Testimony to the House Unemployment Compensation Debt Study Committee

Zach Schiller

Good afternoon, Chairwoman Sears and members of the unemployment compensation study committee. My name is Zach Schiller and I am research director of Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today about Ohio's unemployment compensation system and our UC debt to the federal government.

I'd like to summarize some key points:

- Ohio is very stingy about who it allows to qualify for unemployment benefits, and fewer unemployed qualify here than across the country;
- UC tax levels in Ohio are lower than average, and come to less than a penny per dollar of wages;
- Not all states went broke; most often, those that did had underfunded their UC programs;
- That was the key reason for our insolvency, as a report to the state found earlier, and
- Most importantly, Ohio taxes just the first $9,000 of wages, a very low amount. This amounts needs to be raised and indexed.

Ohio's unemployment compensation system covers fewer of the state's jobless workers than UC across the U.S. This has been consistently true for many years. During the year ended in June, just 22 percent of Ohio unemployed received regular state benefits. Our monetary eligibility – what you have to earn to qualify for benefits – is among the highest of any state. It goes up every year, and while the amount may not seem that great – an average of $233 a week over at least 20 weeks – this means that someone could earn as much as $12,000 a year and not qualify. It means you don't qualify if you make the minimum wage and work as much as 29 hours a week. As of last year, this was true of only one other state, Michigan.

In most states, if you are laid off from a part-time job and meet all of the other requirements, you can seek a job like the one you had and qualify for UC. In Ohio, you can't; claimants must be seeking full-time work to receive benefits. Yet businesses rely on part-time workers. More than a million Ohioans work part-time. Employers pay UC tax on the wages of part-time workers, yet our UC system excludes them. This is an outdated practice.

These factors and others contribute to what the Department of Job & Family Services already has testified: "Simply put, it is already more difficult to qualify for unemployment benefits in Ohio than in most states…" Given this reality it is not sensible to further ratchet up the amount

Ohioans have to earn in order to qualify for benefits—and ODJFS has noted, this option is "unlikely to prove viable."

Ohio's UC benefits, as the committee has heard, rise with wages. That's how most states do it. This means simply that benefits are staying level in relation to the economy. The average weekly benefit in Ohio for the 12 months ended June 30 was $322.97 (nationally, it was $313.99). Added up as if it were an annual total, the Ohio average would be $16,794. The official U.S. poverty line for family of three is of $19,790. That, however, is not enough for a decent yet basic standard of living.

The average benefit in Ohio replaces a somewhat higher share of the average wage than in the country as a whole. But this isn't based on the amount of wages actual recipients of UC had gotten, it's based on the average wage in the state. As described a moment ago, Ohio excludes many low-wage workers from receiving unemployment compensation. If employees working 20 or 25 or 29 hours a week at the minimum wage, or those unemployed who seek part-time jobs, were allowed to receive benefits, this "replacement rate" would come down. Our exclusion of many low-wage workers, who would receive lower weekly benefits in line with their wages, makes our system look relatively more generous than it is. The share of average wages that UC represents was little different in 2013 than it was in 2003 or 1993. Benefit levels in Ohio have merely kept up with wages, they have not grown. And they are basically in line with the nation.

Ohio's unique approach to dependency benefits can make it appear that our benefits are relatively high— if you just look at the maximum benefit of $564 a week. However, this benefit is only available to claimants with three or more dependents, and who earned an average of at least $1,128 a week during their base year. Altogether, as ODJFS has noted, only 5 percent of all claimants report having three or more dependents, and a subset of this group receives the maximum benefit. I am in the process of obtaining updated figures, but during calendar year 2010, almost 38 percent of all recipients received $250 a week or less. Those who make less than the average Ohio wage do not qualify for dependency benefits. Ohio's dependency benefit should be analyzed as a part of the committee's work, but not as a means for deeply slashing overall benefits.

Unemployment compensation is crucial to families – but also to communities. From the outset, it has had two objectives. The first, according to a nonpartisan advisory committee to the president in 1996, "is insurance in the form of temporary, partial wage replacement to workers experiencing involuntary unemployment." The second, the committee noted, "is the accumulation of adequate funds during periods of economic health, thereby promoting economic stability by maintaining consumer purchasing power during economic downturns." This second objective is too often downplayed or ignored. In fact, as various studies have found, unemployment compensation is one of the most effective countercyclical policies. As the Congressional Budget Office noted in a 2010 report, "Households receiving unemployment benefits tend to spend the additional benefits quickly, making this option both timely and cost-effective in spurring economic activity and employment." These effects are weakened when benefit levels are reduced.

In fashioning a solution to Ohio's unemployment debt problem, it makes sense to diagnose how we found ourselves in this position. Most importantly, Ohio has underfunded its UC system. This was the conclusion of Wayne Vroman, the long-time UC expert at the Urban Institute hired by the state in 2007 to analyze the solvency issue.

It was not inevitable that Ohio accumulate $2.6 billion in debt, as we did at the peak of our borrowing in 2011. Some other states with similarly high unemployment levels, such as Oregon, got through the recession without borrowing at all. Of the 16 states that indexed the wage base they tax so that it increases with wage levels, only 6 borrowed between 2009 and 2012. By contrast, of the 35 that, like Ohio, leave their taxable wage base unchanged except through specific action, 29 had to borrow.

Historically low contribution rates led to the solvency crisis in many states. While some states would have needed to borrow even if they met the federal solvency standard, the number would have been greatly reduced – and the total borrowing would have been far less – if they had. Altogether, the states went into the latest recession with just $38 billion in reserves, compared to $54 billion at the end of 2000, prior to the 2001 recession.

Ohio was underfunded more than most. Ohio's trust fund has not met generally accepted solvency standards since 1974. Just prior to the 2001 recession, Ohio had less than two-thirds of the needed reserves to meet the benchmark recommended by a nonpartisan federal commission (this calls for states to have enough money in their trust funds to pay for one year of benefits at the average of the three highest payout years in the last 20 years or the last three recessions, whichever is longer). That year, 28 other states met the benchmark, while only six states had a poorer solvency position than Ohio. After the 2001 recession, we did not increase taxes and replenish the fund to the degree we had in previous post-recessionary periods. As the recession officially began in late 2007, we were tied with Missouri for the third lowest solvency in the country, after Michigan and New York. Altogether, if Ohio employers had paid the average tax paid by employers across the U.S. between 1996 and 2006, the state trust fund would have received an additional $1.7 billion.

As ODJFS previously said, "Ohio's current tax on total wages is very low in comparison with other states…" As you know, Ohio employers are paying additional federal tax because of our debt. Employers in more than a dozen other states also are paying extra federal tax, while in some other states such as Michigan, additional taxes are being paid to retire private debt. But even if you include the additional federal tax in Ohio but not the additional amounts being paid in these other states, our average tax as a share of wages is below the national average. Unemployment taxes in Ohio add up to less than a penny per dollar of wages. According to a Bureau of Labor Statistics survey earlier this year of U.S. employer costs for civilian workers, state and federal unemployment taxes added up to a total of 24 cents an hour out of total employee compensation of $31.93. That amounts to three-quarters of one percent.

The federal unemployment compensation program and Social Security were created by the same act of Congress, and each taxed the same amount of wages at the start. Now, wages up to $117,000 are taxed for Social Security. But Ohio taxes only the first $9,000 in wages for unemployment compensation, or less than a quarter of all wages. That taxable wage base hasn't

risen in almost 20 years. We are taxing a smaller and smaller share of wages—which also means that low-wage workers' wages are being taxed to a much higher degree than higher-paid workers are. Remember that these workers are also less likely to be eligible for benefits.

The average taxable wage base for the country is $13,259. Ohio's $9,000 amount ranks 38th among the 50 states. This means that the total wages taxed under our program are only slightly more than those taxed in Utah. If our taxable wage base had risen along with inflation since 1995, it would be $14,070.

When Wayne Vroman was hired in 2007, it was easy to see that Ohio was going to go broke. In his 2008 report, Vroman reviewed a half century of Ohio benefits and payments and said: "The loss of reserves occurred in a period when payouts were slightly below-average but UI taxes were even further below-average." He concluded: "Most of the explanation for the loss of reserves since 2000 is due to the limited response of UI taxes and not a high the (sic) rate of benefit payouts."

Big increases in the number of unemployed and in long-term unemployment increased the benefit payout and contributed to the amount of debt we owe. However, as noted earlier, Ohio average benefit amounts are not out of line with other states. For years prior to when the state UC fund became insolvent in 2009, Ohio's benefit payouts as a share of total wages covered under the program were close to the U.S. average. That recession year, our benefits exceeded the national average by 11 percent; during the last four years, they have been lower than average. While it's not unreasonable that Ohio had to borrow during this period of high and long-term unemployment, it's clear that Ohio's UC solvency problem was a product of poor policy, not just a poor economy.

The key solution to Ohio's unemployment compensation funding is to raise and index the taxable wage base. Eleven states have raised their taxable wage bases since 2009. As Vroman concluded based on his historical review of tax and benefit levels, "…it would seem that most of the adjustments should involve enhancements to revenue since the benefit side of Ohio's program has not undergone important changes in recent years. Benefit payments have grown as the economy has grown, but taxes have lagged economic growth." Raising and indexing the taxable wage base were two of Vroman's recommendations. I would urge the panel to read Vroman's reports, and to invite him to testify.

Ohio's tax system is clearly broken when across-the-board tax rates are cut even while we are billions of dollars in debt. That's what happened in 2010. The mutualized rate, one of the three component parts of employer taxes, was reduced because state law calls for federal monies Ohio receives to be paid into the mutualized account. Since Ohio received a federal payment for having previously taken a step to modernize its tax benefit system, the mutualized rate was reduced (See http://www.policymattersohio.org/wp-content/uploads/2011/09/UCTaxCutPR2010.pdf for details). Mr. Madson of ODJFS previously testified how the mutualized rate will be at zero for years to come because "the money generated by the reduction in the federal tax credit flows through the mutualized account." State law forces a reduction in the mutualized rate. This underlines that our tax system is not properly aligned with solvency needs.

In recent years, ten states have cut the maximum amount of weeks that jobless workers can receive UC benefits. Despite this, the vast majority of states adhere to the long-time standard, as Ohio does, of offering up to 26 weeks of regular benefits. A recent Policy Matters Ohio study found that for the bottom 70 percent of the earnings spectrum, inflation-adjusted wages are actually lower than they were for their counterparts on the earnings spectrum in 1979 (see *The State of Working Ohio 2014* at http://www.policymattersohio.org/wp-content/uploads/2014/08/Working-Ohio-2014-Final-8-28-2.pdf, p. 16). One key feature of the recent recession and ensuing period has been the stubborn continuation of high, long-term unemployment. Last year, 34.6 percent of Ohio's unemployed had been jobless for 27 weeks or longer. While that was down from the peak of 44.2 percent in 2011, it still was higher than in any year between 1983 and 2008. In short, there are fewer good-paying jobs and it is taking unemployed workers longer to find them. Cutting the maximum duration for benefits would harm unemployed workers who need UC the most, and there is little evidence that it will significantly spur employment.

Thank you for allowing me to testify on this important issue. I am happy to answer any questions that you may have.

Policy Matters Ohio is a nonprofit, non-partisan research institute with offices in Cleveland and Columbus.