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Why Ohio's unemployment compensation fund is going broke and what we should we do about it: A backgrounder

During the next year, Ohio's unemployment compensation system is likely to borrow from the federal government in order to pay benefits to jobless workers. The system is going broke, the only question is when. A backgrounder released today by Policy Matters Ohio explores why the UC (sometimes called UI for unemployment insurance) system is in such poor financial shape and makes recommendations on what should be done.

Unemployment compensation is funded by a tax on employers, separate from the state budget. Between 1996 and 2006, Ohio employers paid lower taxes as a share of wages than the national average. If Ohio employers had paid the average U.S. tax rate during this period, contributions would have been roughly $1.7 billion higher than they actually were.

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 share of overall wages each year. 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.

Ohio's weak economy has also contributed to the stress on the unemployment trust fund. More claimants have sought UC and those who qualify have been unemployed longer. In addition, taxes are being paid on a smaller number of employed workers.

However, despite our weak economy, overall benefit costs in Ohio have been in line with those of the rest of the country. Ohio UC benefits replace a somewhat higher share of the average wage than other states, but fewer jobless workers in Ohio receive unemployment benefits than their counterparts elsewhere. We have an especially high requirement for how much workers must earn in order to qualify.

Wayne Vroman of the Urban Institute, a UC expert who is studying Ohio's solvency problem for the Ohio Department of Job & Family Services, said in one report to ODJFS, "The descent of the trust fund to its present level reflects the failure of UI taxes to respond strongly following the recession of 2001 and the ensuing slow economic recovery."

Unemployment insurance not only helps jobless workers and their families, it pumps money into the economy when it is most needed, acting as an economic stimulus. Jobless Ohioans receive half 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. Average weekly benefits in the first quarter of 2008 were $299.55, compared to the U.S. average of $299.14. The average weekly benefit in Ohio would amount to $15,577 annually, less than the federal poverty level for a family of three.

When the fund goes broke, benefits will continue to be paid, since the state can borrow from the federal unemployment trust fund. However, Ohio will have to pay those loans off, and if it doesn't do so quickly, it must pay interest. Those charges can't be paid out of regular UC taxes, so the state would have to either levy a tax for that purpose or pay out of its General Revenue Fund. ODJFS has estimated that if the fund begins borrowing by the end of this year, the state would have interest charges of more than $105 million in its biennial budget beginning July 1, 2009 (charges could be less if borrowing begins later). Federal law also imposes automatic tax increases on Ohio employers if the state doesn't repay the loans in two years.

"As a first step to putting the fund on solid ground, the state should increase the taxable wage base from $9,000 to at least $12,000 and index it to wage levels," said Zach Schiller, report author and Policy Matters research director. Even with this increase, Ohio's taxable wage base would rank 20th, tied with three other states. Additional temporary steps to increase revenue will be needed if the state is to rebuild its fund to a strong balance. 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," Schiller said.

Policy Matters Ohio is a nonprofit Ohio-based research institute.