Testimony to the Unemployment Compensation Reform Joint Committee

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Good afternoon, Chairmen Schuring and Peterson and members of the committee. My name is Zach Schiller and I am research director at 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 regarding unemployment compensation (UC).

We'd like to summarize a few key points upfront:

- Unemployment compensation taxes overall are a tiny share of employer costs. Average taxes in Ohio are lower than those across the country. Inadequate taxes are the major reason why our fund went broke.
- Benefit levels in Ohio are well in line with those nationally. Our system for years has allowed fewer unemployed to qualify than in other states, partly because of our stringent earnings standard.
- House Bill 394 was an unbalanced bill whose extreme benefit cuts would lead to major employer tax reductions. It did not get us close to solvency. HB 394 and the framework on which it was built should be scrapped.
- A real solution must be based on the real reasons our fund went broke. We provide details of a proposal that addresses these causes, is balanced, and would create a solvent fund.

Many numbers are available to describe the status of our unemployment compensation system. The most important one to start with is this: Unemployment compensation is not, in the aggregate, a significant cost for business. The U.S. Bureau of Labor Statistics captures this in its regular survey of employer costs for employee compensation. That survey from last June found that, overall, state unemployment compensation cost private-sector businesses an average of 19 cents an hour. That's 19 cents out of total average hourly wage and benefit costs of $32.29 (federal unemployment tax cost another 4 cents). Across the country, UC taxes amount to well under a penny out of each dollar of wages.

However, that's the national average. Ohio employers on average pay less. They have paid less for 18 out of the last 20 years, including the last six. In the year ended in June, according to the U.S. Department of Labor, the average state tax as a share of wages in Ohio was 0.58 percent, compared to the national average of 0.71 percent. Our average rate was below that of any neighboring state. Businesses will not flee Ohio if these rates are raised responsibly to create a solvent UC program.

The U.S. Department of Labor keeps track of unemployment taxes. Its publication, *Significant Measures of State Unemployment Insurance Tax Systems 2015*, reveals that Ohio's average state tax last year of $269 per employee compared to a national average of $370. Two-thirds of Ohio employers pay less than half a cent for every $1 in wages in state UC tax, and 29 percent pay the state minimum that amounts to $27 per employee.

How about at the top of the scale, the employers who are taxed the most? Like other states, Ohio has a maximum rate, which this year is set at 8.7 percent of the first $9,000 in wages, or $783 per employee (38 cents per hour for a full-time, year-round employee). Last year, the DOL reports, Ohio's maximum was $774 per employee. Only 12 of the 50 states had a maximum this low. The U.S. average maximum was $1,263.

It is important to recognize that despite the higher amounts these employers pay, they are not charged anywhere near what their laid-off employees receive in UC payments. These firms benefit from the cap on rates. In tax rate year 2015, for example, these maximum-rated employers paid $202.3 million in UC taxes but incurred $359.6 million in benefit charges, a drain on the trust fund of $157.2 million.

In short, UC taxes are not a major cost, and costs in Ohio are lower than average.

How about the benefit side?

According to ODJFS, 196,409 Ohioans received unemployment benefits last year. That was down from the half million who got benefits in 2009, and is the lowest number since 1973. Through July, fewer still were getting benefits this year. For many years, a smaller share of unemployed Ohioans has qualified for benefits than in the nation as a whole. We require that workers earn more than in almost any other state in order to qualify—in effect, 30 hours a week at the minimum wage, averaged over at least 20 weeks. We deny benefits to jobless Ohioans seeking part-time work, even if they are seeking the same jobs they were laid off from, and even though their employers paid taxes on their wages. As ODJFS told the House committee studying the UC solvency issue in 2014, "Simply put, it is already more difficult to qualify for unemployment benefits in Ohio than in most states."

Benefit levels are not out of line. While a huge increase in benefit payout during the recession contributed to the debt, that was a result of high unemployment and very long spells of joblessness experienced all across the nation, not lucrative benefits. Ohio's average benefit in the 12 months ending in June was $349.31, just 3.3 percent higher than the national average (and even this modestly higher average benefit is due in no small measure to state requirements that disqualify many lower-wage workers from qualifying). On an annual basis, our average benefit amounts to less than the federal poverty level for a family of three.

Ohioans who receive unemployment compensation on average do so for a shorter period of time than jobless workers in other states do. As a result, the total amount of benefits received per claimant is a shade below the U.S. average – $4,998 vs. $5,083. And that does not take into account that relatively fewer Ohioans receive benefits than their counterparts in other states. Just 23 percent of Ohio's unemployed received benefits in the year ended June 30, lower than the national average of 28 percent. As a result, overall benefit costs as a share of total wages – the litmus test for comparing benefit costs – are lower in Ohio than across the country. 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 (2009), our benefits exceeded the national average by 11 percent; during the last six years, they have been lower than average.

Dr. Wayne Vroman of the Urban Institute, who the State of Ohio hired in 2007 to analyze our UC system and make recommendations on solvency, noted in his 2008 report that, "Benefit payments have grown as the economy has grown, but taxes have lagged economic growth." Most of the explanation for the loss of reserves since 2000, Vroman found, was due to the limited response of UC taxes, not high benefit payouts.

In short, focusing on benefit costs – as House Bill 394 did – is ill-conceived.

Bruce Madson of ODJFS already has identified as a myth the notion that people prefer benefits to work. Ohio's jobless spend less time than the national average receiving unemployment benefits; most recently, the average was 14.5 weeks. Only nine other states have relatively fewer UC recipients exhaust their benefits than Ohio. The majority of Ohio UC claimants are back on the job, earning wages, in the calendar quarter after filing their initial unemployment claim. In 2015, more than 66 percent of claimants had wages in the three months after receiving their first UC payment. How can one then claim that unemployed Ohioans prefer a so-called "lifestyle" of benefits, and that they are responsible for the fund's problems?

In December 2007, just prior to the recession, Ohio was tied for the third-least solvent fund in the country. That's why the state hired Dr. Vroman – we knew even before economists had determined we were in recession that our fund was going to have to borrow soon. We were the fourth to go broke, in January 2009.

House Bill 394 was an up-side-down non-solution to our solvency problem. It called for huge benefit cuts, amounting to $475 million a year, which in turn would lead to employer tax cuts of $313 million annually. Yet despite the draconian reductions in benefits, it came nowhere near solving our fund's problems. It came up more than $1.3 billion short in 2025 – and that was without including a recession between now and then. The longest recovery in U.S. economic history lasted 120 months; the typical time between recessions since World War II has been 58.4 months. We already have exceeded that average since the last recession ended in 2009. While no one is looking for a recession, under these unrealistic economic assumptions, HB 394 was not a true solvency package.

I've spoken about House Bill 394 in the past tense because that's where it belongs – in the past. *HB 394 should be scrapped and you should start afresh*. Others have begun to chronicle for you the long list of ways in which it inappropriately slashes benefits, which go far beyond reducing the maximum number of benefit weeks. These changes would make our UC program among the most restrictive in the country and would disproportionately negatively impact regions with higher levels of unemployment and slower job growth, such as our Appalachian counties and many of our cities. It would increase eligibility requirements when less than a quarter of unemployed Ohioans get benefits now. No attempt was made to estimate the cost savings from a number of these cutbacks. They are not included in $475 million of annual savings estimated by ODJFS and the Legislative Service Commission. So we don't even know what they will contribute to solvency.

So what would a real, balanced solvency plan look like?

Policy Matters Ohio contracted with Dr. Vroman, one of the foremost authorities on UC financing in the country and a knowledgeable expert on the Ohio system because of his work here, to help come up with a plan. We provided you with that proposal last month. A copy is included at the end of our testimony. According to simulations Dr. Vroman has done, the plan would result in a solvent system in 2025, including a modest recession similar to that in the early 1990s.

Our proposal to modernize the system and make the fund solvent would:

- Raise the share of wages that employers pay taxes on from $9,000 to $14,000. That amount has not increased in more than 20 years, and covers well under a quarter of all wages. Had it kept up with inflation, it would be more than $14,000; had it tracked wages, as wage bases do in many states, it would be $15,600. A $14,000 wage base would be the same or less than that of 28 other states. A broader tax base is an essential element of a viable tax system.
- Increase the top tax rate that is directly tied to each employer's experience, currently 6.5 percent, by 1 percentage point. As mentioned earlier, the maximum-rated employers who would be affected by this change pay far less in UC taxes than their laid-off employees receive in benefits. Affected employers would pay a bit more with this rate increase but still wouldn't pay the full cost of their laid-off employees' benefits.
- Fix a flaw in the tax system and allow extra solvency taxes to go directly into the state's trust fund. As it is now, half of our solvency tax goes into what is called the mutualized account. This account covers charges that individual employers don't pay, such as when an employer goes out of business or an employer's laid-off employees have received more in benefits than the taxes that employer pays. Diverting half of the solvency tax to this account has helped keep the mutualized tax at zero for the last four years. As it stands now, our solvency tax doesn't function the way a solvency tax should. Making sure all of this tax goes directly to the trust fund to improve solvency would correct that.
- Allow unemployed workers to qualify if they have worked for 20 weeks and averaged a weekly wage of 20 times the minimum wage, permitting more low-wage workers access to benefits. Ohio requires workers to make more than in almost any other state in order to qualify for benefits. This also discriminates against low-wage, part-time workers. Currently, a worker making $25 an hour can work 10 hours a week and qualify for benefits if they are laid off. Yet a minimum wage worker can work 29 hours a week and never be eligible. Is that worker less attached to the labor force? Of course not. Allowing more low-wage workers to qualify is not costly; a minimum-wage worker working 20

hours a week would receive just $81 a week in benefits. Without this improvement, Dr. Vroman calculated, the trust fund would still reach full solvency in the same year, 2025.

- Finally, our plan calls for the creation of a new employee tax of 15 cents on each $100 in wages after the first $8,400. Like the employer tax changes, this would begin in 2018. Both the employee tax and the taxable wage base would phase down over a two-year period when solvency is reached.

Three states, Pennsylvania, New Jersey and Alaska, have employee taxes now. An employee tax offers a way for workers to contribute to the solvency of the trust fund without imposing benefit cuts on Ohioans when they are unemployed. Federal law places no limits on the design of state employee contributions used for UC financing. Our plan would tax total wages, but exclude the first $8,400. Including this threshold means that minimum-wage workers who don't qualify for benefits wouldn't have to pay the tax. A worker making $40,000 a year would pay less than a dollar a week in tax. Under our proposal, Ohio workers would contribute an average of $273 million a year to the fund between 2018 and 2025. Employers would remain the major funders of the system, but workers would contribute a meaningful share.

Any measures taken to add UC employee payroll taxes to Ohio's financing mechanism must be coupled with employer tax increases. This is a balanced approach; as shown, employer taxes are insufficient and the primary cause of insolvency. At the same time, the General Assembly must avoid simply shifting existing employer UC financing obligations onto employees without substantively improving overall UC trust fund financing.

Ohio needs to return to a system in which we fund the system well enough that we don't go deep in debt when the inevitable recession arrives, sparking higher taxes soon after. Our plan would allow the state to avoid substantial long-term borrowing and the additional federal (and now state) taxes that that would bring. This would protect Ohio employers from such penalties. It is a balanced approach that attempts to provide a long-term solution to the solvency challenge. We do not support cherry-picking one or more elements of the plan, such as the employee tax, which must depend on improvements to the system and employer contributions as well.

Unemployment compensation does not just help families buy the essentials they need, and permit job seekers to look for work more effectively because they have money to put gas in the car and keep their Internet access. Unemployment benefits "allow the unemployed to maintain more of their previous consumption than they otherwise would be able to," ODJFS noted in a 2014 filing. "When the unemployed cut back on spending, the business owners that serve them lose. By cushioning the fall in these families' incomes, unemployment insurance not only helps the families that receive it, but also prevents further production cuts and layoffs."

Thank you for allowing us to testify. We are 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.