How Ohio Has Underfunded Unemployment Compensation

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Ohio's unemployment trust fund – the money that pays benefits to unemployed Ohioans – has been broke for almost six years. The system owes $1.38 billion to the federal government, money it borrowed to keep paying benefits during and after the recession. Now, an Ohio House committee is reviewing the debt issue.

Ohio's unemployment trust fund ran out of money primarily because we underfunded it. The recession and accompanying high unemployment helped drive the fund deep into debt, but benefit levels are relatively average; the key problem that the General Assembly needs to confront is a stagnant, narrow tax base.

Key findings

- Ohio's unemployment compensation trust fund is $1.38 billion in debt
- Underfunding was the primary reason the fund went broke
- Ohio UC taxes are below average, and only the first $9,000 in employee earnings a year is taxed
- Benefit levels are relatively average, but fewer Ohio unemployed receive benefits than those in other states
- The General Assembly needs to broaden the tax base

Unemployment compensation (UC) is a crucial backstop to workers and families during times of economic distress. But in addition to its role in supporting individuals and families, UC also helps stabilize the economy, creating additional demand for goods and services.

UC is funded by a dedicated payroll tax on employers, separate from the state budget. The small share of employee earnings that is taxed is a key weakness in the system: Ohio employers pay tax on just the first $9,000 in each employee's wages each year. This tax base is below the U.S. average of $13,259. It's also below what it would be if it had been adjusted for inflation since the last change in 1995. Overall, the state's tax rate ranks 40th lowest in the nation. Employers pay less than a penny for each dollar of wages in unemployment tax.

Since 2011, Ohio has had to pay interest on its federal debt. The state has paid $218.2 million in interest on the debt so far, and the Ohio Department of Job and Family Services (ODJFS) estimates the state will pay another $54.5 million by Sept. 30, 2017. Regular state taxes won't be enough to pay off the debt; it is being repaid now mostly through a higher federal tax. Under U.S. law, this flat tax will rise each year until the debt is repaid. ODJFS estimates that is likely to happen in 2017, but that assumes no new recession and would still leave the state with no reserve. Even with this extra federal tax, Ohio tax levels are below the U.S. average.

After recessions in the 1970s, 1980s and 1990s, tax collections rose to replenish the Ohio UC trust fund. But taxes only rose modestly after the two recessions in the 2000s. Many states got away from the practice of building up reserves in good times to pay benefits in bad times. Ohio did so more than most. If Ohio employers had paid the average tax paid across the country between 1996 and 2006, the state trust fund would have received an additional $1.7 billion. We entered the last recession in a tie with Missouri for third-lowest solvency in the country. Though 35 states wound up borrowing from the federal government to pay benefits since 2008, some with high unemployment levels avoided that. Seventeen states index their taxable wage bases, improving the likelihood that their trust funds will stay solvent.

While a constricted tax base is the biggest reason for the Ohio insolvency, the structure of the tax system also contributed. Despite our $1.38 billion in debt, ODJFS has noted, state law requires that employer taxes decrease. The extra U.S. taxes that Ohio employers are paying to eliminate our debt also are credited to an account that is keeping tax rates down. And ironically, another component of the employer tax that is supposed to help the tax system stay solvent has worked in the opposite direction, lowering rates in 2012 and 2013 when the trust fund was deep in debt. These peculiar requirements should be excised from Ohio law.

Big increases in the number of unemployed and in long-term unemployment increased the benefit payout and contributed to our debt. However, benefit levels – and the share of jobless Ohioans who get benefits – are not high. The average weekly benefit in the year ended June 30 was $322.97 compared to the national average of $313.99. While that represents a slightly higher share of average wages than in the country as a whole, it is not enough to keep a family of three above the official poverty line.

Also, Ohio has persistently provided state benefits to a smaller share of unemployed workers than the average state—just 22 percent in the year ended in June. One reason is that we have among the most stringent earnings requirements of any state: This year, you must average at least $233 a week over at least 20 weeks. You can work 29 hours a week all year at minimum wage, and if laid off, you won't qualify. We need to improve the share of Ohio unemployed who receive benefits, not cut back on eligibility.

A majority of states raised the taxable wage base since 2009, either through legislative action or annual increases already provided in state laws. The expert Ohio hired to make solvency recommendations proposed increasing and indexing the wage base. Though they were unable to reach a compromise, both employer and employee representatives to a panel that tried to deal with the issue in 2008 proposed an increase in the taxable wage base, a temporary freeze in maximum benefit levels and a tax surcharge to pay interest charges. After years of underfunding this crucial system, Ohio needs to face the need for more adequate financing and a higher taxable wage base, in particular.