

WHY OHIO'S UNEMPLOYMENT  
COMPENSATION FUND IS  
GOING BROKE, AND WHAT  
WE SHOULD DO ABOUT IT:

A BACKGROUNDER

A REPORT FROM  
POLICY MATTERS OHIO

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JUNE, 2008

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## ACKNOWLEDGEMENTS

We would like to thank Andrew Stettner and Rick McHugh of the National Employment Law Project for their valuable counsel and analysis of many of the issues covered in this report. Doug Holmes of UWC – Strategic Services on Unemployment and Workers' Compensation alerted us to relevant research. Several people at the Ohio Department of Job & Family Services, including Joe Duda, Bob Welsh, Jeff Long and Judi Cicatiello, provided helpful information. Robert Pavosevich of the U.S. Department of Labor also supplied useful data. Policy Matters intern Brandon Henneman helped prepare many of the charts for this report.

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Ohio's unemployment compensation fund is going to go broke soon. Why is this happening? And what should be done about it? Policy Matters Ohio examines these questions in this policy brief.

The Ohio Department of Job & Family Services (ODJFS) estimated recently that Ohio's trust fund will run dry by January 2009. The agency is reevaluating its estimates and may well revise them.<sup>1</sup> However, it is likely that the state will have to borrow next spring from the federal unemployment trust fund to help pay benefits, and it could happen before that if the economy worsens.<sup>2</sup> Whatever the exact timing, unemployed Ohioans will continue to receive benefits. But the state will have to pay those loans from the federal fund off, and if it doesn't do so quickly, it must pay interest on them.

The UC system is a federal-state partnership, in which the U.S. establishes certain rules but states have considerable flexibility in how they set benefits and taxes. Begun in the Great Depression in the 1930s, unemployment compensation is an "automatic stabilizer" that pumps money into the economy when more workers are laid off. This helps unemployed workers and their families and also stimulates the economy.<sup>3</sup> To do this effectively, this means building up the unemployment trust fund in good times, so there is money in the fund to pay higher benefits that naturally ensue when the economy weakens.

Unemployment compensation is funded by a tax on employers, separate from the state budget. Employers pay taxes based on the benefits their laid-off employees have received and their previous contributions into the fund. Interest charges on borrowings from the federal government cannot be paid out of regular unemployment compensation taxes, so the state would have to either levy a tax for that purpose or pay out of the General Revenue Fund. ODJFS has estimated this could cost \$5.7 million in the first six months of calendar 2009, and more than \$105 million in the FY2010-2011 state fiscal biennium beginning July 1, 2009.<sup>4</sup> In the 1980s, Ohio had to pay hundreds of millions of dollars in interest to the federal government because of its borrowings from the U.S. fund.

Federal law also imposes automatic tax increases on Ohio employers if the state doesn't repay the loans in two years. For instance, if Ohio borrows before the end of this year, employers in the state would face an

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<sup>1</sup> Estimates from briefings at Unemployment Compensation Advisory Council Legislative Subcommittee, April 1, 2008, and May 20, 2008. Conversation June 9, 2008, with Robert Welsh, assistant deputy director, Bureau of Program Services, Office of Unemployment Compensation, Ohio Department of Job & Family Services.

<sup>2</sup> Wayne Vroman, an expert at the Urban Institute who was hired by the state to help provide solutions to the trust fund's problems, sees the fund making it through the end of this year with a positive balance in his most recent estimates. However, he said in a memorandum this month that the fund would need to borrow in 2009 and subsequent years even if the tax base was raised. If the fund does not need to borrow so soon, these costs could be reduced. Vroman, *Simulation of Analysis of Policy Options – I*, June 5, 2008.

<sup>3</sup> 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. 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

<sup>4</sup> If the fund does not need to borrow so soon, these costs will be reduced. Ohio Department of Job & Family Services, Trust Fund estimates, May 20, 2008

increase in their taxes of 0.3 percent in calendar 2011, or \$21 for each employee.<sup>5</sup> These charges would increase and continue until the loans were repaid.

*Why is the fund in trouble?*

Numerous factors affect the status of the Ohio unemployment compensation trust fund: How many people are unemployed and for how long; how the state sets eligibility requirements and benefit levels; the size of the tax base and the rates that employers pay; and whether the fund receives extra payments from the federal government or interest, among others. Fundamentally, two factors stand behind the near insolvency of Ohio's fund. One is that taxes have been set at low levels. And the other is that Ohio's economy has been weak.

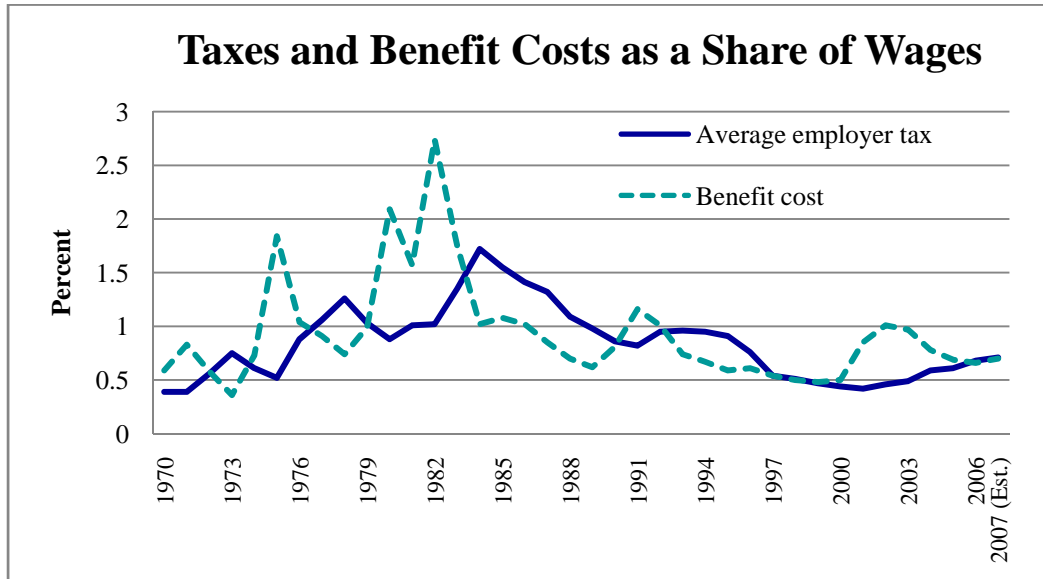
Figure 1 below shows Ohio employer taxes and benefit costs as a share of wages since 1970. The usual pattern is for tax contributions to lag behind benefit costs, catching up and exceeding them after benefit costs have begun to decline. This makes sense: Benefit costs grow during recessions, and taxes rise afterwards to rebuild the unemployment compensation trust fund. However, three things are notable about Ohio's experience over the past decade or so: First, while benefit costs grew early in this decade and have remained higher than they were during the late 1990s, they have not been extraordinary in comparison with earlier periods. Second, taxes never significantly exceeded benefit costs after the last recession, in contrast to the pattern after earlier recessions in each of last three decades. And third, taxes fell below benefit costs in the late 1990s before benefit costs had begun to skyrocket with the last recession. This meant that the trust fund did not continue growing as much as it would have otherwise during this period. Overall, the benefit cost rate has exceeded the average tax rate in 7 of the last 10 years, the reverse of the experience in the previous 10 years,<sup>6</sup> when the average tax rate exceeded the benefit cost rate in 7 years.

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<sup>5</sup> This is based on the federal taxable wage base of \$7,000 on each covered employee.

<sup>6</sup> In those three years between 1998 and 2007 that tax rates exceeded benefit cost rates, they did so only by very small amounts.

Figure 1



Source: U.S. Department of Labor, including DOL estimates for 2007

Ohio has underfunded its UC system. During the decade between 1996 and 2006, Ohio employers paid less in UC taxes as a share of wages than employers in the United States as a whole (see Figure 2 below), in contrast to the early 1990s. If Ohio employers had paid the average U.S. rate during this period, contributions would have been roughly \$1.7 billion or 21 percent higher than they actually were.<sup>7</sup> The U.S. Department of Labor estimates that Ohio's average tax rate should be 46 percent higher than it is for the state to have an adequate financing rate.<sup>8</sup> While that may somewhat overstate the inadequacy of the Ohio tax system, since it is based on high levels of benefit payouts that have not been matched since the early 1980s, it indicates the seriousness of the problem.

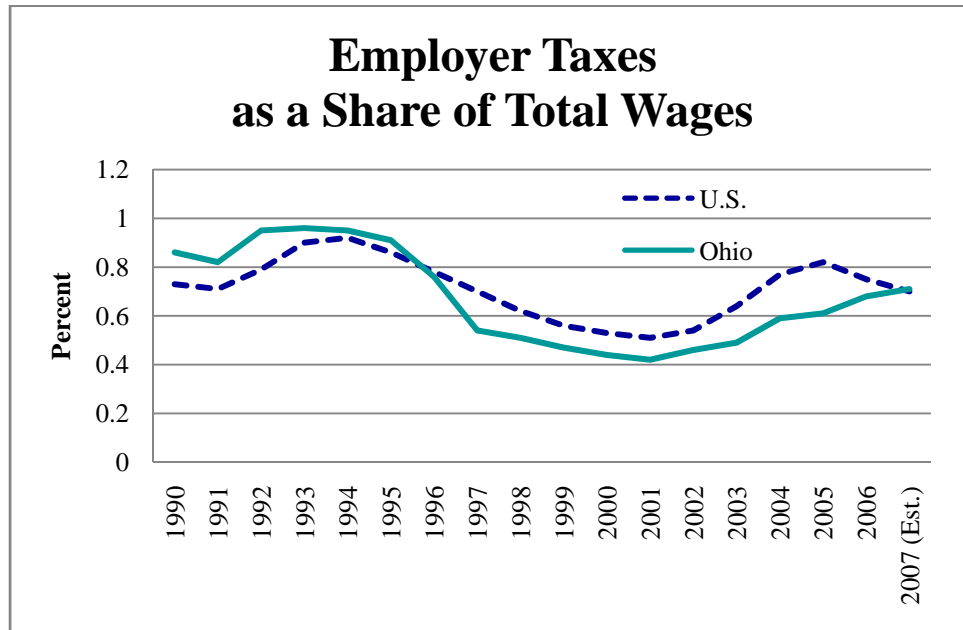
If other states were all funding their UC systems more than adequately, Ohio's comparison with the rest of the nation would not necessarily be problematic. We might have a well-funded system, just somewhat less so than other states. But as a recent report from the National Employment Law Project indicates, that is hardly the case. As of the start of 2008, state trust funds totaled \$38.3 billion, considerably less than the \$54.05 billion seven years earlier, on the brink of the last recession. Trust funds, in other words, were in weaker shape entering this period of economic weakness than they were for the last recession. In the meantime, nine states have borrowed from the federal unemployment trust fund or in the private market

<sup>7</sup> This amount was calculated by multiplying the difference each year between the U.S. and Ohio tax rates times the amount of Ohio contributions. While contributions include certain other items such as penalties and interest paid by some employers, the calculation does not take into account additional interest that the trust fund would have received had higher taxes been paid. Thus, the amount the Ohio fund would have benefited is probably higher than \$1.7 billion.

<sup>8</sup> U.S. Department of Labor, Office of Workforce Security, Division of Fiscal and Actuarial Services, Significant Measures of State UI Tax Systems 2007, p. 44. See <http://workforcesecurity.doleta.gov/unemploy/pdf/sigmeasuitaxsys07.pdf>

in order to continue paying benefits. The NELP report classed Ohio and three other state funds (Michigan, Missouri and New York) as “not solvent,” and another 14 states as “near insolvent.”<sup>9</sup>

Figure 2



Source: U.S. Department of Labor and 2007 estimate by department

The average tax rate in Ohio also ranks near the bottom compared to those in nearby states, as shown in Figure 3:

<sup>9</sup> McHugh, Rick and Andrew Stettner, National Employment Law Project, *Unemployment Insurance Financing: Examining State Trust Funds Facing Recession*, May 2008. See <http://www.nelp.org/docUploads/State%20Unemployment%20Insurance%20Trust%20Fund%20Solvency%202008%20%283%29.pdf>

Figure 3



Source: U.S. Department of Labor

Ohio employers pay UC taxes on the first \$9,000 of each employee's wages. This "taxable wage base" has remained the same since 1995. This means that tax is paid on a smaller and smaller share of overall wages each year. Last year, taxes were paid on only about a fifth of wages covered in the state. If tax rates go up, as they have in recent years, the revenue is less likely to keep up with growth in the economy. The average taxable wage base for all states was \$11,482 last year.

Ohio's tax system has a trigger mechanism that raises taxes when the fund falls below what is seen as a safe level. While this has resulted in an increase in tax revenue, it has not been enough to keep up with benefit costs. Increases in taxes since the recession in 2001 still leave the average employer tax rate below where it was for the entire 20-year period between 1976 and 1996 (see Figure 1). "We have reached the point where **trust fund recovery is mathematically impossible based on current statutes,**" said ODJFS in a recent description of the trust fund and the solvency issue (emphasis in the original).<sup>10</sup> Traditionally, states built up their trust funds in good times and then used the accumulated fund to spend more on benefits during bad times. This helped stimulate the economy during economic downturns. However, Ohio has not been following that formula.

The exact timing for when Ohio will have to borrow from the federal unemployment trust fund is not certain. That will depend in large measure on how much benefit costs increase because of the weak economy. Previous ODJFS estimates this spring, based on a recession like that of 2001, pegged the state trust fund to go broke by the end of this year. However, it won't take a full-blown recession to bust the fund. It fell as low as \$72 million in April 2008, perilously low for a fund that is paying out roughly \$100 million in benefits a month. The fund reaches a low point each spring, as much of the annual revenue comes in with employer first-quarter payments. The number of unemployment claims has been growing

<sup>10</sup> *Unemployment Insurance Trust Fund*, ODJFS, Office of Unemployment Compensation, April 25, 2008, distributed at the Unemployment Compensation Advisory Council legislative subcommittee, May 20, 2008

recently; continued claims were up more than 20 percent in May from a year earlier, the seventh consecutive monthly increase. Thus, borrowing next spring is likely. Absent a change in financing of the system, Vroman sees the system with a balance of just \$2 million at the end of next year and negative balances for years into the future.<sup>11</sup> The question is not if the Ohio fund goes broke, but when.

UC tax rates in Ohio range from 0.5 percent on the \$9,000 wage base, or \$45, up to 9.2 percent, or \$828 (delinquent taxpayers pay somewhat more). Nearly a quarter of Ohio employers pay the minimum UC tax rate of 0.5 percent, or \$45 per covered employee.<sup>12</sup> While that may seem like a large share of employers, it's in line with the national average. As a group, these employers are not that important to the solvency of the fund, since they account for only 1 percent of the benefits charged and 1 percent of the contributions. Thus, an increase in the minimum rate would not generate significant revenue; in a report to the state, Vroman, the UC expert who is studying the solvency of the Ohio system, estimated that each 0.1 percent increase in the minimum tax rate would generate only about \$2.8 million a year.<sup>13</sup>

Altogether, more than two in five Ohio employers pay less than \$100 per employee for state unemployment compensation tax. The average contribution per Ohio employee last year was \$271, according to the U.S. Department of Labor. Based on an average annual wage of more than \$39,000, Ohio state unemployment taxes last year amounted to about 0.71 percent of worker wages for taxable employers.<sup>14</sup>

Ohio's weak economy since 2000 has resulted in the pay-out of more benefits than during the 1990s. Though the number of claimants declined after the recession and remains far below the levels of the early 1980s, Figure 4 shows, it did not return to pre-recession levels.

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<sup>11</sup> Vroman memo, June 5, 2008.

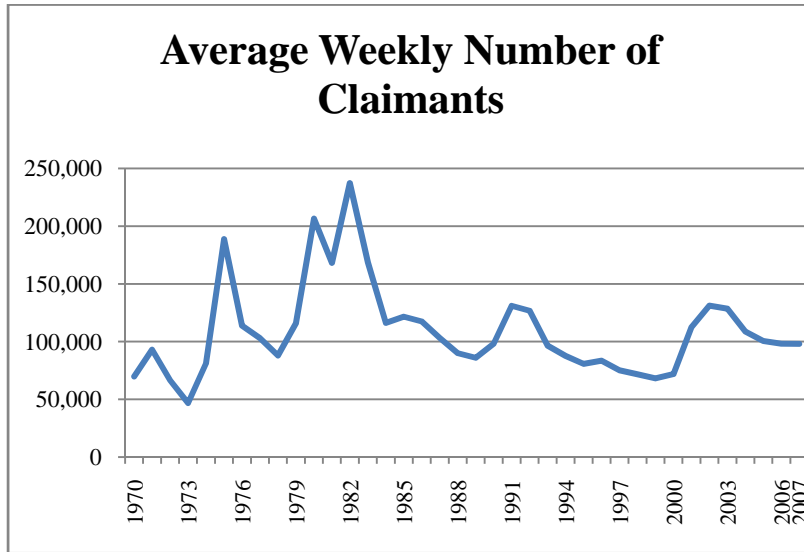
<sup>12</sup> ETA Form 204 filed by Ohio Department of Job & Family Services for rate year ending 12/31/2008

<sup>13</sup> *Review of some options for improving Trust Fund financing*, Wayne Vroman, April 11, 2008, p. 8

<sup>14</sup> U.S. Department of Labor, Office of Workforce Security, Division of Fiscal and Actuarial Services, *Significant Measures of State UI Tax Systems, 2007*, p.44, and estimates from DOL.



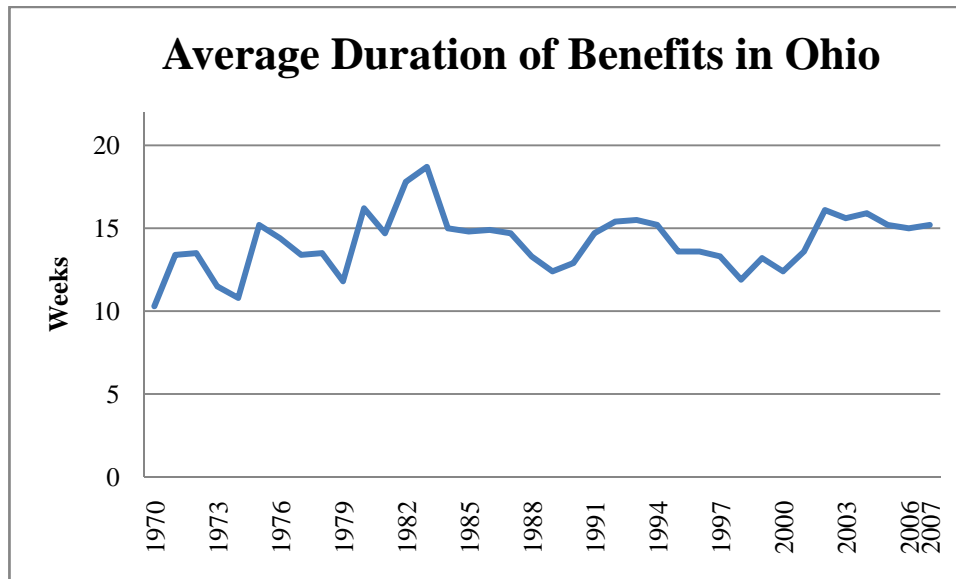
Figure 4



Source: Ohio Department of Job & Family Services

Moreover, those who qualify have been unemployed for longer. Last year, the average Ohio UC claimant received 15.2 weeks of benefits, down from the recession high of 16.1 weeks but higher than the pre-recession 13-plus. Figure 5 shows the trend:

Figure 5

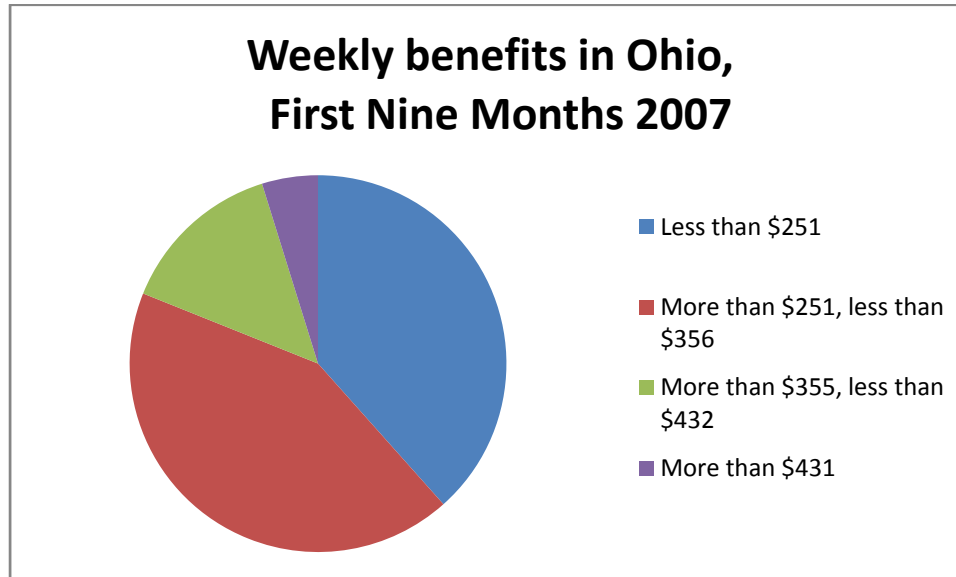


Source: U.S. Department of Labor

Jobless workers who qualify for UC in Ohio receive half of their previous pay, up to a maximum that depends on whether they have any dependents. The state each year adjusts maximum benefits based on the state average wage. This year, a single person may receive up to \$365 a week; a claimant with one or

two dependents may receive up to \$443, and one with three or more dependents may get up to \$493. A bipartisan national commission recommended in 1995 that UC replace half of workers' former wages, up to a maximum of two-thirds of the state's average wage.<sup>15</sup> Under Ohio's current system, only jobless workers with three or more dependents are eligible for maximum benefits close to that level. Most claimants receive less than the lowest maximum: During the first nine months of last year, more than 80 percent of claimants qualified for less than \$356 a week.<sup>16</sup> Figure 6 shows the share of claimants receiving different levels of benefits.

Figure 6



Source: Ohio Department of Job & Family Services

Average weekly benefits for Ohio jobless in the first quarter of 2008 were \$299.55, nearly the same as the U.S. average of \$299.14.<sup>17</sup> Figure 7 shows how Ohio's average benefits have compared with the average U.S. benefit. Ohio benefits have generally been close to the U.S. average – slightly higher for most of the 1990s, slightly lower from 2002 to 2005. The average weekly benefit in Ohio would amount to \$15,577 annually, less than the federal poverty level for a family of three, although workers can only get regular unemployment benefits for half a year.<sup>18</sup> As the *Columbus Dispatch* noted in a recent editorial, the poverty standard is unrealistically low.<sup>19</sup>

<sup>15</sup> Advisory Council on Unemployment Compensation, *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (U.S. Department of Labor, Washington, D.C., 1995), p. 20.

<sup>16</sup> This year's \$365 weekly maximum for single claimants is 48.6 percent of last year's average weekly wage.

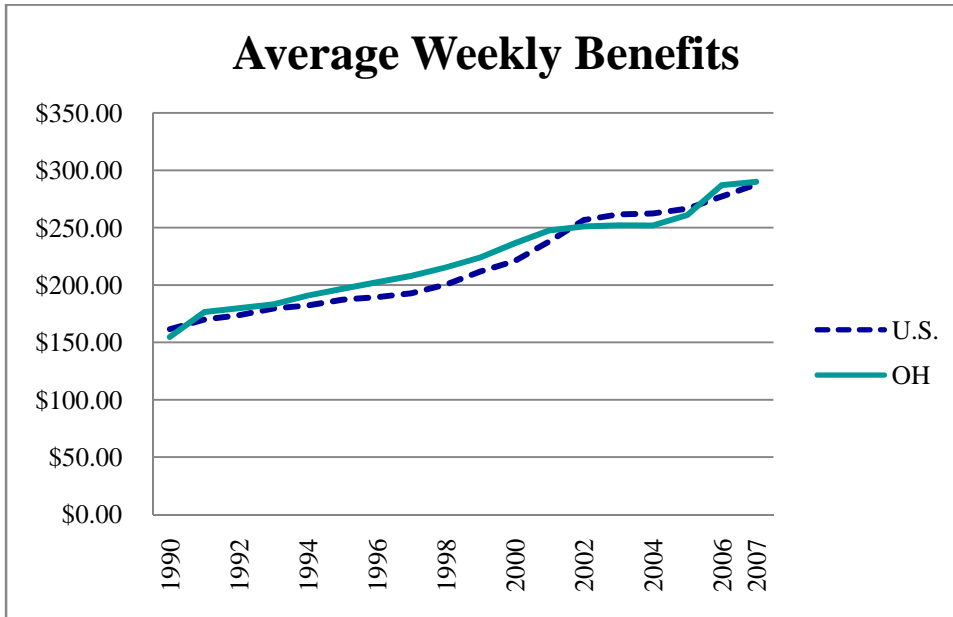
<sup>17</sup> U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Data Summary, First Quarter 2008 see

[http://workforcesecurity.doleta.gov/unemploy/content/data\\_stats/datasum08/DataSum\\_2008\\_1.pdf](http://workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum08/DataSum_2008_1.pdf)

<sup>18</sup> As detailed in previous Policy Matters Ohio reports (see *Making Ends Meet: Basic Family Budgets in Ohio*, July 2006, [http://www.policymattersohio.org/making\\_ends\\_meet\\_2006.htm](http://www.policymattersohio.org/making_ends_meet_2006.htm)) and *The Real Bottom Line: The State of Poverty in Ohio 2008*, a recent report from Community Research Partners, the amount needed for a decent standard of living may be twice the federal poverty standard.. See

<http://www.communityresearchpartners.org/uploads/publications/Real%20Bottom%20Line%2006-6->

Figure 7



Source: U.S. Department of Labor

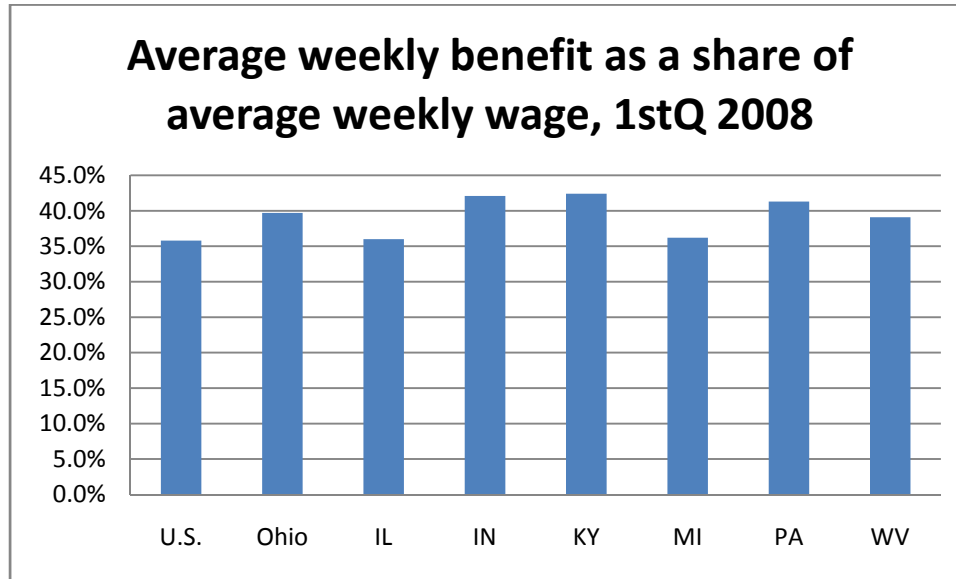
UC in Ohio replaces a somewhat higher share of workers’ wages than it does in other states.<sup>20</sup> Figure 8 shows the share of average weekly wages replaced by unemployment benefits in Ohio compared to the nation as a whole and nearby states. Indiana and Kentucky, among others, replaced a larger share of workers’ average wages than Ohio did in the first quarter of 2008, while Illinois and Michigan replaced a smaller share. These “replacement rates,” as they are called, measure the average weekly benefit as a share of the average wage in the state, not in relation to the previous wages received by UC claimants when they were working.

[08%20no%20Appendix.pdf](#). Unemployment benefits in Ohio are limited to 26 weeks. Annualization of the amount is for description only.

<sup>19</sup> “Federal Poverty Standard Doesn’t Translate Well for Today’s Families,” *The Columbus Dispatch*, May 13, 2008

<sup>20</sup> U.S. Department of Labor, UI Data Summary, First Quarter 2008, and ET Financial Data Handbook 394, see <http://workforcesecurity.doleta.gov/unemploy/hb394.asp>. See also Vroman, *Analysis of UI Benefits in Ohio*, May 30, 2008, and Vroman, *A Model and Initial Simulations of Unemployment Insurance Financing in Ohio*, March 13, 2008, memo, p. 29

Figure 8



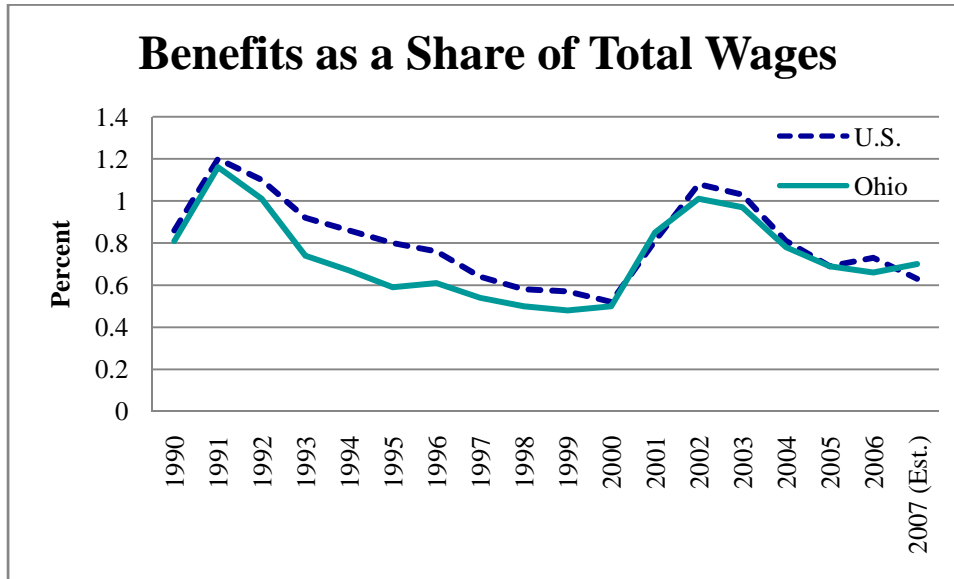
Source: U.S. Department of Labor

One reason Ohio's replacement rate is higher than the national average is that our high standard for how much workers must earn to be eligible excludes many low-income workers from receiving unemployment compensation (see below). This means that the average wage of those who do qualify is higher, and thus our benefits are replacing a higher share of previous wages. However, if we allowed more workers at lower wage levels to qualify, that would bring the replacement rate down.

Average benefits per week in Ohio actually were at or lower than those in other states between 2002 and 2005, when the Ohio trust fund declined sharply. Despite our weak economy, Ohio's overall benefit costs have been right in line with those of the country as a share of wages. Figure 9 shows how closely we have tracked the nation.<sup>21</sup> Thus, while taxes were lower than average for a decade, benefit costs were close to the national average.

<sup>21</sup> Vroman noted in his work for the state that, "While unemployment in Ohio has not decreased as rapidly as the national average, payouts have not been unusually high in recent years." *A Model and Initial Simulations of Unemployment Insurance Financing in Ohio*, March 13, 2008, p. 30. Or as he said in a later memorandum: "The loss of reserves since the start of the present decade has taken place despite generally low annual benefit cost rates." Vroman, *Analysis of UI Benefits in Ohio*, May 30, 2008, p 5.

Figure 9

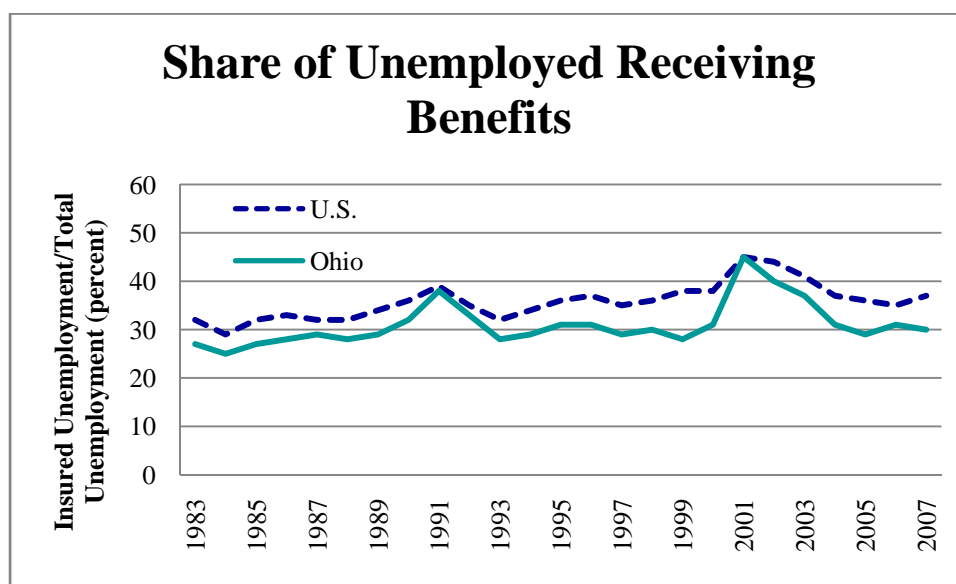


Source: U.S. Department of Labor

Benefit costs have been close to the national average partly because fewer jobless workers in Ohio receive unemployment compensation than in most other states. We have an especially high requirement for how much workers must earn in order to qualify. Ohio is one of only three states in the country where a minimum-wage worker employed 29 hours a week all year long would not qualify for unemployment compensation, and one of only six states where a minimum-wage worker employed 20 hours a week would not be eligible.<sup>22</sup> Figure 10 shows that except during recessions, Ohio has consistently provided UC to a smaller share of its jobless than the country does.

<sup>22</sup> *Ohio Still Excludes Many from Unemployment Compensation*, Policy Matters Ohio, December 2007, available at [http://www.policymattersohio.org/UCCompOhioExcludes2007\\_12.htm](http://www.policymattersohio.org/UCCompOhioExcludes2007_12.htm). A recent paper by Christopher J. O'Leary and Kenneth J. Kline of the W.E. Upjohn Institute for Employment Research for the U.S. Department of Health and Human Services underlined this point. They found that among workers in Texas, Michigan, Ohio and Florida who had received Temporary Aid to Needy Families, gotten employment and been laid off, far fewer Ohioans were eligible for unemployment compensation because they did not meet earnings requirements. Taken as a group, 91 percent of the former TANF recipients in the four states met monetary eligibility requirements for UC, while in Ohio, only 61 percent or 66 percent met those requirements in the two years Ohio was studied. *UI as a Safety Net for Former TANF Recipients: Final Report*, March 2008. Though an increase in the minimum wage has made it easier for some Ohio workers to qualify since the period studied in the paper, monetary eligibility requirements remain among the toughest in the nation.

Figure 10



Source: U.S. Department of Labor, National Employment Law Project

Another contributor to Ohio's solvency woes is the loss of employment the state has experienced in this decade. According to the U.S. Department of Labor, the number of workers covered under Ohio taxable employers fell from 4,432,860 in 2000 to 4,164,616 in 2006, a drop of 268,244, or more than 6 percent.<sup>23</sup> Fewer covered workers means taxes are being paid on a smaller base of employees. Thus, Ohio's weak economy and resultant higher unemployment both increased the benefit payout and reduced taxes paid.

Vroman of the Urban Institute, the UC expert who is studying the Ohio system for the state to help provide a solution to the fund's solvency problems, said, "The descent of the trust fund to its present low level reflects the failure of UI taxes to respond strongly following the recession of 2001 and the ensuing slow economic recovery."<sup>24</sup> While Ohio's weak economy has added to the stress on the state's UC system, the amounts individual workers receive are not extravagant and have not been a major cause of the fund's problems.

*What should be done to fix Ohio's trust fund?*

Ohio should increase the taxable wage base (TWB) – the amount of earnings that is taxed – from \$9,000 to at least \$12,000. Even with this increase, Ohio's TWB would rank 20<sup>th</sup>, tied with three other states, not much higher than the national average (currently, Ohio's TWB ranks 27<sup>th</sup>, tied with that of four other states). Nationally, unemployment compensation originated in the Social Security Act of 1935. Yet while today workers' wages up to \$102,000 are taxed under Social Security, only \$9,000 is taxed for unemployment compensation. It's no wonder with such a narrow tax base that the fund is poorly financed.

<sup>23</sup> The Department of Labor estimated covered employment at 4,181,796 as June 30, 2007. Email from Robert Pavosevich, Office of Workforce Security, Division of Fiscal and Actuarial Services, May 5, 2008. These numbers exclude Ohio employees who are covered by the UC system but work for nonprofit or government employers who reimburse the system for unemployment benefits paid to their laid-off employees. The average monthly number of such employees grew from 992,821 in 2000 to 1,073,658 in 2006.

<sup>24</sup> *Review of some options for improving Trust Fund financing*, Wayne Vroman, April 11, 2008, p. 8

Three of the five states that have approved legislation in the last few years to improve their trust fund solvency have increased their TWB, and a fourth, Minnesota, already has a taxable wage base of \$25,000. The fifth state, Texas, borrowed in the private market to pay borrowings from the federal government, a course of action that is unavailable to Ohio under its state constitution.<sup>25</sup>

At the same time, we should index the TWB so it goes up with wages, just as 16 other states already do. Indexing is not a cure-all. But as noted in the recent report on state trust fund solvency of the National Employment Law Project, the trust funds of most of these states are in good shape. The handful of states with indexed wage bases that have significant financial troubles have taken other steps that undercut their UC financing systems.<sup>26</sup> Indexing the taxable wage base is a crucial element to the long-term solvency of the Ohio fund, since it means that the tax base and benefits will be linked together.

Additional temporary steps to increase revenue will be needed if the state is to build a strong fund. In simulations he did as part of his work for the state, Vroman found that even increasing the taxable wage base to \$12,000 would not put the trust fund in a position to withstand a repeat of the 1991-92 recession and rebuild afterwards to a strong balance.<sup>27</sup>

However, any reductions in benefit levels should be minimized. Benefit levels didn't cause our trust fund problem, and they are hardly adequate as they stand now.

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<sup>25</sup> Vroman, Wayne, *The Recession of 2001 and Unemployment Insurance Financing*, January 2005, available at [http://www.urban.org/UploadedPDF/411075\\_2001recession.pdf](http://www.urban.org/UploadedPDF/411075_2001recession.pdf) The three states were Illinois, Massachusetts and Missouri.

<sup>26</sup> McHugh and Stettner, op. cit., p. 9-10.

<sup>27</sup> Vroman, March 13, 2008, memo, pp. 18-28. These simulations assumed the tax base would increase incrementally to \$12,000. They did not include increases in taxes that might occur because of the removal of the federal tax credit.

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