

# ***Unemployment Compensation in Ohio:***

## ***Protecting a Critical Safety Net for Working Families and the Economy***

A Report by Policy Matters Ohio and National Employment Law Project

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**National Employment Law Project (NELP)** is a non-profit organization based in New York City. NELP has advocated on behalf of low-wage and jobless workers for over 35 years. NELP's Unemployment Insurance Safety Net Project supports expanding unemployment insurance programs, furnishing advice and assistance to legislators and their staff, advocates, unions, community groups, and others involved in state-level reform efforts as well as monitoring federal legislative and administrative developments.

**Policy Matters Ohio**, the co-publisher of this report, is a non-profit research institute dedicated to bridging the gap between research and policy in Ohio. Policy Matters seeks to broaden the debate about economic policy in Ohio by providing quantitative and qualitative analysis of important issues facing working people in the state. Other areas of inquiry for Policy Matters have included work, wages and benefits; economic development and tax policy; education, trade, and privatization of public services.

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## Executive Summary

Unemployment compensation provides crucial basic support to jobless workers and their families, and boosts the economy by maintaining consumer spending when unemployment rises. This report examines Ohio's unemployment compensation system, and finds that while it has provided significant assistance to jobless workers and the economy recently, ill-advised limitations upon eligibility undermine the program's ability to achieve its goals.

Unemployed Ohioans are less likely to receive unemployment compensation than jobless workers elsewhere in the United States. For every 100 jobless Ohio workers, only 36 got unemployment compensation (UC) in 2003. Nationally, 41 of every 100 jobless workers received benefits last year; states with the greatest coverage paid to well over 50 of every 100 unemployed residents.

Workers in Ohio must earn more than those in almost any other state in order to qualify for unemployment compensation. Ohio's monetary eligibility requirement, set at 27.5 percent of the state's average weekly wage, amounts to \$181 a week in 2004. This means that a minimum-wage worker working 35 hours weekly and making \$180.25 each week in 2004 (\$9373) is ineligible for benefits in Ohio. Our analysis of Census Bureau data finds that:

- Extending UC monetary eligibility to individuals working 20-35 hours per week and at least 20 weeks per year at the minimum wage or more (roughly \$100/week) would expand potential UC eligibility by 352,000 individuals, or an additional 6.8% of the total Ohio workforce.
- On average, these currently excluded workers are employed 44 weeks a year, not significantly less than the 50 weeks that higher-wage workers currently eligible for UC worked on average.
- Sixty-seven percent of workers who potentially would become eligible for benefits are women. In comparison, 46.4 percent of workers qualifying under current UC rules are female.

Improving monetary eligibility would not cost a great deal. The Ohio Department of Job and Family Services has estimated that if monetary eligibility rules covered individuals working the equivalent of at least 20 hours a week for 20 weeks, it would cost between \$4 million and \$6 million a year, or less than half of one percent of benefit costs.

Part-time workers in Ohio face other obstacles in obtaining UC benefits. Agency practice results in the denial of benefits to most claimants who state that they are limiting their availability to part-time work, even where these individuals previously worked part-time. The exclusion of part-timers disproportionately affects low-wage and women workers. A growing number of states, recognizing that the exclusion of part-time workers is based on outdated assumptions that part-time workers are not really supporting families, have expanded eligibility for these workers.

Unemployment compensation helps both jobless workers and the economy by providing benefits to involuntarily jobless workers. UC programs best perform these functions by building up reserves from employer payroll taxes during economic good times in order to pay UC benefits during downturns. Ohio's UC program paid more than \$4 billion in benefits overall in 2001, 2002, and 2003, helping hundreds of thousands of Ohioans each month. By drawing down reserves to pay higher UC claims, the program provided a net \$2 billion boost to the state's economy over and above UC taxes paid by Ohio employers during these years.

## Unemployment Compensation in Ohio

Ohio benefit levels, though in the middle of the pack nationally, have lost ground relative to other states in recent years. Weekly UC benefit amounts averaged \$252 in 2003, or \$10 a week below the national average. Ohio is the only state that pays dependency allowances only to workers who earned a minimum amount -- currently \$646 a week -- rather than to all jobless breadwinners.

Ohio sets UC payroll tax rates based upon the prior claims experience of employers compared to their past contributions. Taxes also depend on the balance in the state's trust fund and benefit charges that cannot be recovered from a specific employer account. The state's "minimum safe level" mechanism lowers and raises UC tax rates by comparing trust fund balances to prior benefit payment levels. Ohio's UC financing system favors lowering taxes instead of allowing trust fund reserves to build up during good times, reducing federal interest the fund receives. By lowering UC taxes during economic recovery periods, the minimum safe level mechanism ensures that Ohio enters recessions with lower reserve levels than it would have otherwise. This means that the state must raise taxes to a greater degree following recessions to avoid insolvency.

State UC tax rates remained around 0.5 percent of total wages, or 50 cents on every 100 dollars of Ohio payrolls, between 1997 and 2003. They remain below the national average. In order to pay higher benefit costs and to replenish Ohio's UC trust fund, employer payroll tax contributions are currently increasing, with tax rates expected to climb for the near future.

Since 1995, Ohio employers have paid tax on the first \$9,000 of each employee's earnings. Each year this amount becomes a smaller proportion of total wages. Meanwhile, UC benefit levels keep pace with rising wages, placing a long-term squeeze on UC financing. In general, states with higher taxable wage bases can recover from or avoid insolvency better than states with lower taxable wage bases. Seventeen states automatically adjust their taxable wage bases each year to wages, keeping pace with economic growth.

### Recommendations

1. *Ohio should adopt a monetary eligibility standard that permits individuals working at least 20 hours a week for at least 20 weeks a year to get UC benefits. These individuals are eligible for UC in most states and have enough work history to justify eligibility for benefits.*
2. *Current policies deny benefits to some part-time workers because they are available only for part-time work regardless of their circumstances. Ohio should clarify its policy regarding part-time workers, permitting those with substantial part-time work history to draw UC benefits so long as reasonable numbers of part-time jobs exist in the labor market.*
3. *Ohio, like other states, should look to ensure over time that its UC benefit levels come closer to replacing the average wage. The state should modify its dependency allowances to increase UC benefit payments to all jobless breadwinners*
4. *In order to better prepare for the next economic downturn, Ohio should modify its UC financing mechanism to improve forward financing of its UC trust fund. This will result in employers paying somewhat higher taxes during the growth phase of economic cycles in order to build higher trust fund reserves to cushion employers and the state's economy from UC tax increases before an economic recovery is fully in place.*
5. *Ohio's unchanging \$9000 taxable wage base results in a declining financial base for the state's UC program. Ohio should raise and index its taxable wage base by automatically increasing it to keep pace with annual growth in state average wages.*

## Introduction

Unemployment compensation (UC) is designed to help jobless workers, their families, their communities, and the economy. This report discusses key reforms that could address program shortcomings and improve Ohio's UC safety net, better protecting low-wage unemployed individuals.<sup>1</sup> The report also provides an overview of the positive impact of Ohio's UC program on the state's economy and citizens during the 2001 recession and continuing job slump. We conclude with a discussion of Ohio's UC financing and payroll taxation mechanisms and steps needed to strengthen them.

A weak economy has put the UC program front and center during the last few years, with hundreds of thousands of Ohioans still relying upon the program for benefits in 2004. Ohio's labor market remains listless nearly three years after the official end of the 2001 recession. The state has lost over 200,000 jobs, the majority of these in manufacturing, jobs paying considerably more than the average job in Ohio. New claims for UC benefits rose from less than half a million in 1999, reached 812,000 in 2001, and remained close to this level in 2002 and 2003. Claims levels remain above pre-recession levels in 2004. Some 370,000 Ohioans were jobless in August 2004, with weekly UC benefit payments going to about 100,000 claimants.

The scale of UC benefits is often overlooked. Ohio's UC program provided more than \$4 billion in UC benefit payments overall during calendar years 2001, 2002, and 2003, half of which was above and beyond UC payroll tax contributions from employers over these years. This net spending provided a \$2 billion boost to the state's economy. Meanwhile, state UC tax rates remained around 0.5 percent of total wages, or 50 cents on every 100 dollars of Ohio payrolls during this period.

Despite the significant assistance to jobless workers and the economy provided by UC benefits, ill-advised limitations upon UC eligibility undermine the program's ability to achieve its goals. Ohio's unemployment compensation program has critical shortcomings, especially when it comes to its treatment of low-wage workers. Specifically, Ohio has one of the nation's strictest monetary eligibility requirements. Monetary eligibility is the amount of prior earnings required to establish UC eligibility. Ohio's monetary eligibility requirement, set at 27.5 percent of the state's average weekly wage, amounts to \$181 a week in 2004. This means that a minimum-wage worker working 35 hours weekly and averaging \$180.25 each week for the entire year would be ineligible for benefits if laid off.

Second, Ohio limits eligibility for part-time workers, who are predominantly low-wage and female workers. In order to restore the effectiveness of Ohio's UC safety net, these shortcomings should

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<sup>1</sup> Policy Matters Ohio previously reported on Ohio's unemployment compensation program. See Zach Schiller, *Unemployment Isn't Working: A Proposal to Better Insure Ohio's Workers* (September 2001). National Employment Law Project (NELP) has produced numerous reports on state unemployment compensation (or unemployment insurance) programs. Portions of its February 2004 briefing paper, "Unemployment Insurance in Iowa: Positive Impacts for Working Families and the Economy," have been adapted for this report. All NELP and Policy Matters Ohio publications, including those cited here, are available on their respective websites at [www.nelp.org](http://www.nelp.org) and [www.policymattersohio.org](http://www.policymattersohio.org).

be fixed by adopting policies more consistent with today's labor market and the realities facing working families.

In addition, this report notes that in coming years Ohio must ensure better financing of its UC program. By annually adjusting its UC financing mechanism to cover a higher amount of wages as taxable wages, Ohio can broaden its UC financing base and avoid facing steeper tax increases or pressure to restrict benefits during or soon after future economic downturns. And, by adjusting its financing system to allow for the build-up of bigger reserves during economic expansions, the state can reduce the impact of recessions on employer taxes and earn more in federal interest.

### **Part I:**

## **Expanding UC Eligibility in Ohio to Help Low-Wage Workers and Working Families**

*Summary: Unemployment compensation assists involuntarily unemployed workers by partially replacing their lost wages, using trust funds accumulated from payroll taxes to finance increased payments during downturns. As a result, UC boosts the economy and helps impacted communities. Ohio's UC program is more restrictive than any of its neighboring states (except Kentucky), with only about 36 out of 100 jobless workers getting benefits in 2003. As a result, Ohio's UC program does not do as good a job protecting jobless workers and the state's economy as in states with stronger UC programs.*

State unemployment compensation programs have twin goals; namely, to assist jobless workers and their families and to boost the economy by maintaining consumer spending when unemployment rises.<sup>2</sup> By accumulating UC trust funds built by employer payroll taxes (and federal interest), state UC programs can meet the demands of higher UC claims during economic downturns without immediately boosting taxes on employers. By adopting modest reforms and better tackling its UC financing picture before the next economic downturn, Ohio's UC safety net can be improved and more undesirable options such as tax increases and benefit cuts avoided or minimized during future economic downturns.

Restrictive UC eligibility rules or program administration undercut the effectiveness of UC programs in protecting jobless workers and affected communities from the worst aspects of higher unemployment by limiting the numbers of jobless workers receiving UC benefits. Some of those denied UC benefits must turn to governmental assistance programs, private charities, and local social services agencies. Others turn to their families or neighbors. Over time, there is no avoiding the costs of unemployment on families, communities, and Ohio's economy. The only question is whether or not the state's UC program assumes its assigned responsibility as "first responder" in cases of rising joblessness. To a significant degree, Ohio's UC program is not living up to this responsibility under current rules, especially with respect to low-wage workers. For this reason, the state's UC safety net needs improvement as we detail in this report.

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<sup>2</sup> Advisory Council on Unemployment Compensation, *Defining Federal and State Roles in Unemployment Compensation*, (U.S. Department of Labor, 1996), p. 230.

*Ohio's UC Reciprocity Falls Short*

One important measure of a UC program's performance is the proportion of jobless workers that receive UC benefits. This measure is called the "reciprocity rate." States with the best reciprocity rates (such as Wisconsin, Massachusetts and Pennsylvania) pay benefits to more than 5 out of 10 of their jobless workers, while other states (such as Louisiana, New Mexico, Texas and South Dakota) pay fewer than 3 in 10 jobless workers UC benefits.<sup>3</sup> The national reciprocity rate in the entire country during 2003 was 41 percent.

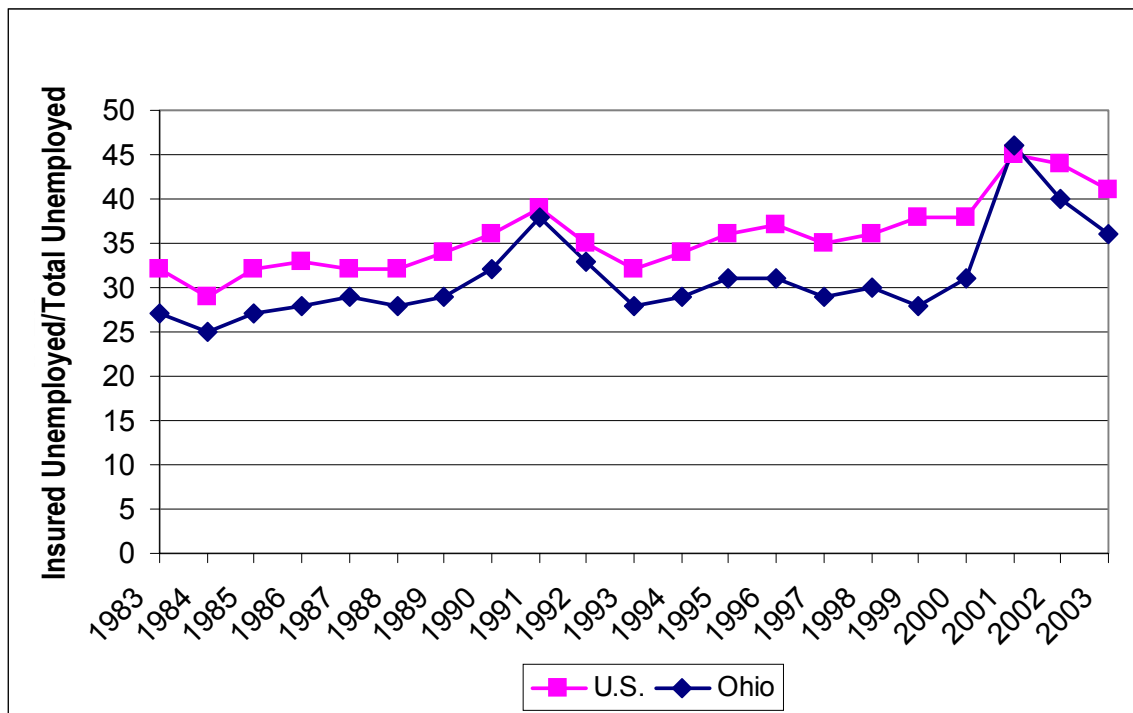
In contrast, for every 100 jobless individuals in Ohio, only around 36 received UC benefits in 2003. That is, there were 36 "insured unemployed" workers (those getting UC benefits or serving a waiting week) for every 100 "total unemployed" workers (those without work that actively sought a job). Ohio's performance in terms of benefit reciprocity rates ranked 33<sup>rd</sup> of 51 UC jurisdictions for the year.<sup>4</sup> Paying UC benefits to a lower proportion of jobless workers undercuts both the wage replacement and economic stimulus goals of Ohio's UC program. In addition to falling below the national average in 2003, Ohio's UC program has a lower reciprocity rate than all of Ohio's neighboring states, except Kentucky (reciprocity rate of 34 percent). Specifically, Pennsylvania's reciprocity rate for 2003 was 64 percent, while Michigan was at 42 percent, Indiana at 40 percent, and West Virginia at 40 percent.

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<sup>3</sup> For a broader overview of UC reciprocity see Wayne Vroman, *LOW BENEFIT RECIPIENCY IN STATE UNEMPLOYMENT INSURANCE PROGRAMS* (U.S. Department of Labor UI Occasional Paper No. 01-05, 2001).

<sup>4</sup> That includes the District of Columbia along with the 50 states. Data on reciprocity, updated from previous numbers, were made available to us by Jeff Chapman of the Economic Policy Institute, based on information from the U.S. Department of Labor, including its Local Area Unemployment Statistics. For most unemployment compensation purposes, District of Columbia, Puerto Rico, and Virgin Islands are treated as "states," resulting in 53 jurisdictions for comparison purposes. Most of the UC program statistics we use in this report are taken from two U.S. Department of Labor sources, the *UI Data Handbook No. 394* (information for 2001 and earlier years) and the *UI Data Summary* for years 2002 and 2003. Both are available online at <[www.workforcesecurity.doleta.gov/unemploy](http://www.workforcesecurity.doleta.gov/unemploy)> under "Program Statistics." In some cases, statistics provided by the Ohio Department of Job & Family Services on its website differ from USDOL data. For comparison and consistency, we use USDOL statistics in this report, unless otherwise noted.

**Figure A – Ohio and National Reciprocity**



Source: U.S. Department of Labor, Economic Policy Institute

Ohio's UC program not only currently pays UC benefits to a smaller proportion of its jobless workers than the national average, but it has done so for many years. As seen in the above figure, Ohio's UC reciprocity rate has been at or below national averages nearly every year since 1983.<sup>5</sup> While there are undoubtedly a variety of reasons for this Ohio's poor performance, there is little question that a state's statutory eligibility and disqualification provisions impact reciprocity of UC benefits. Bringing Ohio's UC reciprocity rate into line with those of better-performing state's UC programs involves expanding UC eligibility. In particular, this report advocates expanding eligibility for low-wage and part-time workers in Ohio.

### Strengthening Ohio's UC Safety Net

*Summary: Ohio has two restrictive eligibility provisions that reduce benefit reciprocity and undercut the income replacement and economic stimulus purposes of UC. Ohio's monetary eligibility requirement, among the nation's most severe,*

<sup>5</sup> Generally, Ohio's reciprocity rate moves closer to national averages during recessions. While reciprocity typically increases nationally during recessions, Ohio's even larger increases of reciprocity during recessions likely results from its above-average levels of manufacturing workers, many working in unionized workplaces. Studies have found that unionized workers and manufacturing workers have higher levels of reciprocity. Even given the typical increase in reciprocity during recessions, there are reasons to seriously question Ohio's 2001 reciprocity rate of 46 percent. First, during 2001, Ohio's reported rates of unemployment were publicly questioned by the Ohio Department of Job and Family Services. If reported unemployment rates were too low, this would boost reciprocity. Second, while there is some variability from year to year in state reciprocity rates, Ohio's 15 percentage point increase, followed by a return to more "normal" reciprocity levels in 2002 and 2003, leads us to suspect the 2001 rate.



*stands out in any review of the Ohio UC program. In addition, Ohio agency policy restricts the eligibility of part-time workers to receive UC benefits. Both these restrictions disproportionately impact low-wage workers and women and should be reexamined in light of today's economy and workforce.*

#### *Ohio's Restrictive Monetary Eligibility Standard*

Monetary eligibility is the measure of a jobless individual's prior labor market participation, usually expressed as an amount of earnings required prior to layoff. Gaining monetary eligibility is a threshold requirement in getting UC benefits. Ohio has one of the strictest monetary eligibility rules in the country. A 2001 national study identified Ohio as one of only 8 states that deny UC benefits to minimum-wage workers working at least 20 hours a week.<sup>6</sup> Ohio's monetary eligibility rule sets its requirement at 27.5 percent of Ohio's average weekly wage for at least 20 weeks of work.<sup>7</sup> This converts to at least \$3620 of earnings for calendar year 2004, requiring wages averaging at least \$181 a week to obtain eligibility. Only North Carolina, at \$3,749, has a higher minimum earnings requirement.<sup>8</sup>

Under Ohio's formula, low-wage workers must work many more hours a week to qualify for benefits than higher-wage workers. The practical effect of Ohio's monetary eligibility rules in 2004 is to bar UC benefits to any minimum-wage worker employed on a full-year basis for 35 hours a week or less (\$5.15/hour times 35 hours equals a wage of \$180.25). Similarly, an individual making \$7.00 an hour would not gain eligibility if averaging 25 hours or less of work per week, since he or she never reaches the weekly \$181 hurdle. In contrast, a worker earning \$25 an hour could become eligible for UC benefits in Ohio with employment of only 7.5 hours in each of 20 weeks. In other words, in Ohio a minimum-wage worker employed for up to 1820 hours a year is not monetarily eligible, while a \$25 an hour worker employed for only 150 hours is eligible for UC benefits.

Ohio's monetary eligibility standard fails to take into account that many jobs today offer fewer than 40 hours of work each week. As a result, many occupations and industries employing lower-wage employees provide insufficient hours of work to satisfy Ohio's monetary eligibility standard. In 2002, an average Ohio worker in the field of retail trade averaged 29.4 hours of work per week, while those in health care and social assistance worked only 31.4 hours a week.<sup>9</sup> Under either of these schedules, lower-wage workers would not meet Ohio's monetary eligibility requirement.

States use a variety of monetary eligibility rules that offer examples of potential alternatives to Ohio's harsh monetary eligibility standard. In order to eliminate discrimination against low-wage

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<sup>6</sup> Maurice Emsellem, et al., *Failing the Unemployed: A State by State Examination of Unemployment Compensation Systems* (Economic Policy Institute, Center on Budget and Policy Priorities, National Employment Law Project: March 2001), Table 3.

<sup>7</sup> Ohio Revised Code Sec. 4141.01(R)(1).

<sup>8</sup> Washington state does not demand minimum earnings, but requires claimants to have worked 680 hours, which amounts to more than the Ohio requirement at the state minimum wage. See U.S. Department of Labor, Office of Workforce Security, "Comparison of State Unemployment Compensation Laws" (January 2004), corrected for an error regarding the Ohio earnings requirement.

<sup>9</sup> Ohio Department of Job and Family Services, Bureau of Labor Market Information, *Average Weekly Hours of Production of Nonsupervisory Workers, 2002*. Estimated in cooperation with the U.S. Bureau of Labor Statistics.

## Unemployment Compensation in Ohio

workers, the best existing practice among states for measuring monetary eligibility is to use hours of work, rather than a specific earnings amount. Three states (New Jersey, Oregon, and Washington) use hours of work as one basis for establishing monetary eligibility. All other states use an earnings threshold as a monetary eligibility standard. Most other states that employ a monetary measure for basic UC eligibility have levels below, and in some cases, far below Ohio's \$3620 requirement.

Rather than disqualifying any claimant who has weekly wages averaging less than a threshold (as in Ohio), most states employing an earnings standard instead require that jobless workers have a set amount of earnings in their 52-week base period, with a variety of distributional requirements added.<sup>10</sup> States using these sorts of eligibility standards either require 1.5 times the amount earned in the quarter during the past year in which they earned the most, or 30 or 40 times the weekly benefit amount.<sup>11</sup> According to the U.S. Department of Labor, 42 states use high-quarter earnings or a multiple of weekly benefit amounts to assess monetary eligibility. These different formulas equate to roughly the same work requirement. What makes Ohio's different is the high wage threshold that workers must meet.

Most of the remaining states use a flat amount of base period earnings to assess monetary eligibility. As particular examples of these sorts of monetary eligibility rules, Illinois requires \$1600 in base period wages, with at least \$440 outside the quarter of highest earnings. West Virginia requires \$2200 in base period earnings and wages in at least two quarters. In comparison, Ohio requires a minimum of \$3620 (20 weeks at \$181 a week). However, because Ohio combines the 20 weeks of work approach with a minimum amount of average weekly earnings over all the weeks worked, workers may actually earn enough to qualify for UC and then lose eligibility because they work additional weeks for pay below the \$181-a-week level.

### *Impact of Ohio's Monetary Eligibility Rules*

In order to better evaluate the impact of Ohio's monetary eligibility for this report, we have examined data that permits us to assess its impact on Ohio workers.

In studying Ohio's monetary eligibility, we analyzed data from the Census Bureau's Current Population Survey monthly and annual work experience survey files to see which workers were excluded from unemployment compensation coverage. (This is the same data used to calculate the state's unemployment and poverty rates.<sup>12</sup>) This data can be used to divide workers in Ohio into groups defined by earnings and weeks of work. The results are displayed in Table A. Table A shows that 83.3 percent of Ohio's workers have more than 20 weeks of work with earnings over

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<sup>10</sup> Comparative information in this section is from U.S. Department of Labor, Office of Workforce Security, "Comparison of State Unemployment Compensation Laws" (January 2004).

<sup>11</sup> Both of these more common types of monetary eligibility requirements using earnings effectively translate into wages representing between 20 and 30 weeks of work. That is, one quarter of wages (13 weeks) times 1.5 equals at least 20 weeks of wages; and, since weekly benefit amounts equal around half of pre-layoff wages, a requirement of 40 times the weekly benefit amount is equivalent to 20 weeks of work.

<sup>12</sup> Current Population Survey Monthly Outgoing Rotation Group files compiled for all 12 months of 2003 and 2002 and the Current Population Survey Annual March Supplement conducted in March 2003, producing data for 2002. This is the most recent available data.

\$181 a week. However, 16.7 percent of Ohio’s workers fall below the state’s monetary eligibility threshold.

**Table A - UC Monetary Eligibility of Ohio's Workforce, 2002**

Earnings and Weeks of Work	Current Eligibility	Number	Percent
Earned less than \$100/week or worked less than 20 weeks per year	Ineligible	508,117	9.9%
<b>20 weeks or more, averaging \$100-\$181</b>	<b>Ineligible</b>	<b>352,302</b>	<b>6.8%</b>
20 weeks averaging \$181 or more	Eligible	4,298,037	83.3%
Total		5,158,456	100.0%

Table A shows that extending unemployment compensation eligibility to those below the current threshold but working 20-35 hours per week and 20 weeks per year at the minimum wage or more (roughly \$100/week) would expand potential UC eligibility by an additional 6.8 percent of the total Ohio workforce, or 352,000 individuals. Under the rules of most states these 352,000 Ohio workers with 20 weeks of work would have the security that UC eligibility provides. Lowering the current eligibility from \$181 a week to \$100 per week (roughly 20 times the minimum wage) would cover slightly less than half of those currently excluded from UC eligibility. The remaining 9.9 percent of Ohio’s workers have less than 20 weeks of prior employment, or earn less than \$100/week.

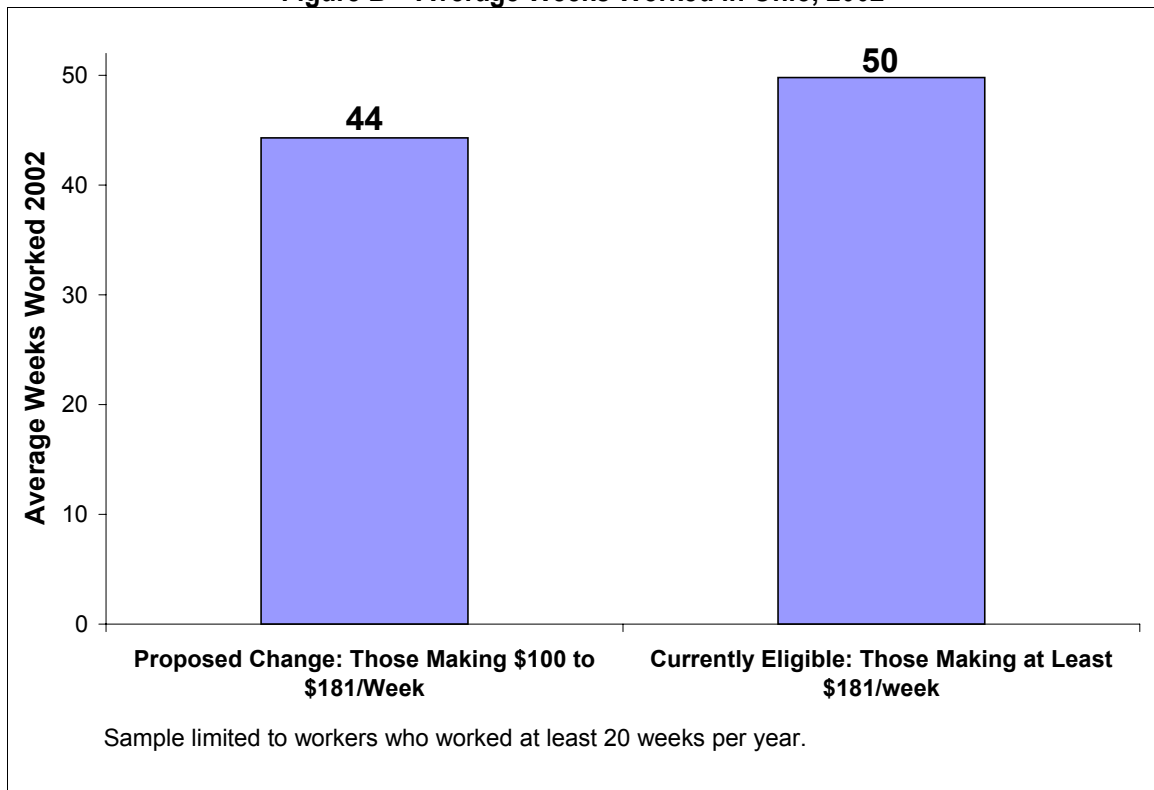
*Missing the Mark: Ineligibility for Jobless Individuals with Significant Work Histories*

Monetary eligibility standards should distinguish between those with sufficient prior work to justify eligibility for UC benefits and those with insufficient labor market participation. Figure B (on the next page) demonstrates that Ohio’s excluded group of workers with at least 20 weeks of work demonstrates strong labor force attachment—averaging 44 weeks of work per year.<sup>13</sup> This is on par with the labor force attachment of currently eligible higher-wage workers, who worked an average 50 weeks per year. In our view, averaging 44 weeks of work a year shows significant labor market participation and should meet any reasonable test of monetary eligibility.

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<sup>13</sup> Sample for Figure B limited to workers who worked at least 20 weeks per year. Source: Current Population Survey, March Supplement.

**Figure B – Average Weeks Worked in Ohio, 2002**



Source: Current Population Survey, March Supplement, 2002

*Demographic Analysis: Adverse Impact on Women*

Data in Table B (see next page) give demographic information about workers who are unable to qualify under current Ohio rules but would do so if earnings requirements were reduced. The strongest observation is that women would benefit most from reforming monetary eligibility—67 percent of the affected group of currently ineligible workers is women. In comparison, 46.4 percent of workers qualifying under current rules are female while 53.6 percent are male. And while those with low weekly wages are disproportionately younger, a majority of these low-wage workers in the excluded group with more than 20 weeks of work are over the age of 25. Clearly, many in the excluded group have considerable work experience and deserve UC eligibility to support their families in times of involuntary joblessness.

**Table B - Characteristics of Workers Earning \$100-\$181 Per Week, 2002-2003**

Demographic Characteristic	Earning \$100-181/Week		Earning More than \$181/Week	
	Number	Percent	Number	Percent
<b>Gender</b>				
Men	118,885	32.6%	2,416,270	53.6%
Women	245,395	67.4%	2,095,294	46.4%
<b>Age</b>				
Age 16-19	98,522	27.0%	103,106	2.3%
Age 20-24	77,393	21.2%	417,324	9.3%
Age 25+	188,365	51.7%	3,991,134	88.5%
<b>Hours Worked</b>				
Less than 20	118,169	32.4%	66,153	1.5%
20-39	226,941	62.3%	842,268	18.7%
40+	--	--	3,602,707	79.9%
<b>Race</b>				
White	300,581	82.5%	3,803,681	84.3%
Black	45,250	12.4%	472,255	10.5%
Other	--	--	235,627	5.2%
<b>Selected Industries*</b>				
Retail or Wholesale Trade	97,511	27.0%	644,115	14.3%
Leisure & Hospitality	100,127	27.8%	296,079	6.6%
Manufacturing	--	--	905,642	20.1%
Education and Health Services	71,650	19.9%	997,106	22.2%

-- Minimal. Sample size too small to make accurate estimates.

Source: Annual averages, Current Population Survey, Outgoing Rotation Group Files. Totals for demographic categories may not add up to Table A totals because this table is based on two years of data to produce accurate demographic breakdowns.

\* Industry data for 2003 only because of switch in classification systems.

As further evidence of their work effort and connection to the labor force, most (62 percent) of these workers work more than 20 hours per week (Table B). They are employed mostly in more insecure retail/wholesale trade and leisure/hospitality jobs and more vulnerable to unemployment.<sup>14</sup> With pressing childcare responsibilities and welfare program limits, low-wage women in particular need income support when they become involuntarily unemployed. In addition, UC eligibility would provide an incentive for companies employing these ineligible workers to avoid experience rating increases in their UC taxes by retaining them in employment whenever possible.<sup>15</sup>

<sup>14</sup> The Bureau of Labor Statistics' "Job Openings and Labor Turnover" survey shows nationally that retail trade and leisure/hospitality jobs had an average monthly separation rate of 5.9 and 4.1 percent, compared to the national average turnover of 3.3 percent.

<sup>15</sup> Employer taxes are based in part on how much a company's laid-off employees have received in benefits. See page 19.

## Unemployment Compensation in Ohio

*Recommendation: Ohio should adopt a monetary eligibility standard that permits individuals working at least 20 hours a week for at least 20 weeks a year to get UC benefits. These individuals are eligible for UC in most states and have sufficient work history to justify basic eligibility for benefits.*

### *Costs of Expanding UC Monetary Eligibility Are Modest*

The costs of expanding UC monetary eligibility to include those working at least 20 weeks at \$100 a week are modest. The Ohio Department of Job and Family Services recently examined the impact of expanding UC eligibility to include workers who received wages in at least two quarters during a year and earned a total of at least 400 times the federal minimum wage (the equivalent of working 20 hours a week for 20 weeks).<sup>16</sup> This proposed expanded measure amounts to a monetary eligibility rule requiring an average of \$103 a week, as opposed to the current system that requires \$181 a week. Based on a sample of Ohio claimants from 2001, ODJFS estimated that an additional 4,865 claimants would qualify who do not under the current rule. Their UC benefits would amount to between \$4 million and \$6 million a year, depending on how many weeks of benefits claimants received. Compared to the more than \$1.2 billion in benefits paid in Ohio during 2001, the expansion amounts to an increase of less than half of one percent in annual benefit costs.

During the last few years, members of the Unemployment Compensation Advisory Council, the official body responsible for recommending changes in Ohio's UC law, have discussed how to address monetary eligibility. However, this has not yet resulted in an agreement.

### *Eligibility for Part-time Workers*

A second restrictive eligibility rule applied to Ohio's UC program concerns jobless part-time workers. In the past, many states treated those looking only for part-time work as not seriously connected with the workforce, adopting eligibility rules requiring workers to seek full-time work in order to get UC benefits.

Ohio's treatment of part-time workers is characterized by ambiguity. Ohio's UC statute is silent on the question of part-time work, requiring only that a claimant be able and available for work.<sup>17</sup> Agency practice results in the denial of benefits to most claimants who state that they are limiting their availability to part-time work, even where these individuals previously worked part-time. As a result of appeals, several courts have ruled that part-time workers who remain available for significant numbers of part-time jobs are eligible in Ohio.<sup>18</sup> While such decisions have allowed part-

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<sup>16</sup> Douglas J. Holmes, Memorandum to Unemployment Compensation Advisory Council Legislative Subcommittee on benefit eligibility formula options, Oct. 1, 2003 (in possession of authors).

<sup>17</sup> Ohio Rev. Code §4141.29(4)(A).

<sup>18</sup> Appeals filed in Ohio courts have found that some claimants met the able-and-available requirement where they were employed part-time during their base period due to a medical condition of themselves or a family member or other reason and where they continued to look for similar part-time work (Karl N. Kahn v. Administrator, OBES, No. 99CV2 (Common Pleas Trumbull County, Jan. 26, 2001) and Robin A. Gilbert vs. Director, ODJFS, No C-030902 (Court of Appeals Hamilton County, September 3, 2004) ). Other cases have found claimants qualified for unemployment where they limit their availability to certain shifts due to medical conditions or to care for a child (Johnson v. Unemp. Comp. Review Comm., 110 Ohio Misc.2d 18

time workers to qualify in some individual cases, clearer rules regarding part-time eligibility would be more in step with today's labor market and provide additional protection to jobless part-time workers in Ohio.

Part-time work is a significant part of our modern economy. Ohio had 1.1 million part-time workers in 2002.<sup>19</sup> For many employers and workers, part-time work is a necessity and in many occupations part-time work is prevalent. The wages of part-time workers are subject to UC payroll and other employment taxes, on the same basis as the wages of full-time employees.<sup>20</sup>

The ineligibility of part-time workers for UC benefits is particularly harmful to low-wage employees. This is because low-wage workers are disproportionately part-time workers. In addition, many of these low-wage part-time workers are women (69.7 percent of Ohio part-timers are female), and, as a result, holding part-time workers ineligible for UC falls particularly hard on female workers.

The original exclusion of part-time workers from UC was based on what are now outdated assumptions that because such workers were mostly female they were not really supporting families. These assumptions were consistent with the "male breadwinner" model that underlies the early days of UC programs, but which are not relevant today, when close to 60 percent of women work outside the home.<sup>21</sup> It has been recognized by authorities in the field for 40 years that rather than presuming that part-time workers are insufficiently attached to the labor market to warrant UC eligibility, it is better policy to simply apply the ordinary UC eligibility rules to all jobless workers.<sup>22</sup>

In fact, there is a growing trend of states reexamining their rules for part-time UC eligibility. Between 2001 and 2003, six states expanded UC eligibility for part-time workers (California, Maine, Minnesota, New Jersey, New Mexico, and North Carolina). As a result, 24 states now have significantly expanded eligibility for part-time jobless workers and no longer flatly require availability for full-time work. Nine states (California, Delaware, Kansas, Nebraska, New Mexico, Pennsylvania, South Dakota, Vermont, and Wyoming) treat part-time workers with essential parity with full-time workers, looking at each claimant on an individual basis to determine his or her availability. Another thirteen states permit payment of benefits when the jobless claimant has worked a substantial amount of part-time work prior to his or her claim (Arkansas, Colorado, Florida, Hawaii, Iowa, Louisiana, Maine, Minnesota, New Jersey, New York, North Carolina, Oklahoma, and Puerto Rico). Finally, two states (District of Columbia and Rhode Island) permit

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(Common Pleas Medina 2000) and Hawkins v. Steinbacher, No. A-8605027 (Common Pleas Hamilton, October 6, 1987)).

<sup>19</sup> U.S. Department of Labor, Bureau of Labor Statistics, "Geographic Profile of Employment and Unemployment, 2002," Table 13, provides the number and gender of part-time workers in Ohio.

<sup>20</sup> The first \$9,000 of an employee's wages are taxable, regardless of whether he or she works part-time or full-time. See page 19.

<sup>21</sup> Rebecca Smith, et al., *Between a Rock and a Hard Place: Confronting the Failure of State Unemployment Insurance Systems to Serve Women and Working Families* (National Employment Law Project, March 2003) and U.S. Census Bureau, *Statistical Abstract of the United States: 2003*, Table 589, Employment Status of the Civilian Population, 1970 to 2002.

<sup>22</sup> William Haber and Merrill G. Murray, UNEMPLOYMENT INSURANCE IN THE AMERICAN ECONOMY (Richard D. Irwin, 1966), p. 267-268, 271-276.

claimants with good cause to restrict their availability to part-time work as another means of providing UC eligibility to part-time workers.<sup>23</sup>

*Recommendation: Current policies deny benefits to some part-time workers solely because they are available for part-time work regardless of their circumstances. Ohio should clarify its policy regarding part-time workers, applying availability rules on a case-by-case basis and permitting those with substantial part-time work history in their base periods to draw UC benefits so long as reasonable numbers of part-time jobs exist in the labor market.*

Given the ambiguity of Ohio's part-time eligibility situation, it is difficult to know the number of part-time workers that currently run afoul of eligibility rules. For this reason, estimating the costs of our recommendation accurately is not possible without further data. Obviously, expanding part-time eligibility will impact Ohio's UC program, but because part-time workers have lower-than-average earnings they will draw lower weekly benefits. In addition, a comparison of those states that treat part-time workers most favorably with those in the more restrictive majority doesn't support claims of excessive costs by opponents of broadening part-time eligibility for UC benefits. The two dozen states that provide broader eligibility for part-timers include both high- and low-tax states, as well as more solvent and less solvent ones.<sup>24</sup> More refined estimates of costs can be developed as part of a review of Ohio's restrictive part-time eligibility policy.

Ohio should join the growing ranks of states protecting part-time jobless workers by expanding UC eligibility to include part-time workers who remain available for and seek part-time work while demonstrating adequate attachment to the labor market. Expanding UC eligibility for part-time workers involves doing no more than asserting that the usual rules of availability be applied on an individual basis to part-time workers, rather than subjecting part-time workers to ineligibility. In short, these workers would have to show that they are available for a significant number of jobs in their local labor market and that they are actively seeking such work. This commonly utilized UC eligibility standard properly applies to part-time and full-time jobless individuals alike. A policy assuming that part-time workers are not available for work cannot be justified in light of today's labor market and the role of part-time work in maintaining family income.

## **Part II: How Unemployment Compensation Helps Working Families and Ohio's Economy**

*Summary: Ohio experienced much higher unemployment beginning in 2001 and jobs are still well below pre-recession levels. As a result, UC benefit payment levels doubled between 2000 and 2002 and remain high. These payments provided more than a \$2 billion boost to the state's economy between 2001 and*

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<sup>23</sup> National Employment Law Project, Fact Sheet: "Part-time Workers and Unemployment Insurance," (Revised March 2004).

<sup>24</sup> Rebecca Smith, et al., *Between a Rock and a Hard Place: Confronting the Failure of State Unemployment Insurance Systems to Serve Women and Working Families*.



*2003. Over time, Ohio could strengthen the UC program's role in protecting jobless workers and its economy by improving its UC benefit levels.*

Ohio has experienced a prolonged job slump following the 2001 recession. Ohio's non-farm employment in August 2004 remained nearly 225,000 below its level at the beginning of the recession in March 2001. As a result of higher unemployment, the number of UC claims climbed dramatically and has not fallen back to previous levels at this point. UC benefit payments totaled \$719 million in 2000, but rose to \$1.213 billion in 2001, \$1.443 billion in 2002, and remained at \$1.401 billion last year. Unemployment remains well above pre-recession levels and manufacturing jobs have yet to show any sustained rebound.

Long-term unemployment has been a major problem in the current job slump. Last year, 125,000 Ohioans exhausted the maximum state UC benefits allowed by law, which range from 20 to 26 weeks, depending upon prior work. That was nearly as many as the 130,000 who exhausted such benefits in 2002, the highest level in 20 years. And the problem continued into this year: More than 39,000 Ohioans exhausted their state benefits in the first four months of 2004, a few hundred more than in the same period a year earlier. Jobs remain scarce and some workers in Ohio are facing long-term spells of unemployment.

Given the extent of unemployment, maintaining Ohio's UC safety net is especially important in the coming years.

#### *UC Benefits Stimulate Ohio's Economy*

The economic benefits of unemployment compensation programs are widely acknowledged by economists, but not understood or discussed enough by the business community or general public. For this reason, UC programs are too often discussed in legislatures or in the media solely as a "cost" to business. This one-sided "business climate" approach is like analyzing a stock's value by only looking at corporate expenses and not considering income. In this section of the report, we discuss the positive contribution of Ohio's UC program to the state's economy and its overall welfare.

Despite its already-noted shortcomings in low-wage and part-time reciprocity, Ohio's UC program boosted the state's economy considerably in recent years. For calendar years 2001, 2002 and continuing through 2003, UC benefits pumped well over \$2 billion into the state's economy. During this period, \$4.057 billion in regular state UC benefits were provided to jobless Ohioans. Over that same time, Ohio's employers paid \$1.938 billion in state UC taxes. This means that, even deducting UC taxes, Ohio's UC program provided \$2.119 billion in net economic stimulus to its economy. An additional \$725 million in federally financed temporary extended (TEUC) benefits helped keep the long-term unemployed attached to the workforce and out of poverty in Ohio.<sup>25</sup>

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<sup>25</sup> Of the 125,000 Ohioans exhausting UC benefits last year alone, 110,000 drew federally funded extended unemployment benefits, receiving \$356 million in Temporary Emergency Unemployment Compensation benefits. As it typically has done in periods of high unemployment, Congress approved these additional benefits beginning in March 2002, allowing workers who exhausted their state benefits to receive up to 13 weeks of federal benefit extensions. Despite the high level of long-term joblessness, the federal government let the extension program expire in December 2003, preventing those exhausting benefits after that time from receiving extensions.

## Unemployment Compensation in Ohio

Overall, more than \$4.7 billion in UC benefits were spent with Ohio businesses, assisting communities hit by layoffs and increased unemployment, and reducing the adverse impact on the business community. The Ohio economy is performing better today than it would be otherwise because of the positive impact of its UC program.

Economists in general agree that UC programs help the economy. A study of UC's economic impact, commissioned by the U.S. Department of Labor in 1999, found that UC benefits produced \$2.15 of increased economic activity (Gross Domestic Product) for every \$1.00 in UC benefits paid to jobless workers. Focusing on the last five recessions in the United States, the report's authors estimated that these recessions were 15 percent milder and had fewer layoffs than otherwise would have occurred if not for UC's contribution toward consumer spending. The report employed a widely used Wharton economic forecasting model for the national economy.<sup>26</sup>

While public officials are particularly sensitive to UC taxes, the benefits of having adequate UC benefits and fair eligibility provisions deserve equal consideration. Certainly, the willingness of individuals that work for a living to accept the risks of unemployment that are increasingly part of a global economy is based in some measure on the knowledge that the entire burden of joblessness won't fall upon their families alone. As noted by Yale law professors Michael Graetz and Jerry Mashaw in their book *True Security*, social insurance protections are "crucial to a society's ability to structure economic risks in ways that are energizing rather than demoralizing," and they "sustain and bolster a market economy."<sup>27</sup> When considered in this broader perspective, maintaining and improving a decent and humane UC program is worthwhile public policy for Ohio.

### *Adequate Benefits for Jobless Workers: A Key Component of Economic Security*

Adequate weekly benefits promote the income replacement and economic stimulation goals of UC, while inadequate UC benefit levels undercut the ability of Ohio's program to fully fulfill these goals. Ohio's UC benefit amounts provide average, and certainly not excessive, income support to its jobless workers. Generally, a replacement rate of pre-layoff wages by UC benefits in the range of 50 percent is recommended, up to a maximum weekly rate set by law. Ohio's program pays a weekly benefit that is one half of the claimant's average weekly wage, up to a maximum weekly benefit. In 2004, maximum benefits range between \$323 and \$436, depending upon the number of dependents.

A significant positive feature of Ohio's UC program is that maximum weekly UC benefits are indexed to growth in statewide wages. Thirty-three other states index their maximum weekly benefits along with Ohio, and these states have a much better track record in paying adequate benefit levels than states that rely upon their legislatures to update weekly benefit levels. The indexing of maximum weekly benefits is a positive feature in Ohio's UC program, and helps ensure that weekly benefits keep in step with growth in wages. Another positive feature of Ohio's program

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<sup>26</sup> Lawrence Chimerine, et al., *Unemployment Compensation as an Economic Stabilizer: Evidence of Effectiveness Over Three Decades*, U.S. Department of Labor, Unemployment Insurance Occasional Paper 99-8, 1999. The degree of economic stimulation from UC benefits estimated by economists has varied from study to study.

<sup>27</sup> Michael J. Graetz and Jerry L. Mashaw, *True Security: Rethinking American Social Insurance* (Yale, 1999), p. 150.

is that it permits earnings from the most recently ended quarter to be included in the determination of eligibility if an applicant does not qualify on the basis of the previous four quarters. Ohio is one of at least 17 states that offer this “alternative base period,” which allows claimants to qualify who may only recently have gotten jobs or are unable to work all the time.

Preventing economic hardship among the jobless remains a bedrock principle underlying UC programs. Recently the Congressional Budget Office found that, “When [unemployment insurance] recipients lost their job, their income – excluding UI benefits – dropped by almost 60 percent. With UI benefits included, the income loss was about 40 percent.”<sup>28</sup> During the early 1990s recession, extended UC benefits prevented tens of thousands of workers from going into poverty, according to another study.<sup>29</sup> It concluded that without regular and extended UC benefits, over 70 percent of UC recipients would have fallen into poverty, compared to the 40 percent who experienced poverty after exhausting their regular UC benefits. Maintaining adequate benefit levels ensures that jobless workers can continue essential household spending and not suffer a permanent reduction of living standards as a result of job loss.

Average regular benefit levels for unemployment insurance recipients in Ohio are in the middle of the pack nationally. However, as recently as 2000, regular UC benefit levels in Ohio were somewhat above average compared to other states. They have lost ground since then, partly because of lower wage growth in Ohio but also because of benefit improvements in other states. Last year, the average Ohio weekly benefit of \$252 ranked 27<sup>th</sup> among states, almost \$10 below the U.S. average.

One key measure of the adequacy of UC benefit amounts is the replacement rate, commonly defined as the average weekly benefit as a percentage of average wages in the state. Generally, a replacement rate in the range of 50 percent was recommended by the Advisory Council on Unemployment Compensation, a body established by federal law in 1991 to examine unemployment compensation programs and recommend changes.<sup>30</sup> Ohio’s replacement rate of 38.4 percent in the first quarter of 2004 ranked 29<sup>th</sup>, slightly above the U.S. average of 37.4 percent.<sup>31</sup> However, that gap has narrowed in recent years, and Ohio replaces a lower share of average wages than any of its neighboring states. Pennsylvania paid average weekly UC benefits

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<sup>28</sup> U.S. Congress, Congressional Budget Office, *Family Income of Unemployment Compensation Recipients* (March 2004), p. 2.

<sup>29</sup> Walter Corson, et al., “Emergency Unemployment Compensation: The 1990s Experience,” Mathematica Policy Research Paper (U.S. Department of Labor, Unemployment Compensation Occasional Paper 99-4)(1999).

<sup>30</sup> Advisory Council on Unemployment Compensation, 1995.

<sup>31</sup> The U.S. Department of Labor also reviews a sample of claims from each state to arrive at another measure of benefit adequacy, a comparison of benefits with the pre-layoff wages of UC recipients. By this measure, Ohio fares much more poorly than under the traditional replacement rate measure, ranking in the bottom 10 of all states. This may result from the comparatively high wages received by unemployed manufacturing workers, whose UC benefits accounted for more than a quarter of all those paid in the state in 2003. E-mails from Scott Gibbons, U.S. Department of Labor, March 22 & 23, 2004, and Ohio Department of Job & Family Services, Office of Workforce Development, Bureau of Labor Market Information, *First Payments, Weeks Compensated and Benefits Paid, by Industrial Group under Regular Ohio Unemployment Compensation Law, Year 2003*. Form RS217.

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of \$292 last year, \$40 more than in Ohio, mostly because it replaces a greater share of average wages than Ohio does.

Ohio's regular UC program, like many others, pays half of a worker's previous weekly wages, up to a maximum. A unique feature of Ohio's program results in higher benefit levels for jobless individuals with dependents, but only if they made enough money while they were employed. The 2004 maximum weekly UC benefits for a claimant with no dependents is \$323, while claimants with 1 to 2 dependents get \$392 in maximum unemployment benefits each week. Jobless individuals with 3 or more dependents have a maximum weekly benefit of \$436 for 2004. Claimants with earnings below \$646 a week, or nearly the average wage in Ohio, get no dependency allowances, so their maximum benefit is \$323 per week. Of the 11 states using dependency allowances, only Ohio limits their use to augmenting maximum benefit levels, as opposed to providing added support to all families with jobless breadwinners.

*Recommendation: Ohio, like other states, should look to ensure over time that its UC benefit levels come closer to replacing the average wage. Currently, only workers with earnings of more than \$646 a week, or nearly the average wage in the state, receive additional benefits if they have dependents. Ohio should modify its dependency allowances to increase UC benefit payments to all jobless breadwinners.*

There is no valid basis for assuming that lower-wage workers with dependents are less deserving of dependency allowances. Making dependency allowances apply to all claimants, not just higher-earning workers, would erase this inequity and improve wage replacement levels in Ohio.

### **Part III Financing Ohio's UC Program**

*Summary: Ohio's UC program is paid for by employer payroll tax contributions. Tax rates are set based upon past claims and contributions by each employer (experience-rating) and the balance in the state's UC trust fund. In order to improve its UC financing mechanism and increase use of federal interest to pay for state UC benefits, Ohio should reemphasize forward funding of its trust fund. In addition, Ohio should raise and index its taxable wage base to broaden the financial base of its UC program.*

#### **Forward Funding of UC Trust Funds**

One of the main goals of unemployment compensation is to accumulate payroll tax revenues in a trust fund during the growth phase of an economic cycle and to automatically stimulate the economy by using those funds to pay increased benefit claims during economic downturns. This philosophy of UC financing is termed "forward financing" (or sometimes advance financing). Wayne Vroman, the nation's leading authority on UC financing, summarizes the overall economic theory underlying forward funding of UC programs:

Trust fund balances are built up before recessions, drawn on during recessions, and then rebuilt during the subsequent recoveries. The funding arrangement implies that the program acts as an automatic stabilizer of economic activity, that it makes larger benefit payments than tax withdrawals during recessions and larger tax withdrawals than benefit payments during economic expansions.<sup>32</sup>

At the outset, several frequently unacknowledged facts about UC financing deserve mention. State unemployment compensation programs are essentially self-financing, in the sense that UC benefits are financed through employer UC payroll taxes. These tax contributions are held in a trust fund that is legally dedicated solely to payment of benefits. In the long run, UC taxes must cover UC benefits. While a state's UC financing mechanism can impact the timing of UC taxes and the distribution of UC taxes among employers, ultimately UC costs will be paid. As a result, keeping UC taxes low throughout an economic cycle is not a viable policy. Taxes must rise and fall over an economic cycle just as benefits do.

The extent and duration of tax increases following an economic downturn are determined by the state's pre-recession trust fund balance and its UC experience-rating mechanism. In this report we show that because Ohio's UC financing mechanism favors lower taxes over building reserves in good times, Ohio must rely upon higher UC taxes soon after a recession to rebuild its trust fund. In contrast, states placing greater reliance upon forward funding collect somewhat higher UC taxes during the recovery phase of an economic cycle and then use higher trust fund reserves and bigger federal interest payments as a cushion during and after downturns.

#### *ABC's of UC Financing in Ohio*

State trust funds are retained as an account in the U.S. Treasury, which pays federal interest on state UC reserves. When reserve levels are higher, federal interest can make a substantial contribution to state trust funds. For example, Ohio's trust fund received from \$96 to \$144 million in federal interest payments for each year between 1995 and 2001. Obviously, states with bigger trust funds can collect more federal interest, and, as a result, pay a higher proportion of UC benefits with federal interest.

Ohio's current "taxable wage base" (the amount of wages subject to tax) is \$9000. Once an employer has paid wages on the first \$9000 of wages each employee earns in a calendar year, that employee's wages with that employer are no longer subject to UC taxes.

In simplified terms, the state UC tax rate is a combination of three components. What is termed the "experience rate" component is the most commonly discussed portion of UC tax rates. The second component of tax rates under Ohio's UC financing mechanism is called the "mutualized" rate. The third component is related to the solvency of the trust fund as determined by Ohio's "minimum safe level" definition.<sup>33</sup> All three components determine the overall UC tax rate imposed on Ohio's

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<sup>32</sup> Wayne Vroman, *Topics in Unemployment Insurance Financing*, (Upjohn Institute, Kalamazoo, Michigan, 1998) p. 10.

<sup>33</sup> Employers pay a separate federal payroll tax (Federal Unemployment Tax Act, or FUTA) that funds the administration of state UC agencies as well as federal UC functions, including federal extensions and the federal loan fund. The federal FUTA tax is imposed on a tax base of the first \$7000 in wages, and is

## Unemployment Compensation in Ohio

\$9000 taxable wage base in a calendar year. In 2004, the minimum UC tax rate is 0.2 percent and the maximum is 7.5 percent of taxable wages, or from \$18 to \$675 per employee.<sup>34</sup> Since 1990, the lowest UC tax rate has been zero, while the highest has been 8.6 percent of taxable wages.<sup>35</sup>

One component of the overall UC tax rate is based upon the prior claims experience of employers compared to their past contributions. This relationship between past claims and tax rates is called “experience rating,” meaning that firms’ tax rates depend upon the volume of claims for benefits paid to former employees of each firm.<sup>36</sup> Currently, Ohio’s experience rating mechanism distinguishes between “positive” and “negative” balance employers. An employer with a trust fund account that has more UC tax contributions in its account than benefit payments to its former employees has a positive balance. In contrast, an employer that has had more benefits paid to employees than it has paid into its trust fund account is said to have a negative balance.

Ohio law contains a range of tax rates that are triggered by firms’ account balances and make up the experience rate portion of the overall tax rate.<sup>37</sup> A negative-balance employer pays a maximum experience rate component ranging from 6.5 percent to 4.8 percent under the statutory tax schedule. Firms with positive account balances pay tax rates ranging from 4.7 percent to 0.1 percent, depending on the degree to which their accounts reflect contributions exceeding benefits over the years. In addition, additional tax components of mutualized rates and any surcharges related to the fund’s solvency add to these basic rates set by each firm’s individual experience rate.

Mutualized rates are the second component of state UC taxes. Not all UC benefits can be charged effectively to a specific employer’s account. Benefits that are legally not chargeable to a specific firm’s trust fund account are charged to Ohio’s mutualized account.<sup>38</sup> Charges to the mutualized account are balanced against credits, including taxes that are derived from any mutualized rate and federal trust fund interest. If the mutualized account is negative on June 30, an additional tax ranging from 0.1 percent to 0.5 percent is imposed as the mutualized rate during the next calendar

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currently set at 0.8 percent, or a maximum of \$56 for every employee in covered employment. FUTA funds are also the source of federal “Reed Act” distributions.

<sup>34</sup> Ohio Department of Job and Family Services, “News Release: Unemployment Compensation tax rates to increase in 2004” (November 24, 2003).

<sup>35</sup> E-mail communication from Brad Mayo, Ohio Department of Job & Family Services, Sept. 20, 2004

<sup>36</sup> Non-profit and governmental entities are generally not subject to experience-rated UC taxes, but are “reimbursing employers,” meaning that they are billed quarterly for any UC benefits paid to their laid off former employees. Some non-profits elect to pay UC tax contributions under Ohio law.

<sup>37</sup> Ohio compares the balance of each employer account as a percentage of each employer’s average annual payroll over the past 3 years with a series of steps expressed as percentages. The range extends up to a negative balance of 20 percent or more and down to a positive balance of 14 percent or more. Ohio Revised Code 4141.25(3). So, for example, an employer with an account balance that is between 5 percent and 5.5 percent positive is assigned a rate of 2.8 percent, while an employer with a negative balance between 5 and 9 percent has a rate of 5.7 percent.

<sup>38</sup> Examples are charges remaining in accounts of firms that have gone out of business, certain quits for reasons unrelated to employers, and improperly paid UC benefits that have not been recovered from claimants. At the same time, federal interest, improperly paid benefits collected as overpayments, and federal Reed Act transfers are credited to the mutualized account. Ohio Revised Code 4141.25(B).

year.<sup>39</sup> For many firms with lower experience rates, the mutualized rate can form a considerable portion of their UC taxes in years when it is in effect. If credits to the mutualized account exceed charges, then there is no mutualized rate for the succeeding calendar year. The mutualized rate has stood at zero since 1997. The amount in the mutualized account has fallen considerably, but the rate is likely to remain there again next year.

The third component of Ohio's state UC tax rates is based upon the overall health of the state's UC trust fund. Ohio law includes a statistically defined "minimum safe level" that is based upon past UC payments from the trust fund. The minimum safe level, as defined in 1990 legislation, is basically a level of reserves that can satisfy benefit payment requirements during the second worst recession since 1970. State UC tax rates are then adjusted upwards or downwards depending upon the amount by which the trust fund balance exceeds or falls below the minimum safe level.

For example, when the minimum safe level is exceeded by 30 percent or more on June 30, tax rates are lowered 0.2 percentage points below the rates set purely by experience rating for the next calendar year. The minimum safe level mechanism is designed to lower taxes automatically when the trust fund balance exceeds the safe level by at least 15 percent, while raising additional taxes when the balance falls 15 percent or more below it. The minimum safe level mechanism then includes a descending set of steps, each at 15 percent intervals, that lower or raise tax rates as the fund balance varies in relation to the minimum safe level.<sup>40</sup> Once the fund reaches 30 percent above the minimum safe level or 60 percent below it, rates do not change further because of it.

In recent years, the MSL rate has functioned this way: From 1999 to 2001, when the trust fund balance was more than 15 percent above the minimum safe level, employer rates were cut by 0.1 percentage points. Tens of thousands of employers paid no unemployment compensation tax at all during these years. In 2002, the 0.1 percent rate cut disappeared, because the fund was no longer 15 percent above the safe level. In 2004, rates increased because the fund had slipped to more than 30 percent below the safe level.

As a result of the overall mechanism involving the three components, firms' total UC tax rates rise as valid claims for UC benefits are paid to their former employees and the trust fund shrinks. Conversely, during good times with increasing employment, UC taxes will fall as firms' account balances and the trust fund grow. As Table C on the next page shows, this ebb and flow of tax rates has begun in Ohio, with 2003 rates rising from earlier lows to reach 0.49 percent of total wages and 1.75 percent of taxable wages. For 2004, ODJFS estimated that average rates on taxable wages would rise to 2.4 percent of taxable wages.<sup>41</sup>

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<sup>39</sup> The mutualized rate is calculated as a ratio between the amount of mutualized charges that exceed credits to the account and average annual payrolls of all taxable employers, rounded to the nearest 0.1 percent.

<sup>40</sup> However, once taxes begin to be levied because the fund is below the minimum safe level, all such rate increases stay in effect until the fund climbs about that level again. Ohio Revised Code 4141.25.

<sup>41</sup> Ohio Department of Job and Family Services, "News Release: Unemployment Compensation tax rates to increase in 2004" (November 24, 2003).

**Table C: Ohio UC Trust Fund and Payroll Taxes (1988 to 2003)**

Year	Yr. End Trust Fund Balance- Millions \$\$	Trust Fund Revenue- Millions \$\$	Avg. Taxes as % of Total Wages	Avg. Taxes as % of Taxable Wages	Trust Fund as % of Total Wages
1988	\$443.9	\$761.1	1.09	2.96	0.56
1989	\$778.5	\$816.3	0.98	2.71	0.94
1990	\$886.6	\$735.1	0.86	2.44	1.02
1991	\$647.4	\$709.7	0.82	2.35	0.74
1992	\$602.5	\$852.3	0.95	2.80	0.65
1993	\$845.1	\$897.7	0.96	2.82	0.88
1994	\$1167	\$955.8	0.95	2.77	1.13
1995	\$1601	\$982.9	0.91	2.66	1.46
1996	\$1751	\$806.6	0.76	2.27	1.52
1997	\$1875	\$661.5	0.54	1.68	1.52
1998	\$2028	\$669.1	0.51	1.64	1.54
1999	\$2152	\$631.9	0.47	1.53	1.56
2000	\$2236	\$640.5	0.44	1.47	1.55
2001	\$1904	\$594.1	0.42	1.42	1.33
2002	\$1537	\$685.9	0.46	1.61	1.09
2003	\$882.6	\$749.3	0.49	1.75	0.61

Sources: U.S. Department of Labor, *Handbook No. 394* (1988-2001); *UC Data Summary*, 4th Quarter 2002 and 2003. 2002 and 2003 tax rates are from U.S. Department of Labor, Unemployment Insurance Program Letter No. 28-04 (July 21, 2004).

Table C shows UC financing information for Ohio over the last two recessions. Even with 2004's tax increases, employer UC payroll taxes fell in Ohio since the years following the 1991 recession, and remain well below the highest rates in recent history. UC tax rates fell from their most recent post-recession peak of 0.96 percent of total wages in 1993 to 0.49 in 2003, or about half. The trust fund balance grew every year after 1993 in terms of total dollars, but stayed flat in terms of its percent of total wages from 1995 through 2000 (around 1.5 percent of state total wages).

During this same period, Ohio's taxes fell not only in terms of historic rates within the state, but were well below national averages for UC taxes as well. For example, in 1999, Ohio's employers paid average UC taxes amounting to 0.47 percent of total wages and 1.53 percent of taxable wages, while the U.S. national average was 0.56 percent of total wages and 1.76 percent of taxable wages. For 2003, Ohio's taxes were 0.49 percent of total wages and 1.75 percent of taxable wages, well below the national averages of 0.64 percent of total wages and 2.16 percent of taxable wages. Estimated tax rates for Ohio in 2004 remain below national averages as well,<sup>42</sup> although final rates will not be available for comparison until 2005.

*A comparison: The Ohio system vs. forward financing*

As shown in Table C, UC tax rates fell between 1994 and 2001, both as a percent of total and taxable wages. At the same time, the trust fund balance leveled off at around 1.5 percent of total

<sup>42</sup> Estimated 2004 average rates for Ohio are 0.5 percent of total wages and 1.8 percent of taxable wages, while the U.S. averages are 0.8 percent and 2.6 percent. U.S. Department of Labor, Office of Workforce Security, Unemployment Insurance Program Letter 28-04: "Preliminary Estimates of Calendar Year (CY) 2004 Average Employer Contribution Rates" (July 21, 2004).



wages between 1995 and 2000. Trust fund levels stopped rising because of all three elements in Ohio's financing system. A strong economy caused more employers to improve their experience ratings and pay lower tax rates. In addition, reductions in the mutualized rate and the functioning of the minimum safe level mechanism resulted in tax cuts. Combined, the effect was to keep the trust fund from reaping the full benefit of good economic times.

Ohio's UC financing arrangements have been recently described as "a balanced system that keep the taxes employers pay as low as possible while ensuring there is sufficient funding to pay benefits during times of higher unemployment."<sup>43</sup> In contrast, a majority of states follow a more traditional philosophy of forward financing in their UC financing practices. Under this approach, the emphasis is not on lowering tax rates as much as possible during economic good times, but on building trust fund reserves prior to the next downturn. While trust fund growth slows as trust fund balances grow under forward financing (usually by shifting to lower tax rate schedules), traditional financing arrangements never focus on lower taxes as conscious goal. Ordinarily, forward-financed trust funds grow as a percent of total wages until a recession increases claims levels and reserves are drawn down to meet higher demands for UC benefits.

One example of a forward financing state is New Jersey. New Jersey's tax schedules shift to produce lower tax rates as trust fund balances grow, but there is no point at which its financing mechanism shifts from building reserves to lowering overall UC tax payments, as in Ohio. Consistent with its forward funding philosophy, New Jersey maintained much higher balances in its unemployment trust fund during the 1990s. As a result, New Jersey never had a trust fund balance under \$2 billion after it pulled out of the early 90s recession, its total trust fund balance grew each year beginning with 1995, and it kept its trust fund over 2.0 percent of total wages throughout the post-1980s period. At its peak in 2001, New Jersey's trust fund was at \$3.122 billion, or 2.22 percent of total wages. Declines in New Jersey's trust fund level did not begin until 2002, when the impact of the recession hit the state's economy.

As a result of its forward funding approach, New Jersey collected federal interest amounting to \$2.8 billion between 1988 and 2003, amounting to over 16 percent of the state's UC payroll tax contributions during this period. In comparison, Ohio collected \$1.3 billion in federal interest, amounting to 10.75 percent of its UC revenues during these years.<sup>44</sup> If Ohio had maintained higher trust fund balances after the mid-90s in order to achieve interest payments equal to 16 percent of revenues as with New Jersey, it would have collected roughly \$640 million in added federal interest between 1988 and 2003.

As another positive consequence of its more traditional forward funding approach to UC financing, New Jersey was able to afford UC program improvements, including a state-funded benefit extension and elimination of its waiting week in the wake of the 2001 recession. In addition, New Jersey does not face near-insolvency in coming years, with its trust fund balance remaining at \$1.5 billion at the end of 2003.

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<sup>43</sup> Ohio Department of Job and Family Services Director Tom Hayes, quoted in ODJFS News Release: "Unemployment Compensation tax rates to increase in 2004," (November 24, 2003).

<sup>44</sup> These figures are based upon NELP calculations of data from U.S. Department of Labor for this time period.

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In summary, Ohio's average state UC tax rates fell by half between 1993 and 2002, but its trust fund balance did not keep pace with growth in Ohio's economy. The trust fund balance grew in dollar terms to \$2.236 billion at the end of 2000. But, when compared to growth in total wages in the state, the trust fund's reserves leveled off at about 1.5 percent of total wages in 1995 and stayed near that level. This leveling off of trust fund growth was due to tax cuts triggered by the minimum safe level mechanism as well as lower claims levels in a good economy reducing the experience-rated tax component of UC rates and a reduction in the mutualized rate.

The performance of Ohio's UC financing arrangements during the last 10 years confirms its ability to lower taxes, but raises questions about whether it provides a sufficient cushion for Ohio's UC program following economic downturns. In May 2004, the ODJFS projected that fund balances would dip to between \$200 million and \$300 million next spring, a very small margin of safety when benefits this year are projected at more than \$1.2 billion. That projection was based on an 11.9 percent drop in benefits paid this year compared to 2003. Hopefully, Ohio will escape more serious solvency issues like those faced by the state in past decades. But, while Ohio's UC financing arrangements carried Ohio safely through the 2001 recession and may avoid federal loans in 2005, we would question whether this defines "success." In short, Ohio's performance shows that its present UC financing arrangements stress lower taxes too strongly, while underemphasizing building trust fund reserves.

*Recommendation: In order to better prepare for the next economic downturn, Ohio should modify its UC financing mechanism to improve forward financing of its UC trust fund. This will result in employers paying somewhat higher taxes during the growth phase of economic cycles in order to build higher trust fund reserves to cushion employers and the state's economy from UC tax increases before an economic recovery is fully in place.*

Our review indicates that taxes are kept low under Ohio's current financing arrangements, but that greater consideration should be given to the impact that bigger trust fund balances can have on the timing of tax payments. Simply put, over the course of a business cycle benefit costs must be covered by UC tax revenues. For this reason, the debate over forward funding largely comes down to a question of when UC taxes are paid over that cycle. There is no question under current arrangements that Ohio's employers are going to pay for the tax reductions of the late 90s with higher UC taxes in coming years. With greater reliance upon forward financing, Ohio would have built higher reserves during the 90s and have appreciably less need now to raise taxes so soon after the 2001 downturn and tepid recovery. Common sense says that employers are better able to pay UC taxes when the economy is growing and profits are higher. Ohio's UC financing arrangements appear to flout this common sense proposition. When debating the proper response to its UC financing challenges in coming years, policy makers in Ohio should reexamine the state's current emphasis on tax reductions at the expense of stronger forward financing.

### *Federal Reed Act Funds*

In March 2002, \$343.7 million in federal "Reed Act" funds were transferred to the state's trust fund. This influx of federal funds was provided as part of the federal government's overall transfer of \$8.0 billion in federal funds collected from federal UC taxes, held in federal UC trust funds and distributed as part of President Bush's 2002 "economic growth package." The size of this Reed Act transfer was unprecedented and it has impacted Ohio's UC financing. While eventually the state's

UC financing mechanism will account for the impact of Reed Act dollars by making up these lower 2003 and 2004 contributions in coming years, the current effect of the Reed Act transfers has been a reduction in Ohio's overall UC trust fund solvency. Here's how it has worked.

At the end of March 2002, Ohio's trust fund had a balance of \$1.852 billion, including the \$343 million in Reed Act funds. This means that Reed Act funds boosted the state's trust fund by roughly 20 percent at the time they were deposited. As a result, the trust fund balance was higher on June 30, the date used to calculate tax rates for the following year. ODJFS announced that this avoided state UC tax increases that would have occurred.<sup>45</sup> By the end of 2003, Ohio's trust fund balance of \$882 million included \$327.5 million in Reed Act funds, or 37.1 percent of the state's trust fund balance. Reed Act funds again helped Ohio employers avoid higher taxes in 2004 by affecting the mutualized rate and minimum safe level calculations of June 30, 2003.<sup>46</sup>

Since the trust fund balance was considerably higher on those two calculation dates, taxes for both the following years were lower than they would have been otherwise. How much lower? According to a recent report published by the National Association of State Workforce Agencies, ODJFS has estimated that the infusion of Reed Act funds reduced Ohio's UC taxes in 2003 and 2004 by a combined \$520 million.<sup>47</sup> This means that to date Ohio's employers have obtained at least \$177 million in tax relief above and beyond the \$343 million amount of Reed Act funds. As a result, the net impact of the Reed Act transfer to date has been a reduced balance in Ohio's trust fund and lower taxes for employers in 2003 and 2004.

Unlike normal trust fund dollars derived from state UC taxes, which are legally restricted to use as UC benefits, Reed Act funds can be used for operation of state UC agencies. The Ohio legislature has appropriated \$151 million of the 2002 Reed Act money. The appropriation is intended to pay for administrative costs, for the closing of local offices and shift to a telephone claims operation as well as other purposes. As of the end of April 2004, only \$18.2 million of this appropriated amount had been spent. The degree to which remaining appropriated Reed Act funds will be spent in light of dwindling trust fund balances remains to be seen. However, there is little remaining question that Reed Act dollars have not yet gone to finance benefit improvements in Ohio's UC program that go directly to jobless workers.

#### *Indexing Ohio's Taxable Wage Base*

UC payroll tax rates are imposed only on a "taxable wage base," rather than upon total wages. In Ohio, the taxable wage base is \$9000.<sup>48</sup> Ohio's taxable wage base has been at \$9000 since 1995, rising in four \$250 increments from \$8000 beginning in 1992. This fixed taxable wage base shrinks each year as a proportion of total wages, and forces Ohio to finance its UC program on a declining

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<sup>45</sup> Ohio Department of Job and Family Services, News Release: "Unemployment Compensation tax rate schedule to remain unchanged in 2003," (November 22, 2002).

<sup>46</sup> Testimony of Melissa De Lisio, Assistant Director, ODJFS to the Ohio Senate Finance and Financial Institutions Committee, Human Services Subcommittee, May 1, 2003.

<sup>47</sup> National Association of State Workforce Agencies, "State Use of the \$8 Billion Reed Act Distribution," April 26, 2004, available at <[www.naswa.org](http://www.naswa.org)>.

<sup>48</sup> This section of the report is based upon a longer fact sheet by NELP, "Indexed State Taxable Wage Bases: Taking A Significant Step Toward Better UI Financing"(February 2004).

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percentage of overall wages. In 1995, taxable wages represented 34 percent of total wages. By 2003, taxable wages had fallen to 28 percent of total wages.

On the employer side, this reduces the effectiveness of experience rating because higher and higher percentages of UC benefit charges cannot be recovered from the smaller taxable wage base. In other words, negative balance employers at the maximum tax rate cannot be taxed on their taxable wage bases at sufficient levels to bring their account balances to a positive balance. As a result, these charges are shifted to all employers, as higher tax rates take effect to increase trust fund reserves.

A low taxable wage basis also means that low-wage workers' employers pay UC taxes on a much higher proportion of wages as compared to higher-wage workers and their employers. For example, a worker making \$10,000 a year has 90 percent of his or her wages subject to UC payroll taxes, while a worker making \$100,000 a year has only 9 percent of his or her wages taxed. There are substantial questions regarding the equity of taxing low wages at much higher rates.

Finally, as we earlier noted, Ohio is one of a majority of states that increases its maximum weekly benefit as wages grow. This is a positive measure for ensuring that jobless workers get adequate wage replacement and that benefits provide sufficient economic stimulus. But, there is a tension between automatically raising maximum weekly benefit levels and financing those benefits on a fixed amount of taxable wages. As UC benefit levels rise with growth in wages, they outpace the UC financing mechanism's ability to pay for those higher UC benefit payments.<sup>49</sup> Although the minimum safe level mechanism helps keep the system from going out of balance, it does so only after the trend is under way.

In short, there are many UC financing advantages to higher taxable wage bases. In 2003, states had UI taxable wage bases ranging from \$7000 to \$30,200. Higher taxable wage bases put UI financing on a broader basis and increase the responsiveness of UI taxes when recovering from higher UI benefit payments during a recession. In general, states with higher taxable wage bases can recover from or avoid insolvency better than states with lower taxable wage bases. They can also have lower tax rates to generate a similar amount of revenue than states with low taxable wage bases, since those rates are applied to a bigger taxable wage base. Higher taxable wage bases also reduce the adverse impact of UC taxes on lower-wage employment and make experience rating more effective.

The best practice with respect to taxable wage bases is to automatically adjust them as wages grow. Seventeen states have taxable wage bases indexed to state wages. That is, they adjust their state taxable wage base annually as wages increase, imposing their state tax rates for that calendar year on that tax base. As a result, states with indexed taxable wage bases have UI financing arrangements that keep pace with their economic growth, ensuring that their UI programs are not squeezed between an ever-diminishing taxable wage base and increasing UC benefit levels.

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<sup>49</sup> Phillip B. Levine, "Financing Benefit Payments," in Christopher J. O'Leary and Stephen A. Wandner, ed., *Unemployment Insurance in the United States: Analysis of Policy Issues*, (Kalamazoo, Michigan, Upjohn Institute, 1997), p.332.

*Recommendation: Ohio's \$9000 taxable wage base has been in place since 1995, and results in a declining financial base for the state's UC program. Rather than waiting for legislative action each time the taxable wage base is raised, Ohio should raise and index its taxable wage base by automatically increasing it to keep pace with annual growth in state average wages.*

Employer groups support a policy of low taxable wage bases, although the reasons for this policy stance are murky. A low taxable wage base undercuts UC financing mechanisms over time. Ohio should raise and index its taxable wage base in order to improve the financial base of its UC program and avoid the necessity of legislative action to do so.

### **Conclusion: Reforming Ohio's UC Program**

Ohio's UC program has protected its jobless citizens from hardship and boosted its economy during the 2001 recession and through the continuing job slump. Ohio should address shortcomings in its UC program while boosting its economy and assisting jobless workers. By expanding monetary eligibility for low-wage workers and paying benefits to jobless workers seeking part-time employment, Ohio can improve its UC safety net at an affordable cost to its employers. Ohio can improve its UC financing mechanism by adopting a greater emphasis upon forward funding and trust fund solvency. And, like the best-financed states, Ohio should index its taxable wage base to annual growth in state wages.