likely. However, since the prevalence and type of employer-paid health insurance varies considerably in different sectors of the economy, some types of employers will face much higher added costs than others. In general, the burden will fall heaviest on small employers with relatively lower wages whose employees are not subject to collective bargaining.