FISCAL RESEARCH CENTER

ANALYSIS OF GEORGIA'S UNEMPLOYMENT INSURANCE TRUST FUND RESERVES

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Executive Summary

Purpose of the Trust Fund

The uneven distribution of the risk of unemployment implies that a market for Unemployment Insurance (UI) would not form naturally in the private sector, since workers with a lower risk of becoming temporarily unemployed would form their own pool so as to pay lower insurance premiums. Therefore, if UI was voluntary, workers facing a higher risk of temporary unemployment, especially in volatile industries like manufacturing and construction, would face prohibitively high premiums.

This implies therefore that federal and state governments need to partially subsidize the premiums of high-risk workers. A payroll tax collected from employers ensures coverage of both high and relatively low-risk employees.

The federal-state system of UI in the United States was established by the provisions of the Social Security Act of 1935 to provide partial wage replacement for involuntarily unemployed workers, to reduce the dispersal of skilled workers when employers make temporary layoffs, to help maintain aggregate purchasing power during economic downturns, and to prevent the breakdown of general labor standards during such periods.

Financing the UI Trust Fund

Georgia's UI is financed entirely by payroll taxes statutorily levied on employers. Unlike in the states of Alaska, New Jersey, and Pennsylvania which collect employee contributions, employees in Georgia do not contribute to the Trust Fund.

UI taxes have both a federal and state component. Since Georgia's unemployment compensation program has been approved by the federal government and continues to adhere to federal guidelines, the federal tax is, in effect, 0.8 percent of the first $7,000 of wages, or an equivalent of $56 per covered worker each year.

Proceeds from the federal government UI tax are used to pay administrative costs of the program at both the federal and state levels, to partially cover the cost of

extended benefits, and to maintain a federal unemployment Trust Fund which a state may borrow from should it exhaust its own Trust Fund. Federal government UI taxes are typically not used to pay benefits.

Federal loans come at a cost to employers as additional federal UI taxes are imposed on employers whose states have borrowed from the federal UI Trust Fund. Federal rules dictate that interest payments on federal loans can only be financed by UI surcharges or general revenues and not paid out of Trust Fund balances.

Georgia's UI taxable wage base is the first $8,500 of earnings for each employee each year, paid by all liable employers or employers subject to the Employment Security Law. Wages over $8,500 are considered non-taxable for UI purposes in the state of Georgia.

Tax rates are based on the "experience rating principle." This principle considers the history of an employer's UI benefits paid to former workers, the growth of an employer's payroll, and the overall unemployment conditions for the state. The experience rating principle requires that an employer's tax rate vary positively with its propensity to lay off workers, suggesting that each employer is subject to a different rate.

The minimum and maximum UI rates in Georgia for 2005 were 0.03 percent and 6.48 percent, respectively. The maximum UI tax rate for 2006 is 6.21 percent while the minimum rate is unchanged at 0.03 percent.

Revenues from the state UI taxes are deposited in the UI Trust Fund managed by the U.S. Treasury. The U.S. Treasury pays approximately 7 percent in interest on the accounts and states draw down the Trust Fund to pay benefits and refund overpayments to employers.

The UI Trust Fund is used exclusively to finance the payment of regular benefits which comprise the biggest proportion of total UI costs. Federal loans to the state must eventually be repaid with interest, and as such, Georgia's UI system is essentially self-financed by its employers.

UI Benefits

UI provides unemployment benefits to eligible workers who are unemployed through no fault of their own and who are either looking for another job, have definite recall to their jobs within 6 weeks of the last day worked, or are in approved training. Eligibility for benefits is determined based on past wages, reason for job separation, and availability and job search requirements.

The weekly benefit amount (WBA) of benefits a claimant may receive is the whole dollar amount which is computed by dividing the two highest base period quarters (or the first four of the last five completed calendar quarters at the time of filing) by 46.

The number of weeks of entitlement ranges from a minimum of nine weeks to a maximum of 26 weeks. The total maximum benefits to which a claimant is entitled during the benefit year (365 days forward from the date the claim is filed) is one-fourth of the total base period wages or 26 times the weekly benefit amount, whichever is less.

The extended benefit program provides up to 13 weeks of additional benefits or "extended benefits" to workers who have exhausted their regular UI benefits especially in times of high unemployment.

The state of Georgia is reimbursed by the federal government for 50 percent of all but the first week of extended benefits, implying that there is a charge of 100 percent to Georgia employers for the first week of these benefits. Governmental agencies are charged 100 percent of all weeks paid with extended benefits.

Structure of Georgia's UI Trust Fund

Georgia's Trust Fund balance has grown steadily over the past 30 years (1970-1999), with only minor drawdown cycles during the periods 1974-1976, 1981-1982, and 1990-1992. The onset of the new millennium saw a marked drawdown in Georgia's Trust Fund reserves which lasted for four years starting in 2000 through 2003.

The duration and percentage decrease of the early 2000 drawdown cycle far exceeds any other drawdown cycle in the 35 year history (1970-2004). The drawdown during the period 2000-2004, is among other things, considered to be a result of a 1999 moratorium by the state's legislature providing for the temporary suspension of employer contributions to the Trust Fund.

Georgia's UI structure is designed to ensure solvency of the Trust Fund while minimizing the UI payroll tax burden on the state's employers via surcharges on covered employers when the reserve ratio falls below 1 percent and rate reductions when the reserve ratio gains by over 2.44 percent. According to this criterion, it appears that the rate reduction provision only applied prior to 1975 when the reserve ratio exceeded the 2.44 percent mark, while surcharges should have been imposed after 2002 when the reserve ratio fell short of the 1 percent threshold.

Solvency of Georgia's UI Trust Fund

The solvency of Georgia's UI Trust Fund is evaluated by three widely used measures of assessing UI Trust Fund adequacy: the average high cost multiple (AHCM), high cost multiple (HCM), and the reserve ratio. We compute the second highest cost multiple or 2HCM for comparison purposes.

The AHCM, computes adequate reserves to finance at least 12 months of benefits paid out at the average of the state's three highest "cost rates" (statewide ratio of benefits paid out of total wages of UI eligible employees in any calendar year) over the previous 20 years. For comparison purposes, we also compute the AHCM over the past 35 years.

Our findings reveal that Georgia's AHCM is 119 which falls short of the U.S. Labor Department (U.S. DOL) endorsed AHCM of 150. The U.S. DOL standard requires Trust Fund reserves sufficient to finance 18 months of benefits paid out at the average of the three highest cost rates recorded during the past 20 years.

Georgia's AHCM reveals that the state has sufficient reserves to finance 14 months of benefits paid out at the average of the three highest cost rates recorded during the past 20 years. When the period of analysis is extend to 35 years, our results indicate that Georgia's Trust Fund reserves are only sufficient to finance 11

months of benefits paid out at the average of the three highest cost rates recorded during the past 35 years.

The high cost multiple (HCM) measure computes Trust Fund reserves sufficient to finance 12 months of benefits paid out at the highest cost rate recorded during the previous 20 years. According to the HCM standard, Georgia Trust Fund reserves are sufficient to finance approximately 9 months of benefits paid out at the highest cost rate recorded during the past 20 years.

A variant of the HCM measure, the second highest cost multiple or 2HCM, calculates adequate Trust Fund reserves to finance 12 months of benefits paid out at the second highest cost rate recorded during the previous 20 years. Georgia's 2HCM of 118 indicates that the state has sufficient reserves to finance 14 months of benefits paid out at the average of the second highest cost rate recorded during the past 20 years.

The reserve ratio measure on the other hand is a ratio of Trust Fund balances to total wages and is the highest possible threshold of solvency. The reserve ratio assesses Trust Fund reserves relative to full wage insurance. Our findings show that Georgia's reserve ratio was 0.6 percent by the end of 2004, indicating that the state's Trust Fund reserves could replace 0.6 percent of all wages. Most UI solvency experts feel that a pre-recession reserve ratio of at least 2.0 is ideal.

Major Conclusions

The structure of Georgia's Trust Fund is similar to other states in some aspects including the determination of UI tax rates using the experience rating principle while differences encompass the financial health of Georgia's Trust Fund and the liability of employers and employees in the financing of the Trust Fund.

Georgia's UI tax structure is designed to both maintain solvency of the Trust Fund and to minimize the UI tax burden on the states' over 200,000 employers.

The experience rating principle used to compute Georgia's UI tax rates promotes allocative efficiency by imposing a price on each employer that reflects the social costs of the unemployment generated by the employer.

The biggest disadvantage associated with the experience rating principle is the prospect of promoting bankruptcy since it requires higher tax payments from employers at a time when they can least afford them.

Georgia's current Trust Fund is underfunded for two of the four solvency measures examined in addition to the reserve ratio standard. However, Georgia's Trust Fund has not approached insolvency during the historical period examined.

The current Trust Fund structure yields a reasonably stable reserve ratio over the extended period of time (35 years), with the balance remaining above the lower bound of 1 percent throughout the historical period until the year 2000.

I. Introduction

This report explores several aspects of Georgia's Unemployment Insurance (UI) Trust Fund, including the structure and the solvency of the Trust Fund. The main focus of this report is on the appropriate target level for the Trust Fund balance for the state of Georgia. This report is divided into six sections. Section II discusses the institutional background of the UI Trust Fund, Section III analyzes the structure of the Trust Fund while Section IV discusses the performance of Georgia's Trust Fund during previous business cycles. Section V looks at the UI payroll tax rate cuts and Section VI concludes.

II. Institutional Background

The UI program was created over 70 years ago and is designed to assist the short-term unemployed blue-collar worker by providing funds with which to purchase necessities. It lessens the fear of joblessness, while allowing the out-of-work individual an opportunity to make a deliberate search for employment reflective of skills and prior earning power. Stated differently, the unemployment compensation program helps people bridge the gap between jobs. Employers benefit in that unemployment insurance helps to sustain a labor force involuntarily laid off for a temporary period. Unemployment compensation also helps to slow the downward spiral of business activity at the onset of a downturn in the economy.

The unemployment compensation program in Georgia is administered by the Georgia Department of Labor[1] (GDOL), Division of Unemployment Insurance, in accordance with the provisions of the Official Code of Georgia (O.C.G.A.) Title 34, Chapter 8, Sections 1 through 280 also referred to as the Employment Security Law of Georgia. The UI Division is responsible for processing unemployment insurance claims and appeals; determining employer tax rates and liability; and, for processing employers' quarterly reports and tax payments (GDOL, 2005).

1. Purpose of the Trust Fund

The federal-state system of UI in the United States was established by the provisions of the Social Security Act of 1935 to primarily provide partial wage replacement for involuntarily unemployed workers. The original UI provisions aimed to partially reduce lost income for involuntarily unemployed workers, to reduce the dispersal of skilled workers when employers make temporary layoffs, to help maintain aggregate purchasing power during economic downturns, and to prevent the breakdown of general labor standards during such periods (O'Leary, 2000).

Due to the uneven distribution of the risk of unemployment, a market for UI would not form naturally in the private sector, since workers with a lower risk of becoming temporarily unemployed would form their own pool in order to pay lower

[1] The Georgia Department of Labor is an affiliate of the U.S. Department of Labor.

insurance premiums. Consequently, if UI was voluntary, workers facing a higher risk of temporary unemployment, especially in volatile industries like manufacturing and construction, would face prohibitively high premiums. To ensure coverage of both high and relatively low-risk employees, the federal and state governments partially subsidize the premiums of high-risk workers through a payroll tax collected from employers.

2. Financing the UI Trust Fund

Who Pays into the Fund: Role of State versus Federal Government

UI in Georgia is financed entirely by payroll taxes levied (statutorily) on employers. Employees in Georgia do not contribute to the Trust Fund unlike in the states of Alaska, New Jersey and Pennsylvania which collect employee contributions as well. Unemployment taxes have both a federal and state component. The federal component is nominally 6.2 percent of the first $7,000 of the wages of covered employees.[2] However, the federal government grants a credit to employers against all but 0.8 percentage points of the tax, provided that they pay their state taxes in a timely manner and the state's unemployment compensation program adheres to federal guidelines (Tannenwald and O'Leary, 1997). Thus, since Georgia's unemployment compensation program has been approved by the federal government, the federal tax is, in effect, 0.8 percent of the first $7,000 of wages, or an equivalent of $56 per covered worker each year (Tannenwald and O'Leary, 1997).

The federal government uses the proceeds from this tax to pay for administration of the program at both the federal and state levels, assume partial responsibility for the cost of extended benefits, and maintain a federal unemployment Trust Fund which a state may borrow from should it exhaust its own Trust Fund. Thus, federal government UI taxes are typically not used to pay benefits. Federal loans come at a cost to employers as additional federal UI taxes are imposed on employers whose states have borrowed from the federal UI Trust Fund. Federal rules

[2] The GDOL defines total covered wages as the all wages paid to an employee during his or her employment by a contributory employer which were covered under the Employment Security Law.

dictate that interest payments on federal loans can only be financed by UI surtaxes or general revenues and not paid out of Trust Fund balances.

The taxable wage base for the state of Georgia is the first $8,500 of earnings for each employee each year, paid by all liable employers. Wages over $8,500 are considered non-taxable for the state of Georgia. Tax rates are based on the "experience rating principle" with newly liable employers[3], usually employers with less than three year's employment history, being assigned a beginning rate of 2.70 percent. The minimum and maximum UI tax rates are set by the legislature and vary from year to year (GDOL, 2005). The minimum and maximum rates for 2005 were 0.03 percent and 6.48 percent, respectively. The maximum UI tax rate for 2006 is 6.21 percent while the minimum rate is unchanged at 0.03 percent.

Revenues from the state UI taxes are deposited in the UI Trust Fund. The UI Trust Fund is used exclusively to finance the regular benefit payments which comprise the biggest proportion of total UI costs. The state's UI system is essentially self-financed by its employers, especially since any federal loans to the state must eventually be repaid with interest.

Determining UI Tax Rates

As with other states, Georgia's UI tax structure is based on the experience rating principle. This principle considers the history of an employer's UI benefits paid to former workers, growth of an employer's payroll and the overall unemployment conditions for the state. Specifically, this principle requires that an employer's tax rate vary positively with its propensity to lay off workers, and thus each employer is subject to a different rate. The UI tax rate also reflects the extent to which the employer's former employees have drawn UI benefits. Lower UI rates are earned by employers whose unemployment experience costs are less, and higher rates are assigned to employers whose experience indicates greater costs.

[3] A liable employer refers to an employing unit that is subject to the Employment Security Law.

Georgia's UI tax rates are determined using the "reserve ratio" approach. Under this approach, the GDOL keeps track of each firm's cumulative tax payments to the state Trust Fund since the firm's inception, and the cumulative benefits paid to the firm's laid off workers. For a given computation date, usually three years ending shortly before the beginning of the taxable year, the GDOL determines the firm's "total tax reserve"—difference between its cumulative contributions and benefit charges. The "total tax reserve" is then divided by the average annual payroll, to yield the percent applied. The resulting percentage is then applied to base rate tables provided in the Employment Security Law. The computed rate applies to taxable wages paid during the calendar year immediately following the computation date.

To illustrate the effect of the experience rating principle on UI tax rates, let us consider two firms: Tann Inc. and Wolt Inc. both of which have been in existence for 8 years. Assume that both firms have a 3-year taxable payroll of $750 million and an average annual payroll of $250 million during the "computational" period. During its existence, Tann Inc. has paid $50 million in UI taxes and due to large and frequent layoffs of its employees, $100 million has been charged to its UI account. Wolt Inc. on the other hand has experienced better fortunes, paying $30 million in UI taxes with only $10 million in benefits charged to its account. This implies that Tann Inc. has a total tax reserve of -$50 million ($50 million - $100 million) while Wolt Inc. has a total tax reserve of $20 million ($30 million - $10 million). Given this information, Tann Inc. and Wolt Inc. have a reserve ratio or percent applied of -20 percent (-$50/$250) and 8 percent ($20/$250), respectively. These reserve ratios indicate that Tann Inc. would be subject to a higher UI tax rate compared to Wolt Inc. since the latter has a better experience rating than the former.

The experience rating principle implies that the employer's UI tax rate should vary with the employer's account, since changes in an employer's experience history lead to an assignment of a new rate. This therefore suggests that an employer can be assigned a different UI tax rate each computation period.

The experience rating principle divides employers into separate risk pools, with firms whose employees face a higher risk of incurring involuntary unemployment being subject to a higher tax rate. Such a rate structure is intended to

promote allocative efficiency by imposing a price on each employer that reflects the social costs of the unemployment that the employer generates. Tannenwald and O'Leary (1997) argue that the experience rating principle has the potential disadvantage of promoting bankruptcy during recessions since it requires higher tax payments from firms when they can least afford them.

3. UI Benefits

According to the GDOL, UI provides unemployment benefits to eligible workers who are unemployed through no fault of their own and who are either looking for another job, have definite recall to their jobs within 6 weeks of the last day worked, or are in approved training. Eligibility for benefits is determined based on past wages, reason for job separation, and availability and job search requirements.[4]

The weekly benefit amount (WBA) of benefits a claimant may receive is the whole dollar amount computed by dividing the two highest base period quarters by 46.[5] Alternatively, the highest base period quarter is divided by 23 to establish the WBA up to the allowed maximum set by the legislature. The established WBA is based on the individual's earnings and may range from a legislatively established minimum amount to a maximum amount. The number of weeks of entitlement ranges from a minimum of nine weeks to a maximum of 26 weeks. The total maximum benefits to which a claimant is entitled during the benefit year (365 days forward from the date the claim is filed) is one-fourth of the total base period wages or 26 times the weekly benefit amount, whichever is less (GDOL, 2005). The extended benefit program provides up to 13 weeks of additional benefits or "extended benefits" to workers who have exhausted their regular UI benefits in times of high unemployment.

The state of Georgia is reimbursed by the federal government for 50 percent of all but the first week of extended benefits. Therefore, there is a charge of 100 percent to Georgia employers for the first week of these benefits. Governmental

[4] See the GDOL (2005) for details on eligibility requirements.
[5] The base period is the first four of the last five completed calendar quarters at the time of filing.

agencies on the other hand are charged 100 percent of all weeks paid with extended benefits (GDOL, 2005).

4. Georgia's Trust Fund Size and UI Tax Rates

The Employment Security Law requires that the UI Trust Fund be maintained at a reasonably adequate level. The "Statewide Reserve Ratio" (SRR) compares Georgia's Trust Fund balance to the state's total covered wages and is used as a measurement tool to gauge the adequacy of the state's Trust Fund. Conventionally, a SRR greater or equal to one, indicates a moderately solvent UI Trust Fund. Computation of the SRR and other measures of Trust Fund adequacy are explored in Section III below.

The reserve ratio approach used to compute UI tax rates in Georgia symbolizes the concept of "precautionary" balances, where each firm has an account that builds up a surplus of contributions over benefit charges during periods of economic expansion. This surplus is then drawn down during downturns and/ or recessions. Following a surge in benefit payouts, a firm's tax liability rises gradually, but remains at a higher level for a substantial period of time and then falls steadily in response to improving economic conditions.[6] This implies that everything else equal, Georgia's UI tax system is less procyclical compared to UI tax systems based on the "benefit ratio" approach.[7]

In the computation of annual tax rates, the status of an employer's account-total tax contributions relative to benefit charges-affects the assignment of a new rate. An increase in taxable payroll may cause an increase in the tax rate even though no claims have been paid out. Employers with positive balances (tax collections exceed benefit charges) are assigned lower rates compared to employers with deficit balances (benefit charges exceed tax collections).

[6] Tax rates respond gradually because experience ratings are based on cumulative contributions relative to benefits, implying that the "weight" of each firm's prior history creates inertia in experience ratings with respect to changes in the incidence of layoffs (Tannenwald and O'Leary, 1997).

[7] The benefit ratio method is similar to a "pay as you go" approach in which payments for benefit charges are made with a lag. A surge in benefits is paid for relatively rapidly, followed by a steep fall in payments once the benefit charges have been "paid off" (Tannenwald and O'Leary, 1997).

Georgia like other states constrains the range of employer UI tax rates. An employer's tax rate stops rising at some point regardless of how much its experience rating has worsened and stops falling irrespective of how much the experience rating has improved. The minimum and maximum rates assignable for each type of employer account in Georgia are set by the legislature and vary from year to year.[8]

[8] Many employers are given the option to make a voluntary contribution to lower their tax rate for the year. Tax accounts are reviewed each year to determine employers eligible for this option. Employers are not eligible for a voluntary contribution if they (1) have the lowest possible tax rate, (2) have not filed all Quarterly Tax and Wage Reports, or (3) because of insufficient experience history, they are not otherwise eligible for a rate computation (GDOL, 2005).

III. Structure of Georgia's Trust Fund

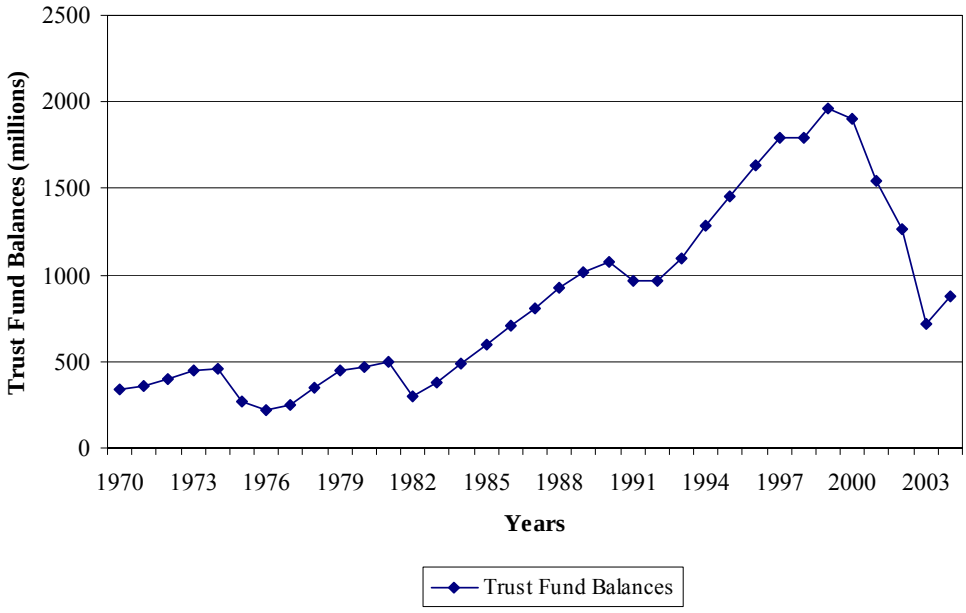
This section evaluates the financial status of Georgia's UI Trust Fund using three widely used standards of Trust Fund adequacy. Before analyzing the solvency of Georgia's UI Trust Fund, we briefly examine the history of the UI Trust Fund balances.

1. History of Trust Fund Balance

Overall, the Trust Fund balance has grown steadily over the past 30 years (1970-1999), with only minor drawdown cycles during the periods 1974-1976, 1981-1982, and 1990-1992. The onset of the new millennium saw a marked drawdown in Georgia's Trust Fund reserves which lasted for four years starting in 2000 through 2003. The duration and percentage decrease of the early 2000 drawdown cycle far exceeds any other drawdown cycle in the 35 year history considered here. The drawdown during the period 2000-2004, is among other things, considered to be a result of a 1999 moratorium by the state's legislature providing for the temporary suspension of employer contributions to the Trust Fund.[9] Figure 1 below shows the trend of Trust Fund balances over the period 1970-2004.

[9] See Section V for details on Georgia's UI tax cuts.

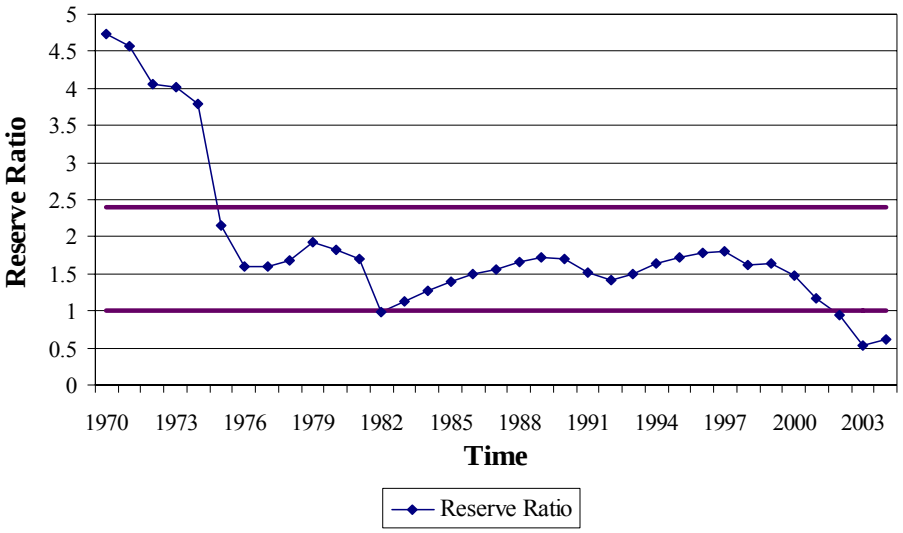
FIGURE 1: TRENDS IN TRUST FUND BALANCES (1970-2004)



2. Surcharges and Rate Reductions

To ensure solvency of the Trust Fund while minimizing the UI payroll tax burden on the state's employers, Georgia's UI Trust Fund structure provides for surcharges on covered employers when the reserve ratio falls below 1 percent and rate reductions when the reserve ratio gains by over 2.44 percent. Figure 2 below shows that the rate reduction provision would only apply prior to 1975 when the reserve ratio exceeded the 2.44 percent mark and after 2002 when it fell short of the 1 percent threshold.

FIGURE 2. RESERVE RATIO, SURCHARGES AND RATE REDUCTIONS



3. Solvency Measures

The adequacy of the unemployment insurance (UI) Trust Fund across the nation has been the subject of much debate in recent years. Most attention has been directed toward what constitutes an adequate amount of Trust Fund reserves and whether there is a single most consistent measure of solvency that can be applied to UI. In addition to the reserve ratio standard which is a ratio of Trust Fund balances to total wages as mentioned earlier, there are two other measures used to assess UI Trust Fund solvency:

- Average High Cost Multiple, Trust Funds are compared to recent benefit history;
- High Cost Multiple, Trust Funds compared to long term benefit history.

Average High Cost Multiple

The Advisory Council on Unemployment Compensation (ACUC) recommends the "average high cost" standard for Trust Fund solvency. According to this guideline, a state should have enough reserves to finance at least 12 months of benefits paid out at the average of its three highest "cost rates" over the previous 20

years. The cost rate is the statewide ratio of benefits paid out of total wages of unemployment insurance eligible employees in any calendar year. According to this standard, adequacy requires that a state's average high cost multiple (AHCM) should equal at least 100 percent. (Tannenwald, O'Leary, and Huang, 1999).

[1] AHCM = 100*((Trust Fund balances as a percentage of total wages in covered employment)/ (the average high cost rate)).

The average high cost rate is the average of the three highest calendar year benefit cost rates in the last 20 years. Benefit cost rates are benefits paid (excluding reimbursement benefits) as a percent of total wages in taxable employment. For comparison purposes, we also compute the AHCM over the past 35 years.

The U.S. Labor Department has endorsed an AHCM of 150 as a solvency guideline. In effect, the standard requires Trust Fund reserves sufficient to finance 18 months of benefits paid out at the average of the three highest cost rates recorded during the past 20 years. (Tannenwald and O'Leary, 1997). Table 1 reveals that the state of Georgia does not meet this remarkably stringent solvency requirement.

High Cost Multiple

The High Cost Multiple (HCM) goes back further in time to compare reserves to benefit outlays. In this case, the denominator of [1] will be the highest cost rate rather than the average of the three highest cost rates in a state's benefit history. Stated differently, the HCM measure computes the Trust Fund reserves sufficient to finance 12 months of benefits paid out at the highest cost rate recorded during the previous 20 years. We also include a measure (Second Highest Cost Multiple or 2HCM) that calculates adequate Trust Fund reserves to finance 12 months of benefits paid out at the second highest cost rate recorded during the previous 20 years. The findings are presented in Table 1 below. Like in the AHCM case, the U.S. DOL has endorsed an HCM and 2HCM of 150 as a solvency guideline. The ACUC on the other hand contends that a multiple of at least 100 for both the HCM and 2HCM is sufficient.

TABLE 1. MEASURES OF SOLVENCY: ALTERNATIVE STANDARDS

	Sufficient Reserves to Finance			
	12 Months of Benefits/ Highest Cost Rate in 20 years (HCM)	**12 Months of Benefits/2nd Highest Cost Rate in 20 years (2HCM)**	**12 Months of Benefits/Avg. of 3 Highest Cost Rates in 20 years (AHCM over 20 years)**	**12 Months of Benefits/Avg. of 3 Highest Cost Rates in 35 years (AHCM over 35 years)**
Highest Cost Multiple	73	118	119	92
Current Reserves (2004)	$874,339,726	$874,339,726	$874,339,726	$874,339,726
Adequate Reserves (12 months)	$1,197,725,652	$740,965,869	$734,739,266	$950,369,267
Adequate Reserves (12 months)	$1,796,588,478	$1,111,448,804	$1,102,108,899	$1,425,553,901

Table 1 reveals that using the U.S. Labor Department's most preferred solvency measure (column 4), Georgia has sufficient Trust Fund reserves ($874,339,726) to finance 14 months of benefits paid out at the average of the three highest cost rates recorded during the last 20 years. Therefore, the adequate amount of Trust Fund reserves needed to finance 12 months of benefits paid out at the average of the three highest cost rates recorded during the most recent 20 years is $734,739,266. Further, the sufficient amount of reserves to fund 18 months of benefits paid out at a similar average cost rate is $1,102,108,899.

The more stringent measure of solvency (column 2 of Table 1) shows that Georgia requires $1,197,725,652 in Trust Fund reserves. This is the amount of Trust Fund reserves that is sufficient to finance 12 months of benefits paid out at highest cost rate recorded during the past 20 years.

Table 1 therefore indicates that Georgia has a moderately healthy Trust Fund reserve as two of the solvency measures (columns 3 and 4) indicate that the state has more than the required amount of Trust Fund reserves to finance at least 12 months of benefits, but falls short of the U.S. DOL's recommended standards. The solvency standard adopted by a given state depends in part on the state's previous economic history. For instance, a state may adopt a more stringent solvency standard (see columns 2 and 5 in Table 1) if it was severely affected by a past recession, which led to a marked drawdown in the state's Trust Fund balance. A more stringent solvency

standard will in such a case be adopted with the goal of rebuilding the Trust Fund balance and to ensure solvency if the state ever experienced such a severe downturn.

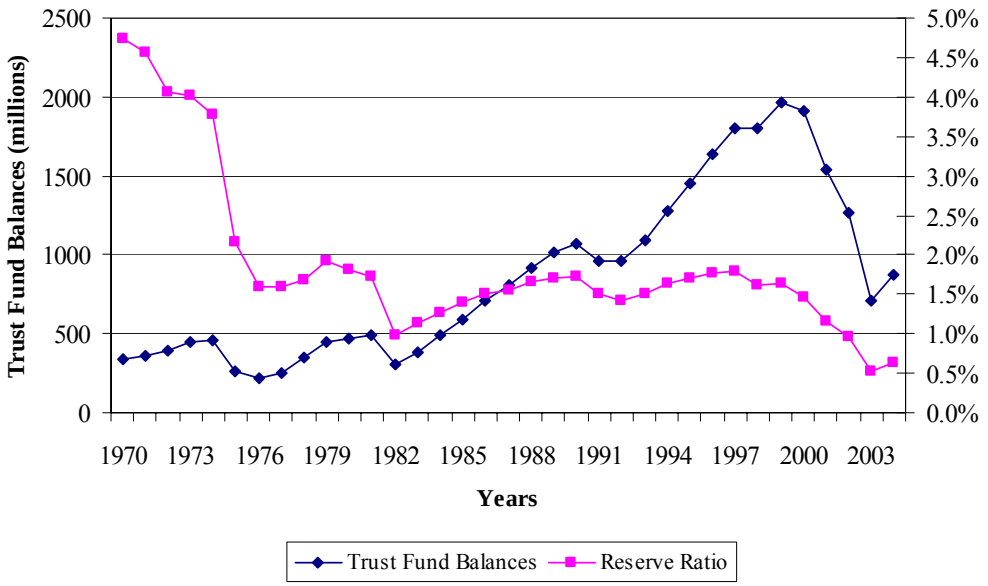
Reserve Ratio

Another indicator of Trust Fund solvency is the ratio of Trust Fund balances to total wages, also known as the reserve ratio. It is expressed as a percentage. This is the highest possible threshold of solvency and in effect, it assesses Trust Fund reserves relative to full wage insurance. The rationale for this measure of Trust Fund solvency is that covered salaries and wages serve as a proxy for the size of a state's economy and roughly account for economic growth and increased wages and salaries.

By the end of 2004, Georgia's reserve ratio was 0.6, indicating that the state's Trust Fund reserves could replace 0.6 percent of all wages. Though there is no consensus among UI solvency experts regarding an acceptable reserve ratio standard, most feel that a pre-recession reserve ratio of at least 2.0 is ideal (National Employment Law Project Publications, 1999).

Figure 3 below compares the trend of Trust Fund balances to the reserve ratio over the period 1970-2004. As seen from Figure 3, the reserve ratio has been very stable since the late 1970s through 2000.

FIGURE 3: TRENDS IN TRUST FUND BALANCES AND RESERVE RATIO (1970-2004)



To summarize, our analysis shows that as of 2004, the Trust Fund is under-funded for two of the four solvency measures (HCM and AHCM computed over 35 years, see Table 1) examined in addition to the reserve ratio standard. The Trust Fund is adequately funded according to the other two less stringent measures: 2HCM and AHCM computed over 20 years (See Table 1). The current Trust Fund structure yields a reasonably stable reserve ratio over the extended period of time (35 years), with the balance remaining above the lower bound of 1 percent throughout the historical period until the year 2000. Further, the fund has not approached insolvency during the historical period examined.

IV. Trust Fund and the Business Cycle

1. Trust Fund Performance over the Business Cycle

We examine the performance of the Trust Fund over four cycles during the period 1974-2000: 1974-1981, 1981-1990, 1990-1999, and 1999-2004. Figure 4 shows the drawdown and build-up of the Trust Fund over these cycles. For each cycle, we compare the level of the Trust Fund balance in any given year to the level of the Trust Fund balance in the succeeding year. This ratio is always 100 percent in year one because the focus of this particular comparison is to measure fluctuations in the Trust Fund balance over the duration of the cycle relative to the onset of the cycle. Higher Trust Fund balances in upcoming years result in an upward trend or build-up while lower Trust Fund balances in subsequent years lead to a downward trend or drawdown. Figure 4 indicates that during the period examined, the shortest drawdown lasted only one year and was experienced during the 1974-1981 cycle while the longest drawdown lasted four years and occurred during the 1999-2004 cycle. Further, the longest build-up in the level of Trust Fund balances was experienced during 1990-1999 cycle and lasted eight years. The build-up in all cycles lasted over four years except during the 1999-2004 business cycle, a feature that can be attributed to fact that we have data only through 2004, and thus the 1999-2004 cycle is not yet complete.

FIGURE 4. TRENDS IN TRUST FUND BALANCES: 1974-2004

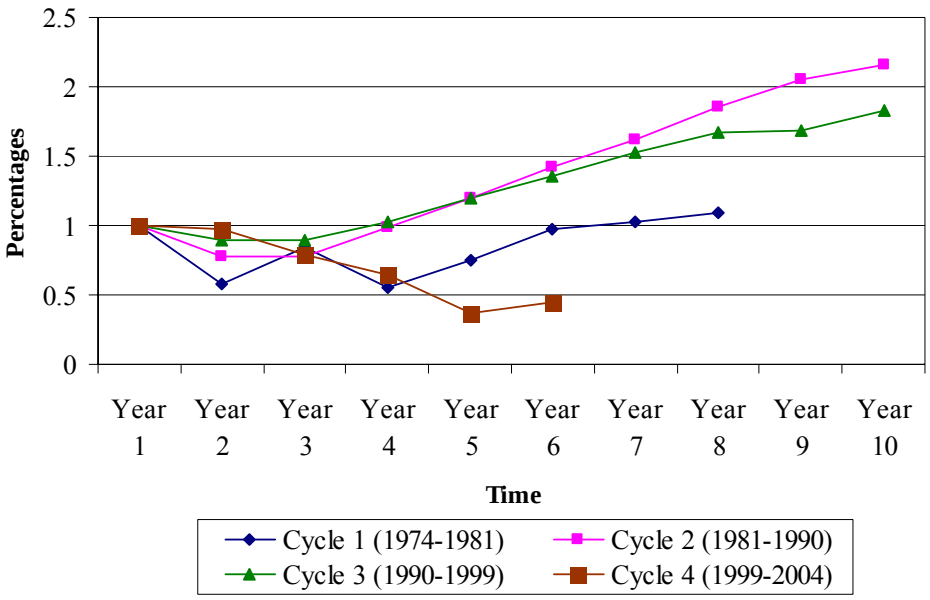


Table 2 shows the duration from peak to trough of the business cycle and the resulting percentage decline in the Trust Fund balance. The longest peak-trough duration was four years and was experienced during the 1999-2004 cycle. The resulting percentage decline during this cycle was 63.7 percent and was also the highest percentage decline in all of the four cycles considered. Table 2 also shows the duration of the build up from trough to peak together with the resulting increase in Trust Fund balance compared to the previous peak. The longest build-up lasted eight years and occurred during the 1990-1999 cycle. The percent change for trough to peak in Table 2 measures the percent change over the previous peak and therefore it measures the extent to which the fund is fully replenished before the next drawdown cycle begins. The 1981-1990 cycle had the highest trough-peak percentage gain in Trust Fund balances at 116.4 percent followed by the 1990-1999 cycle at 83.2 percent.

TABLE 2. PERFORMANCE STATISTICS

	Peak to Trough			Trough to Peak		
Cycle	Duration	%Change	Reserve Ratio at Peak	Duration	%Change vs. Previous Peak	Reserve Ratio at New Peak
1974-1981	2 Years	-51.2%	3.8%	5 Years	8.7%	1.7%
1981-1990	2 Years	-22.8%	1.7%	7 Years	116.4%	1.7%
1990-1999	1 Year	-10.2%	1.7%	8 Years	83.2%	1.6%
1999-2004	4 Years	63.7%	1.6%	NA	NA	NA

2. Stress Testing of Alternative Measures of Solvency

This section evaluates each of the solvency standards over the four cycles discussed earlier. Specifically, we examine whether the Trust Fund balance becomes negative at the end of the cycle, which would indicate insolvency, and whether the end of cycle peak equals or even exceeds the standard against which it is being compared. We assume that the balance at the initial peak is the target balance based on the standard and actual wage base. We then examine the draw downs and build-up based on actual dollar values of the fund balance for that cycle.

Tables 3-6 indicate that for all four solvency standards used, the end of cycle peak Trust Fund balance becomes negative during the 1999-2004 cycle. Further, end of cycle peak balance only exceeds any given standard during the 1990-1999 cycle. This suggests that the Trust Fund experienced a substantial build-up during the economic expansion of the 1990's while the economic slowdown that characterized the onset of the new millennium led to a marked drawdown of the Trust Fund balance.

TABLE 3. STANDARD—12 MONTHS OF BENEFITS AT HIGHEST COST RATE IN 20 YEARS

Cycle	Target Balance at Peak ($)	$ Drawdown	Balance at Trough	$ Build-Up	Balance at Peak ($)	New Peak Meets Standard?	Reserve Ratio at New Peak
1974-1981	238,572,190	233,200,220	5,371,970	272,921,417	278,293,387	No	0.97%
1981-1990	423,413,744	113,024,575	310,389,169	689,745,047	1,000,134,216	No	1.61%
1990-1999	1,454,916,837	109,790,898	1,345,125,939	943,965,135	2,289,091,074	Yes	1.91%
1999-2004	872,950,102	1,251,622,389	(378,672,287)	161,824,385	(216,847,902)	No	-0.15%

TABLE 4. STANDARD—12 MONTHS OF BENEFITS AT SECOND HIGHEST COST RATE IN 20 YEARS

Cycle	Target Balance at Peak ($)	$ Drawdown	Balance at Trough	$ Build-Up	Balance at Peak ($)	New Peak Meets Standard?	Reserve Ratio at New Peak
1974-1981	171,952,031	233,200,220	(61,248,189)	272,921,417	211,673,228	Yes	0.74%
1981-1990	188,362,768	113,024,575	75,338,193	689,745,047	765,083,240	No	1.23%
1990-1999	1,044,754,112	109,790,898	934,963,214	943,965,135	1,878,928,349	Yes	1.57%
1999-2004	701,477,761	1,251,622,389	(550,144,628)	161,824,385	(388,320,243)	No	-0.28%

TABLE 5. STANDARD—12 MONTHS OF BENEFITS AT THE AVERAGE OF THE THREE HIGHEST COST RATES IN 20 YEARS

Cycle	Target Balance at Peak ($)	$ Drawdown	Balance at Trough	$ Build-Up	Balance at Peak ($)	New Peak Meets Standard?	Reserve Ratio at New Peak
1974-1981	173,920,948	233,200,220	(59,279,272)	272,921,417	213,642,145	No	0.74%
1981-1990	266,340,903	113,024,575	153,316,328	689,745,047	843,061,375	No	1.36%
1990-1999	1,055,988,027	109,790,898	946,197,129	943,965,135	1,890,162,264	Yes	1.58%
1999-2004	711,644,105	1,251,622,389	(539,978,284)	161,824,385	(378,153,899)	No	-0.27%

TABLE 6. STANDARD—12 MONTHS OF BENEFITS AT THE AVERAGE OF THE THREE HIGHEST COST RATES IN 35 YEARS

Cycle	Target Balance at Peak ($)	$ Drawdown	Balance at Trough	$ Build-Up	Balance at Peak ($)	New Peak Meets Standard?	Reserve Ratio at New Peak
1974-1981	173,920,948	233,200,220	(59,279,272)	272,921,417	213,642,145	No	0.74%
1981-1990	266,340,903	113,024,575	153,316,328	689,745,047	843,061,375	No	1.36%
1990-1999	1,055,988,027	109,790,898	946,197,129	943,965,135	1,890,162,264	Yes	1.58%
1999-2004	930,870,962	1,251,622,389	(320,751,427)	161,824,385	(158,927,042)	No	-0.11%

V. Unemployment Insurance Tax Cuts

Georgia has embraced the fact that the best way to ensure the financial health of the UI Trust Fund is to constantly create jobs. Job growth simultaneously increases payments into the fund and lessens flows out of the fund. This realization has led to unemployment compensation and UI tax rate reforms.

According to the National Employment Law Project Publications (NELP) (1999) the state of Georgia reduced the UI tax rate by 6.25 percent in 1994, costing the Trust Fund an estimated $45 million in UI tax revenues. A bill passed by the state's legislature in 1998 cut the UI payroll tax by another $112 million, which provided for tax cuts of $92.2 and 30.6 million in 1999 and 2000, respectively. This was followed by a moratorium that provided for a temporary suspension of employer payments. In February of 1999, the governor announced plans to slash UI payroll taxes by $1 billion over the next four years. This four-year moratorium, ending at the start of 2004, saw many employers pay very little into the Trust Fund due to its previous hefty balance.

In light of the tremendous gains in the state's economy coupled with reduced pay-outs during the most recent recovery, the state announced a $50 million UI tax cut toward the close of 2004. This tax cut which translates into a 7.3 percent tax break for employers is not expected to have a substantial effect on the financial health of the UI Trust Fund in 2005. The UI trust Fund is projected to collect well over $650 million in UI taxes in spite of the 2005 UI payroll tax cut. Unlike the previous 1999 moratorium where almost all of the states' over 200,000 employers benefited from temporary suspension of employer payments, UI tax savings will this time round hinge on the employers' track record in layoffs and workforce force stability.[10]

However, UI pundits at the NELP argue that in spite of being one of the 10 best-financed, Georgia's UI Trust Fund at its current level of almost $875 million, would still have a tough time financing future payouts especially if the state suffered a fairly quick downturn in 2006 or 2007. Experts draw a close comparison with New

[10] Atlanta Journal-Constitution (2004).

York, Texas, Illinois and other states whose UI Trust Funds are now insolvent following UI tax cuts during the celebrated economic times of the 1990's.

VI. Conclusions

This report discusses various aspects of Georgia's Trust Fund, pointing out several similarities and differences with UI tax systems in other states. Major similarities include the determination of UI tax rates using the experience rating principle while differences encompass the financial health of Georgia's Trust Fund and liability of employers and employees in the financing of the Trust Fund. Further, Georgia's UI tax structure is designed to both maintain solvency of the Trust Fund and to minimize the UI tax burden on the states' over 200,000 employers. The experience rating principle used to compute Georgia's UI tax rates promotes allocative efficiency by imposing a price on each employer that reflects the social costs of the unemployment generated by the employer. The disadvantage of this principle is the possibility of promoting bankruptcy since it requires higher tax payments from firms at a time when they can least afford them.

Our analysis on the solvency of Georgia's Trust Fund shows that the current Trust Fund is underfunded for two of the four solvency measures examined in addition to the reserve ratio standard. The current Trust Fund structure yields a reasonably stable reserve ratio over the extended period of time (35 years), with the balance remaining above the lower bound of 1 percent throughout the historical period until the year 2000. Further, the fund has not approached insolvency during the historical period examined.

Treating the alternative Trust Fund solvency measures as target ratios for the Trust Fund, the fund would have come extremely close to insolvency or even become insolvent at points during the historical period. Analysis of the business cycles reveals that the build-up cycle does not consistently reach the target ratio for these measures. Our analysis shows that Georgia's Trust Fund appears to have been severely affected by factors including the slowdown of the U.S. economy in 2001, past UI tax rate reductions, and the temporary suspension of employer UI tax payments into the Trust fund. Therefore, a cushion in addition to the target ratio is needed to manage the risk of insolvency.

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Edward Sennoga is a research associate in the Fiscal Research Center and is currently finishing his Ph.D. in Economics at Georgia State University, writing on tax evasion and tax structure. He has received numerous academic and teaching awards in the Andrew Young School. Mr. Sennoga is from Uganda, and earned his B.A. in Economics from Makerere University in Kampala.

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