The Case for Unemployment Insurance Reform in Ohio

A POLICY PRIMER

Introduction

Ohio's unemployment insurance (UI) system is in a state of crisis. The Ohio Unemployment Insurance Trust Fund, which is funded by employers and pays out benefits to qualifying jobless workers, is insolvent. The benefits the system pays out are substantially out of balance with the tax receipts it takes in to fund it. The system is nearly $775 million in debt to the federal government – money it borrowed to keep paying benefits during and after the Great Recession of 2008. As a result, Ohio's system is dangerously unstable and a deterrent to economic development. Reforms are urgently needed to update and strengthen Ohio's UI program for the benefit of Ohio's employers, employees and economy. Most specifically, Ohio's Unemployment Insurance Trust Fund is not likely to recover solvency before the next recession unless the state takes action to pay off its outstanding federal unemployment compensation loan balance and better aligns benefits with contributions to build a balance.

How the System Works[1]

The Social Security Act of 1935 (SSA) created a federal-state unemployment insurance program to (a) provide temporary, partial wage replacement to individuals out of work, generally through no fault of their own, and (2) promote economic stability by maintaining a steady flow of dollars throughout the economy even when there is widespread unemployment.[2] The UI system historically has been forward funded – i.e., a sufficient positive balance is needed in the state unemployment trust fund to avoid having to borrow to pay benefits resulting from a reasonably foreseeable economic downturn.

To be eligible for unemployment benefits, jobless workers must demonstrate "workforce attachment," usually measured by a work requirement (e.g., number of weeks of work) and/or a wage requirement (e.g., dollar amount of wages earned). Individuals also must be able, available and actively seeking work. Each state has a different formula for determining the amount of workforce attachment needed to obtain UI benefits from the state.

The UI program is a federal-state partnership conforming to federal requirements and administered by state agencies under state law:

- Federal law – i.e., SSA and the Federal Unemployment Tax Act (FUTA) – establishes broad coverage provisions, some benefit provisions, the federal tax base and rate, and administrative requirements.

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[1] This section of the document borrows heavily from a U.S. Department of Labor publication, *Unemployment Compensation: Federal-State Partnership,* April 2015.
[2] http://www.bizfilings.com/toolkit/sbg/office-hr/managing-the-workplace/unemployment-benefits-system-info.aspx

- Each state designs its own UI program within the framework of the federal requirements. State statute establishes eligibility and disqualification provisions, benefit amounts, and state taxable wage base and tax rates.

The Office of Unemployment Insurance Operations at the Ohio Department of Job and Family Services (ODJFS) administers Ohio's UI program. Administrative funds for ODJFS are allocated by the federal government from federal payroll taxes employers pay to the Internal Revenue Service.

Financing the Program

Unemployment compensation paid to unemployed workers is financed largely through both federal and state unemployment taxes paid by employers. Just three states – Alaska, New Jersey and Pennsylvania – collect UI taxes from employees.

UI taxes are based on various factors, including the wages employers pay their employees, the type and size of the business, and the number and amount of unemployment claims filed against the business.

- At the federal level, the FUTA imposes a single flat rate payroll tax on the first $7,000 of wages employers pay each employee in a year. The current FUTA tax rate is 6.0 percent. However, employers can earn credits against their FUTA tax to reflect the state employment taxes they pay. Employers who pay their State Unemployment Tax Act (SUTA) taxes in a timely manner under an approved state unemployment compensation program can earn a credit of up to 5.4 percent against the 6.0 percent, resulting in an effective tax rate of 0.6 percent. These states also are eligible to receive federal grants to cover the costs of administering the program through federal appropriations. Additionally, funds from the FUTA-funded Federal Unemployment Account reimburse the state unemployment trust fund for 50 percent of charges for "extended" unemployment benefits when extended benefits are triggered by periods of high unemployment.
- At the state level, each state determines its own SUTA tax rates. Some states apply various formulas to determine the taxable wage base; others use a percentage of the state's average annual wage; and a few simply follow the FUTA wage base of $7,000. In 2014, SUTA tax rates ranged from 0.0 percent to 2.6 percent for minimum rates, and from 5.4 percent to 10.89 percent for maximum rates. All but a handful of states' wage bases exceeded the FUTA minimum requirement of $7,000. In 2014, Ohio's SUTA base was $9,000, with a minimum contribution rate of 0.3 percent and a maximum contribution rate of 8.60 percent.

The state assigns or computes a specific individually determined UI tax rate for each employer annually. Every state uses some kind of "experience rating" system to determine the rate. Generally, the fewer the claims, the lower the rate the business pays in state UI taxes.

States lacking sufficient funds to pay their required unemployment benefits are authorized by Title XII of the SSA to request advances (i.e., loans) from the FUTA's federal loan fund account, the Federal Unemployment Account. If not repaid, these loans carry interest that must be paid from sources other than the state UI trust fund.

Impact of the Great Recession

The Great Recession of 2008 was the nation's longest and deepest since the Great Depression of the 1930s. A majority of states did not have sufficient balances in their state unemployment trust funds to pay benefits without requesting advances (i.e., loans) from the federal government to assure that unemployment compensation benefits were paid. Ohio was among the states hardest hit by the recession. The timing of the recession contributed to a slow solvency response in adjustments to state unemployment contribution rates to bolster the trust fund.

There were significant increases in unemployment claims at the end of 2008 and beginning of 2009. At the same time, the automatically triggered contribution increases to pay increasing benefits were insufficient and additional revenue was not realized until after the end of the first quarter of 2009. As claims continued to increase through 2009 and 2010, the response in state UI tax rate adjustments to pay for the increases was too slow and too little to keep up.

The impact in Ohio has been severe. Ohio's unemployment trust fund balance has been a negative number as of the end of the second quarter every year since 2009. ***Today, Ohio's UI trust fund is among the least solvent in the country.*** The only state with a larger outstanding federal loan balance is California, and Ohio's current outstanding balance of approximately $775 million is nearly equal to the cost of benefit payments for an entire year.[3]

General Responses to the Threat of Insolvency

In response to the threat of insolvency, states have taken various actions to bolster tax revenue and reduce benefit outlay, including the following:

- Eliminating outstanding loan debt to the federal government by obtaining bank loans and/or using bonds to finance the debt through the private sector
- Enacting solvency legislation with a combination of benefit cuts and tax increases to eliminate Title XII debt and better align benefit costs with revenue over the long term
- Reducing the number of potential weeks of unemployment compensation
- Increasing tax bases
- Revising contribution rate schedules
- Reducing maximum weekly benefit amounts
- Enacting more aggressive integrity measures to identify and collect additional revenue through benefit overpayment recovery and contribution collection improvements

Ohio is one of a small number of states with significant outstanding federal debt that have chosen not to enact solvency measures, instead allowing automatic FUTA penalties to continue to increase to provide the revenue needed to reduce the state's outstanding debt.

This is a dangerous path to follow. Failure to pay off a state's outstanding FUTA debt has costly consequences. Under federal law, if a state has an outstanding Title XII loan balance on

[3] A number of states that show positive balances in their unemployment trust funds and are not borrowing federal funds to pay unemployment compensation are relying on private bonds and/or loan financing to pay off outstanding federal loans to avoid automatic FUTA increases. In some case, Ohio's outstanding total debt may be less than a number of these states that have private financing.

January 1 for two consecutive years, and the full amount of the loan is not repaid by November 10 of the second year, the 5.4 percent FUTA tax credit for employers in that state will be reduced annually by 0.3 percent for each succeeding year until the loan is repaid. From the third year onward, additional reductions in the FUTA offset credit may be imposed. States that continue to have outstanding loan balances over five years in a row are subject to an even greater FUTA tax increase as a penalty for not having addressed solvency through increases in taxes and/or cuts in benefits. This additional penalty is the Benefit Cost Rate (BCR) Add On.

Ohio is one of just four states currently subject to the increased FUTA penalty rates and potentially subject to a BCR Add On for 2015.

Based on its loan status as of November 10, 2014, Ohio was one of eight states whose FUTA credit for taxable year 2014 was reduced, meaning that employers in Ohio paid extra FUTA taxes retroactive to January 1, 2014. Because Ohio is four years in arrears on repayment of its UI loan from the federal government, the credit reduction in 2014 was 1.2 percent, resulting in Ohio employers paying an additional $84 per employee in FUTA taxes for 2014. Ohio also failed to pay off the state's outstanding FUTA debt before November 10, 2015, triggering an additional reduction in the FUTA offset credit for employers in Ohio. This will result in Ohio employers paying even higher FUTA taxes for 2015, retroactive to January 1 – at least an additional $105 per employee, on top of the normal $42 per employee.

Title XII loans repaid before November 10 of 2016 or 2017 would result in the FUTA tax for either year dropping back down to the normal 0.6 percent for that year. Loans repaid before January 1, 2017, or January 1, 2018, would break the continuation of the FUTA increases under federal law and result in the FUTA tax returning to 0.6 percent for calendar year 2017 or 2018. As revenue from the increased FUTA taxes is credited to the Ohio Trust Fund in early 2016 and 2017, the state may be able to pay off the remaining federal debt before November 10, 2017, eliminating the continued imposition of the FUTA increase for 2017.

Another impact of not paying off Title XII loans is that state loans that remain due and unpaid as of January 1 of a calendar year accrue interest at the federal funds rate. For 2015, the interest rate is 2.3385 percent. Failure to pay the interest by the required date in a given year will result in a state losing its full FUTA credit of 5.4 percent for that year. The state also could lose the federal grant for the cost of administering the state's UI system.

Under federal law, the loan interest must be paid from a source other than the state unemployment benefit trust fund account. States with outstanding Title XII loans have chosen a number of ways to pay this interest, including allocations from state general revenue, special assessments to be paid by employers, as part of bond proceeds, and from state account loans. Ohio has paid the interest from state general revenue.

Federal law contains provisions allowing states with outstanding loans to seek relief from the automatic repayment provisions if certain requirements are met. For a state to qualify for a BCR Add On waiver, for example, the state must show that no action has been taken legislatively, administratively or judicially that reduces the net solvency of the state's trust fund. Ohio requested a waiver for 2015 and will need to closely monitor any legislation, administration and judicial decisions to avoid the potential BCR Add On for 2016 and 2017. Legislation enacted to improve solvency effective between October 1, 2015, and September 30, 2016, would ensure that Ohio was able to qualify for the waiver of the BCR Add On tax for 2016.

Careful management of Ohio's unemployment trust fund balance and loan repayment in 2016 and 2017 is needed to avoid a BCR Add On tax and to take advantage of opportunities to pay off the state's outstanding debt. ***Solvency efforts are needed not only to manage the repayment of the federal loan, but also to align UI tax revenue and benefit pay out over the long term*** – to build a significant balance in the Ohio Unemployment Insurance Trust Fund to avoid having to borrow during a reasonably foreseeable recession and to avoid the imposition of future automatic FUTA tax increases.

Solvency Comparisons: Tax Burden

The UI tax burden in Ohio generally increased as a result of the Great Recession as claims experience increased, the payroll against which experience was determined was reduced, and Ohio became subject to the FUTA offset credit reductions under federal law. As the economy slowly recovered with increased payrolls and reduced claims experience, experience rates improved and the average state unemployment insurance contribution was reduced. ***However, the FUTA tax has continued to increase as Ohio's Title XII loan has not been repaid.***

Experience rate reductions were restrained due to tax increases automatically triggered by the state's failure to meet Ohio's Minimum State Level (MSL) standard for UI trust fund solvency levels. This solvency provision results in the maximum contribution rate for Ohio employers being increased to 8.60 percent, although the maximum rate on the base rate schedule is just 6.70 percent.

For 2015, Ohio's maximum rate of 8.60 percent compared to Michigan's 12.70 percent, Pennsylvania's 10.89 percent, West Virginia's 8.50 percent, Kentucky's 10.21 percent and Indiana's 7.54 percent[4]. It should be noted, however, that the effect of the flat FUTA tax increase in Ohio further increased the overall unemployment-related tax burden for maximum rated employers as well as other contributing employers.

Ohio's unemployment tax base at $9,000 is currently lower than most states in the country. In 2015, tax bases ranged from $7,000 (the minimum required to match with FUTA) up to $42,100 in the state of Washington. California, Texas, Florida and Puerto Rico have UI tax bases of $7,000. Only 8 states (including Puerto Rico) have tax bases lower than $9,000. DC, Nebraska, Ohio, Pennsylvania, Tennessee, and Texas have $9,000 tax bases.[5] Contribution rates are typically lower in states with higher tax bases; however, the per-employee tax ranges significantly. For 2014, per-employee costs ranged from $0 at the minimum rates up to $3,279 at maximum rates. Ohio contributions per employee ranged from $27 at the minimum up to $774 at maximum.[6]

It should be noted that for 2015, although Ohio's state UI tax on total wages is comparatively low, the total cost associated with financing unemployment compensation includes the increased FUTA tax. ***If Ohio's Title XII debt was paid off so as to eliminate the FUTA offset credit reduction, the total amount being paid by Ohio employers would be cut significantly with the reduction in the FUTA tax rate.*** State UI tax rates and wage base would be at or below the rates and base of surrounding states.

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[4] Highlights of State Unemployment Compensation Laws 2015 published by the National Foundation for Unemployment Compensation and Workers' Compensation

[5] Highlights of State Unemployment Compensation Laws 2015 published by the National Foundation for Unemployment Compensation and Workers' Compensation

[6] Significant Measures of State Unemployment Insurance Tax Systems published by the US DOL Office of Unemployment Insurance, Division of Fiscal and Actuarial Services

Solvency Comparisons: State Trust Fund Levels

Each state has the responsibility to design a system of unemployment contributions and benefits that assures unemployment compensation is paid to unemployed individuals who meet requirements "when due." There are a number of policy points to consider in determining what a state solvency standard should be, including the following:

- Current balance and projected revenue
- Projected benefit outlays
- Amount needed to avoid borrowing to pay benefits during recessionary periods
    - Funds needed to withstand any recession
    - Funds needed to withstand the most common recent recessionary period
    - Funds needed to avoid borrowing from federal accounts or private financing
    - Funds needed to avoid triggering an additional FUTA tax

The higher the solvency standard, the larger the tax increases and/or benefit cuts needed to reach the solvency balance.

The primary U.S. Department of Labor (US DOL) solvency guidelines recommend that a state maintain a UI trust fund balance equal to or exceeding one and one-half times the **High Cost Model (HCM)** determined by taking the historically highest claims activity in the state for a year and multiplying by 1.5. The actuarial justification for this is that it provides a sufficient balance to withstand any recessionary period without borrowing from the federal government.

US DOL ultimately determined that the required trust fund balances for the 1.5 HCM standard were not realistically reachable by most states, including Ohio, because the size of tax increases and/or benefit cuts to reach the guideline would be too great.

US DOL developed a more reachable alternative called the 1.0 times **Average High Cost Model (AHCM)** that reviews claims over the most recent 20 years or last three recessionary periods and sets the solvency goal at the average of the three highest years of claims. This standard seeks to set a balance that is likely to withstand a reasonable foreseeable recession, but not an historic outlier recession. It results in a lower required balance but still is difficult for many states, particularly industrialized states, to reach within a short period.

A third option, **Ohio's Minimum Safe Level (MSL),** was developed in response to the recession of the early 1980s. The MSL sets the minimal solvency at an amount to cover a reasonably foreseeable recession without building up a trust fund balance that would only be needed for the historically deepest recession. When enacted, the MSL required a smaller trust fund balance than US DOL guidelines recommended, but results over time approach the AHCM balance requirements. The Ohio MSL also is more sensitive to short-term changes in benefit payout increases and contribution payments.

The Recession of 2008 was much greater than expected, wiping out positive unemployment trust fund balances across the country and in Ohio. Automatic tax trigger provisions in Ohio law designed to address a milder recession were insufficient to meet the increased benefit payout. The size of the deficit after the 2008 recession was too great to make up with benefit cuts or tax increases alone and even years after the recession, benefit payments each year continue to be nearly as high as unemployment contribution revenue.

Clearly there is a need for improved solvency before the next recession – not only to manage the repayment of Ohio's remaining Title XII loan balance but also to align benefit and contributions to build an adequate unemployment trust fund balance. The best solvency plan is one that also includes a focus on job creation because increased employment not only increases contributions but also reduces benefit payout. For that reason, rates also should be in line with surrounding states and states with which Ohio competes to attract and retain new business.

Issue to Consider: Benefit Provisions

Benefit payment amounts in Ohio are higher than the national average due to a number of factors, including the following:

- Automatic increases in maximum weekly benefit amount tied to the Statewide Average Weekly Wage
- Dependency provision that adds a significant additional amount, particularly for higher wage workers
- Potential number of weeks of unemployment compensation up to 26 weeks

Ohio's average weekly benefit amount, maximum weekly benefit amount, and potential number of weeks compared to surrounding and competing states demonstrate the differences that contributed to Ohio's high-benefit payments.[7]

	Avg. Weekly Benefit Amount	Max. Weekly Benefit Amount	Max. Number of Weeks
Ohio	339.55	572	26
Michigan	277.93	362	20
Pennsylvania	377.11	581	26
West Virginia	300.26	424	26
Kentucky	306.57	415	26
Indiana	256.25	390	26
North Carolina	233.69	350	12-20
South Carolina	255.19	326	20
Georgia	277.91	330	14-20

Additionally, specific benefit provisions that merit consideration as options for addressing UI solvency and better aligning benefit payments with contributions include the following:

- **Dependency.** Ohio is one of just 14 states that include dependency allowance as part of the determination of a claimant's weekly benefit amount. The provision is somewhat unique in that it provides an additional amount for claimants with dependents who have sufficient wages in relation to the statewide average weekly wage – but no additional benefit to the lowest-wage workers. Ohio's dependency provision has significantly increased benefit payout and increased the average weekly benefit amount compared to most of the surrounding and competing states.

  The unemployment insurance program is designed as a short-term partial wage replacement for the individual as the individual actively searches for work, is able to work and is available for work. ***It is not designed as a public assistance program providing household support.***

[7] U.S. Department of Labor UI Quarterly Data Summary

- **Maximum weekly benefit amount.** The formula used in Ohio to determine the maximum weekly benefit amount increases each year with the statewide average weekly wage. This automatic increase contributes significantly to insolvency. Thirty-three states provide for an increase in the maximum weekly benefit amount tied in some way to the average weekly wage; however, many of them modify the application of the increase when the state UI trust fund is below a certain level or when there are outstanding Title XII loans or other solvency concerns.
- **Number of potential weeks of unemployment compensation.** Since the Great Recession of 2008, a number of states have taken steps to reduce the maximum number of weeks of unemployment compensation provided under state law. Most states, including Ohio, currently pay benefits for a maximum of 26 weeks. Massachusetts pays up to 30 weeks and Montana provides for up to 28 weeks. Eight states have fewer than 26 maximum weeks of benefits.

  A new policy direction was developed in Florida and adopted in Georgia and North Carolina to set the maximum of number of weeks of benefits in relation to the state's unemployment rate. This is based on the premise that individuals who become unemployed when unemployment rates are down are most likely to find employment in a shorter period of time than when unemployment rates are high.

  The average duration of unemployment compensation in Ohio as of the first quarter of 2015 was 14.9 weeks, even though the maximum number potentially available was 26 weeks. ***For most claimants in Ohio, a reduction in the potential number of weeks below 26 would not impact the availability of benefits during the period of unemployment between jobs.***
- **Workforce attachment.** Current Ohio law requires employers to report employee wages with respect to a quarter and the number of weeks during the quarter for which the individual earned or was paid wages. This requirement can inadvertently result in situations where short-term "cyclical" employment results in higher weekly benefit amounts and/or more weeks of benefits than the individual actually worked. Adding a requirement that base period wages be paid with respect to three quarters within the base period would reduce the number of claimants affected as they would have a longer period of time during which to demonstrate workforce attachment in at least three calendar quarters.
- **Waiting week.** One of the common features of state unemployment insurance law is the "waiting week" at the beginning of a benefit year before an individual may be paid unemployment compensation for a week claimed. The first week of unemployment compensation claimed that is compensable generally serves as the waiting week.

  The policy behind the waiting week is that unemployment insurance is designed as a ***temporary partial wage replacement***. As individuals become unemployed, they typically receive their last payroll check and accrued sick leave, vacation leave and separation pay for the weeks after leaving employment. Unemployment compensation payments are not needed to replace wages until after the last payment of wages is received.

  Forty-four states require a waiting week, and North Carolina has imposed an administrative waiting week any time there is a break in the claims series within the benefit year. The North Carolina Department of Commerce reports that this provision has been shown to be effective in battling identity theft and avoiding the overpayment of multiple weeks of benefits.

- **Labor dispute disqualifications.** All states and jurisdictions have provisions that provide for disqualification from unemployment compensation if an individual becomes unemployed due to a labor dispute in which the individual participates and the dispute is in progress. Some states have provisions such that if the employer takes the initiative to physically lock out employees so that they are not permitted to work even though they make themselves available, there may be an ongoing labor dispute but it may not be the cause of the unemployment.

  A small number of states, including Ohio, have statutory provisions and/or case law requiring that individuals who are "constructively" locked out may not be denied unemployment compensation due to the labor dispute. The determination of whether individual claimants (often represented by unions) are willing to return to work pending the results of contract negotiations and/or whether the employer has or has not permanently replaced workers due to the labor dispute can be difficult. An amendment removing the specific lock out exception in the current statute would bring Ohio into line with the majority of states on this issue.

- **Deductible income.** Because unemployment compensation is a temporary partial wage replacement program, if the claimant receives other income or wage replacement payments with respect to the same week or weeks claimed, most states provide for the reduction or denial of unemployment compensation taking those other payments into consideration. For example, an individual who is laid off for lack of work, becomes unemployed and files a claim for benefits may receive accumulated separation pay, vacation pay, holiday pay or other sources of payments in the week or weeks after becoming unemployed. States typically reduce unemployment compensation for such payments that are attributable to a week claimed.

  States have adopted more rigorous requirements that such payments must be allocated to ensuing weeks of unemployment compensation. This policy approach reduces benefit payout without jeopardizing the purpose of the UI program to provide temporary partial wage replacement as the individual searches for work. It also increases the incentive to actively seek work immediately after becoming unemployed.

- **Social security and workers' compensation disability and cash payments.** Federal law enacted effective in 1980 required the amount of unemployment compensation payable to an individual based on a specific period of time also used to determine social security or other similar periodic retirement benefits paid to the same individual must be reduced by the amount of those payments. The law was later amended in such a way that virtually no state today reduces unemployment compensation dollar for dollar for social security retirement payments.

  The reduction of unemployment compensation in light of social security benefit payments is consistent with the UI program goal to provide temporary partial wage replacement for individuals who become unemployed. Individuals who receive unemployment compensation and social security and potentially other sources of wage replacement payments are less likely to return to work and more likely to exhaust unemployment compensation, increasing costs to the trust fund.

  Similarly, cash payments from workers' compensation awards for the same week that unemployment compensation is claimed result in individuals receiving nearly as much, if not more, in combined cash payments when they are not working as when they are working. Individuals who are totally disabled under Social Security Disability Insurance or Workers' Compensation generally are by definition not able to work and should not be eligible for unemployment compensation as it requires that a claimant be able to work.

Program Integrity Measures

The following "able, available and actively seeking work requirement" issues merit consideration as options for strengthening UI program integrity:

- **Overpayments and collections.** Erroneous payment rates for unemployment compensation benefits in recent years have exceeded 10 percent nationally. One of the primary reasons for the increased overpayment rate is the US DOL performance measure that states are expected on average to make 87 percent of benefit payments within 14 days after a compensable week. This measure drives states to make payments within this time frame even when there may be a need for additional fact finding. It also causes employers to rush to respond to requests for information in a short time frame and provide what they can but choose to appeal more negative decisions to the next level. In other instances, states are forced to write off uncollected amounts prematurely.

  Many states, including Ohio, have statutory provisions that automatically write off overpayments after specified periods and limit fraud prosecutions. Ohio law currently automatically writes off as uncollectable any non-fraud overpayment amounts after three years. This is among the group of states with the shortest period of time for write off. Ohio law also currently requires prosecution of unemployment compensation fraud within six years after an administrative determination of fraud.

  A better approach is to repeal artificial statutory time frames in favor of best collection and prosecution practices and not to automatically write off amounts that have not yet been collected. If an individual has an outstanding overpayment amount due and can be located for collection, the outstanding overpayment amount should not be written off. Likewise, prosecutions should not be limited in proceeding within an artificial time frame.

- **Disqualifications.** Once a claimant has established benefit rights by meeting the monetary and workforce attachment provisions the claimant must also be determined to have become unemployed through no fault of his her own in connection with the work. The definition of "fault" or "misconduct" varies in each state but generally falls within the broad description of misconduct in connection with work. States typically refer to these determinations as nonmonetary disqualifications. An individual who quit work without just or good cause or was discharged for just or good cause by an employer is disqualified from eligibility to be paid unemployment compensation. However, if the individual subsequently works in covered employment for a period determined by the state and becomes unemployed through no fault of his or her own, the initial disqualification may be removed so the individual may claim and be paid benefits.

  The period required and/or the amount of subsequent wages in these so called "duration" suspensions varies from state to state. In 2015, requirements ranged generally from 3 to 10 weeks of wages and/or work subsequent to the non-disqualifying separation for the individual to once again become eligible to claim benefits if the individual became unemployed.

  Ohio currently requires that an individual work at least six weeks and have earnings equal to or greater than six times 27.5 percent of the statewide average weekly wage. This formula was determined as a way to assure that the employment was sufficient to establish a meaningful workforce attachment before the individual may become eligible after a disqualification to be paid benefits. Ohio may consider increasing the duration suspension removal requirements as a solvency and integrity measure.

- **Work search requirement.** Individuals must be actively searching for work as a condition of being eligible to be paid unemployment compensation. States set minimum work search requirements for claimants based on their individual circumstances if they have a specified return-to-work date, are referred to work through a hiring hall, or are indefinitely unemployed and required to conduct a broader search.

  Individuals with return-to-work dates from an employer are typically required to be available to return to work to that employer while they are unemployed. Likewise, unemployed workers required by agreement to be available to work through a hiring hall are required to meet the terms of referral through the hall. Others are required to seek work more broadly and to make a number of contacts with employers ranging from 2 to 5 contacts per week at a minimum. Individuals also may not refuse offers of suitable work, and refusal of a bona fide offer of work is grounds for disqualification.

  There are two policy points of significance in administering work search requirements: (1) the work for which the individual must search and be available to accept, and (2) the terms and conditions of the work, including pay, distance to travel to work, etc. Reemployment of claimants improves when work-search requirements are clearly stated, enforced and meet the needs of the claimants in effectively seeking work. The requirements also should be verifiable for purposes of proper claims administration.

- **Drug testing.** Individuals are required to be able to work and available for work as a condition of being paid unemployment compensation and may not be eligible to be paid if they are using illegal drugs so as to render themselves unavailable or unable to work. In the Middle Class Tax Relief and Job Creation Act of 2012, Congress recognized that under certain circumstances state unemployment insurance agencies may require drug tests and disqualify individuals who test positive for the presence of controlled substances. The authority is limited, however, to circumstances in which the individual was separated from employment due to a drug test or the only job for which the individual is suitable is one which requires that the individual must pass a specified drug test (e.g., truck drivers required to have commercial drivers' licenses).

  It is permissible for a state to inquire of an individual if the individual became unemployed due to failing to pass a drug test, and there is some value in having such a provision to encourage unemployed workers to choose not to use drugs and to disqualify them from benefits if they continue to do so. There is also value in the development of reemployment plans for claimants to be aware that there may be a barrier to employment to be addressed and to assist the claimant through referral to other programs that may provide treatment for drug dependency.

  In evaluating drug testing programs, it should be noted that no additional federal administrative funds were provided along with the authority to test under certain circumstances. A review of the benefits and costs should be conducted in determining the scale and scope of such a program. In administration of drug tests, the agency should be careful not to interfere with drug testing on behalf of the employer.

Contributions and Tax Provisions

Employers in Ohio are currently paying more than employers in most states in total costs associated with unemployment compensation. Because Ohio to date has chosen not to address insolvency through benefit cuts and/or increases in state unemployment contributions, the cost driver has been the automatic increases in the FUTA tax rates.

For 2015, employers in Ohio are likely to pay the second-highest FUTA tax rate in the country, second only to Connecticut. Assuming Ohio qualifies for a waiver of the Benefit Cost Rate Add-on, the 2015 FUTA tax rate is likely to be 2.1 percent on the FUTA $7,000 tax base, for a per-employee cost of approximately $147. The normal FUTA cost per employee is only $42.

This increased FUTA tax puts Ohio at a disadvantage with other states that have paid off their federal loan debt and adopted solvency measures to keep state unemployment contributions down as well.

A vital first step for Ohio should be to pay off of the remaining Title XII loan to eliminate the FUTA tax increase as soon as possible. The fact that additional revenue from the FUTA tax increase will be deposited into the unemployment trust fund should enable the state to pay off the remaining balance in 2017, assuming that the country does not slip back into an economic downturn.

Ohio's state unemployment tax burden in 2015 is slightly below the national average and surrounding states. Although the combination of the FUTA tax and the state unemployment tax results in high total costs in 2015 and 2016, as the additional FUTA tax burden is removed with the repayment of the Title XII loan in 2017, there will be an opportunity to address additional state UI tax revenue along with a package of benefit cuts and reforms designed to improve the positive balance and align benefit payout with state unemployment tax revenue.

Through carefully crafted legislation and fund management, Ohio can make the transition over the next three years from a high-benefit, high-cost state to one with competitive tax rates while maintaining benefits at appropriate levels.

Other tax and contribution provisions that merit consideration for change include the following:

- **Tax base.** Ohio's state unemployment tax base of $9,000 in 2015 is below the national average and below or equal to the base in surrounding states. A tax base increase could be part of a long-term solvency package for Ohio without significantly increasing total costs if it were increased the year after the FUTA tax returned to the normal rate.
- **Contribution rate schedule.** Ohio's contribution rate schedule is fairly sensitive to changes in its experience rating. Although there continue to be a number of maximum-rated employers, due to legislation enacted after the Great Recession the amount of benefits effectively non-charged has been reduced and compares favorably with other states.
- **Mutualized tax and account.** Decades ago, Ohio enacted a mutualized tax and established a mutualized account. The purpose of the account was to keep track of the list of items that are not chargeable to individual employer accounts but are nonetheless obligations of the unemployment benefit account for the state. The tax is set at 0.0 percent to 0.5 percent on the tax base as necessary to generate revenue to cover these charges to the account.

  In recent years, because FUTA tax revenue has been credited to the account and benefit charges have reduced claims, the account has accumulated a significant positive balance so that the mutualized tax is now 0.0 percent.

  As a matter of policy, it is more consistent with experience rating to charge and credit individual employer accounts with benefit charges and contributions. Consideration should be given to modifying the crediting of MSL tax revenue currently credited in part to the mutualized account to instead be credited to individual employer accounts. This

will provide a greater benefit to employers with positive experience rates without jeopardizing the continuation of the 0.0 percent mutualized tax.

- **Minimum Safe Level surtaxes and reductions.** Current law in Ohio provides for a series of triggered additional taxes when the state unemployment trust fund is below the minimum safe level and reductions when it exceeds the minimum safe level. Because Ohio's unemployment trust fund balance has been negative for many years, the Minimum Safe Level (MSL) surtax has been computed each year based on the trust fund being 60 percent or more below the MSL. As the trust fund balance becomes positive and increases to a level above this mark, state unemployment contributions will be reduced.

  The US DOL recommended solvency guidelines would require Ohio to dramatically increase contributions and/or slash benefits. Contribution increases to achieve these levels would place Ohio at a disadvantage with other states in keeping and attracting new business. A realistically reachable MSL would enable the state to better manage the trust fund within an environment that recognizes the need for a significant balance in the trust fund and includes solvency measures that may reach the goals being set.

  Projections of the effect of changes in the MSL, the MSL surtax, and the Mutualized Tax would be helpful in evaluating the appropriate solvency measures. As part of the review, attention also should be given to whether solvency measures may be enacted on a temporary basis until the MSL is reached and/or whether some measures should be permanent features to improve long-term solvency.

- **New employer rate.** One of the items considered by states in reforming their state unemployment tax provisions is the contribution rate assigned to new employers who have not had sufficient time to qualify for a computed experience rate .

  Many states, including Ohio, have a different new employer rate for employers in the construction industry and others. The reasoning for the difference is that employers in the construction industry typically have higher rates due to the cyclical nature of the business and there is concern that out-of-state construction companies would be given an advantage over in-state businesses if they were assigned a new employer rate lower than the average of construction industry employers in the state.

  Other than contribution rates for the construction industry, new employer rates vary by state depending on state policy and the contribution rates being paid by existing employers as some guidance. In Ohio, new employers, excluding construction, are assigned a rate of 2.7 percent.

  Federal law recognizes the need for new employer rates and permits states to adopt new employer rate as low as 1.0 percent. States seeking to more aggressively attract new employers have adopted rates as low as 1.0 percent.

  A lower new employer rate may be helpful in attracting new business, which grows the economy and increases the state tax base and state tax revenues. Reducing Ohio's new employer rate from 2.7 percent to 1.0 percent could result in a minor reduction in revenue if a new business would have located in Ohio anyway, or if it ceases operation shortly after starting up.

- **Employee contributions.** The Federal/State Unemployment Insurance system was established as a system which depended on employer contributions as the source of funding for unemployment compensation to be paid by the states. A federal/state system was chosen over a national system because some states already had systems in place

and there was opposition to an additional federally mandated requirement. Instead, the unemployment insurance system was devised to impose a federal unemployment tax but to provide for a significant offset credit against the federal tax to be paid by employers in states meeting minimum federal requirements. Experience rating was added to the system as a way to encourage management of state unemployment claims and to distribute the cost of unemployment compensation to employers based on claims experience.

As unemployment trust fund accounts have been impacted by swings in claims load and recessions, states have chosen to add other sources of revenue to bolster state unemployment trust fund account balances and improve solvency on a permanent or temporary basis. Employee contribution provisions have been adopted in New Jersey, Pennsylvania and Alaska. In each state the amount of the employee contributions differs based on the individual state trust fund solvency and/or ongoing support for benefit levels. Employee contributions can add significantly to revenue for UI trust funds. Employee contributions reduce the net wages provided to all employees but are typically cited as justification for higher weekly benefit amounts for those who file for unemployment compensation. They are not included as contributions in the calculation of employer unemployment experience rates because they are not based on unemployment compensation claims experience.

Conclusion

Ohio faces an urgent need to explore options for reforming the state's unemployment insurance system so that it better meets the needs of employers, unemployed workers and the state's economic development and job creation and retention efforts. Currently, Ohio ranks poorly on many important unemployment insurance program metrics. For example:

- Ohio's Unemployment Insurance Trust Fund is insolvent.
- Ohio's outstanding Title XII debt is approximately $775 million – nearly equal to the cost of unemployment insurance benefit payments for an entire year. Only California has a larger unpaid Title XII loan debt balance.
- Ohio is one of a small number of states with significant outstanding federal debt that have chosen not to enact solvency measures.
- Employers in Ohio currently pay higher total costs associated with unemployment compensation than employers in most other states, while benefit payment amounts in Ohio are higher than the national average. This makes Ohio a high-cost, high-benefit state.
- The FUTA tax paid by Ohio employers has continued to increase as Ohio's Title XII loan has not been repaid.
- Ohio is one of just four states currently subject to higher FUTA penalty rates and potentially subject to an additional Benefit Cost Rate (BCR) penalty in 2015 for having outstanding loan balances five years in a row and failing to address insolvency.
- Ohio failed to pay off the state's outstanding FUTA debt before November 10, 2015, triggering an additional reduction in the FUTA offset credit for employers in Ohio. This will result in Ohio employers paying higher FUTA taxes for 2015 – at least an additional $105 per employee, on top of the normal $42 per employee.

- Ohio's Unemployment Insurance Trust Fund is not likely to recover solvency before the next recession unless the state takes action to pay off its outstanding federal loan balance and better align benefits with contributions to build a balance in anticipation of the next recession.

UI policy reform priorities should focus on eliminating the state's current unemployment trust fund debt, aligning benefit payout with contribution revenue, and building a balance in the unemployment trust fund sufficient to avoid triggering automatic FUTA tax increases that have significantly increased unemployment taxes for Ohio employers since the Great Recession of 2008. A vital first step for Ohio should be to pay off of the remaining Title XII loan balance to eliminate the FUTA tax increase as soon as possible.

# # #

See Appendix on next page.

APPENDIX

Ohio UI Trust Fund Balance –Twelve Months Ending 4th Quarter

The following chart of end-of-year Ohio Unemployment Insurance Trust Fund balances illustrates the impact of the Great Recession on the fund's solvency:

Year	Trust Fund Balance (thousands)	Contributions (thousands)	Benefits (thousands)
2006	499,580	1,115,312	1,177,610
2007	444,530	1,096,249	1,206,524
2008	63,121	1,093,657	1,586,561
2009	35,395 Loan Balance: 1,727,938	1,106,204	3,164,940
2010	104,059 Loan Balance: 2,314,187	1,254,698	2,167,459
2011	39,981 Loan Balance: 2,078,387	1,535,736	1,725,694
2012	21,477 Loan Balance: 1,739,094	1,451,064	1,417,137
2013	51,016 Loan Balance: 1,552,346	1,197,653	1,194,420
2014	345,479 Loan Balance: 1,378,734	1,183,458	1,037,075
2015	590,517 Loan Balance: 978,459	1,161,293	983,430

Source: United States Department of Labor Quarterly Data Summary for the 4th quarter of 2014 and 2nd quarter of 2015

Outstanding Loans from the Federal Unemployment Account
Balances as of November 3, 2015

As of November 3, 2015, the only states with remaining Title XII loan debt, which triggers higher unemployment tax rates and possible additional penalties, included the following:

California	$6,128,378,020.63
Ohio	$774,834,855.39
Connecticut	$101,716,619.13
Virgin Islands	$72,190,452.23

These states are not likely to recover solvency until they pay off their outstanding federal loan balances.

Source: United States Department of Labor UI Trust Fund Loan Status