FISCAL RESEARCH CENTER

STATUS OF HEALTH AND PENSION BENEFITS FOR EMPLOYEES OF THE STATE OF GEORGIA

David P. Richardson

Georgia State University
ANDREW YOUNG SCHOOL
OF POLICY STUDIES

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Fiscal Research Center
Andrew Young School of Policy Studies
Georgia State University
Atlanta, GA

FRC Report No. 102
April 2005

Acknowledgments

The author thanks the staffs at Georgia Department of Community Health, the Georgia Merit System, the Employee Retirement System, the Teachers Retirement System, and Board of Regents for supplying data and useful discussion. I thank Sally Wallace for providing useful comments. Any errors are my own.

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Executive Summary

This report analyzes the Health and Retirement Package offered to employees of the State of Georgia. The analysis covers the two primary state employment systems: the Georgia Merit system (GMS) and the Board of Regents (BOR) system. Under each system, health and retirement benefits are offered to employees working at least half time. Covered employees become vested in a retirement pension benefit and a retirement health benefit after ten years of creditable service.

For 2003, system-wide health revenues totaled $1,821 million and retirement contributions totaled $1,508 million. System-wide health expenditures totaled $1,895 million and system wide retirement benefits totaled $2,090 million. For both the GMS and BOR systems, self-insured health insurance assets satisfied a two month reserve threshold. Likewise, each system had retirement benefits assets that exceeded 100 percent of estimated terminal liability.

Health Insurance costs for active and separated employees have increased faster than the rate of inflation over the past five years. Average annual growth of GMS health benefits was about 8.2 percent over the past five years. Comparatively, average annual growth of BOR health benefits was slightly negative, with a 1 percent decline between 2002 and 2004.

GMS employees are covered by the Employee Retirement System (ERS) and pubic school system employees are covered by the Teachers Retirement System (TRS). Since 1998, average annual growth of pension benefits has been about 12.5 percent, with approximately 13 percent and 12.1 percent growth in the TRS and ERS, respectively. The ratio of beneficiaries to contributing participants is growing rapidly over this time period. For the TRS, there were about 4.3 workers per beneficiary in 1998. By 2003, there were only 3.7 workers per beneficiary. Comparable ratios for the ERS were 3.3 and 2.6 workers to beneficiaries in 1998 and 2003, respectively. These trends are attributable to a quickly aging employee population.

Compared to other states in the Southeastern region, Georgia offers a very competitive overall benefit package, ranking second in generosity of benefits and third in total compensation. Georgia is one of only twelve states that still offer a traditional indemnity health insurance plan to employees. Georgia's health insurance

and pension trusts were relatively well-funded in 2003. However, there is considerable pressure on health insurance reserves, particularly within the GMS.

This report identifies seven issues that merit attention.

Issue 1: No Consolidated Annual Labor Report

Many states produce consolidated annual labor reports that analyze a variety of factors, such as the level and growth of total compensation, the level and growth of benefits, average age and average tenure.

Option: It is recommended that the State Legislature adopt a requirement for the Governor's office to produce a consolidated annual labor report for the State of Georgia. The report should provide information on the structure of the labor force and the structure of employee compensation, including any cost drivers, in particular retiree health insurance and pension benefits.

Issue 2: Retiree Health Insurance Funding

Recent changes to Government Accounting Standards Board (GASB) requirements call for pre-funding of retiree health benefits. The goal is to ensure the funding adequacy of this rapidly growing benefit. While securing retiree well-being, the new GASB rules will place significant stress on state and local governments.

Options: The State of Georgia has several options.

- Freeze provision of self-insured retiree health insurance. Current retirees will retain the option of self-insured health insurance. Future retirees must choose between a fully-insured managed care plan or no state sponsored retiree health insurance. In essence, the State of Georgia will opt out of the retiree health insurance business.
- Retain the current system and fully pre-fund retiree health insurance through state revenues. This option will place significant burdens on the state budget.
- Retain the current system and allow active employees to purchase into the fully-insured retiree health insurance pool. Active employees that desire to participate in a fully-insured retiree program, in contrast to a self-insured system, would contribute to the system while employed, subject

to normal service and vesting requirements. Under this option, participating workers would be responsible for pre-funding their fully-insured retiree health insurance benefit.

- A mixture of all the above options. As discussed below, the State may decide to base the generosity of the benefit of employee tenure.

Issue 3: Retiree Health Insurance Benefit Generosity

All vested retirees receive the same options with respect to health insurance benefits. For example, a retiree with 10 years of creditable service receives the same retirement health benefit as a retiree with 35 years of creditable service. By contrast, the retirement income benefit becomes more generous with longer tenure.

Options: The State of Georgia should provide relatively more generous retiree health benefits to longer tenured retirees. If structured correctly, this change can significantly reduce pressure on the health insurance program. There are two main options.

- Do not restrict plan options but increase premiums and out-of-pocket expenses. Under this option, all retirees have the same program options. Shorter tenured retirees will pay comparatively higher premiums, deductibles, and co-payments relative to longer tenured retirees. To avoid administrative complexity, it is recommended that retirees by placed in five year pools, e.g. 10 to 14 years, 15 to 19 years, etc.
- Restrict the options of shorter tenured retirees. For example, retirees with 10 to 14 years of service are eligible only for a high deductible policy that is designed for use in conjunction with a Health Savings Account (HSA). Retirees with 15 to 19 years of service have the additional option of a lower deductible self-insured managed care plan. Retirees with at least 20 years of creditable service can select from a full menu of options.

Issue 4: GMS Health Insurance Cost Sharing

Currently, the State of Georgia contributes 13.1 percent of active employee salary to the GMS health insurance system. This method can help insure budget balance during recessionary periods since the growth of the State's contribution is tied to salary growth. Thereby, salary freezes result in State of Georgia health insurance contribution freezes. Unfortunately, this method also puts incredible stress on solvency of the self-insured funds. First, the state makes no real contribution for retiree health care. When an employee retires and is replaced with a new hire, the state's contribution is 13.1 percent of the new employee's salary. This new salary is often below the retiree's final salary. The resulting smaller State contribution must cover a share of the costs for both the new active employee and the retiree. Second, the fixed percentage method creates a negative feedback effect on program solvency in recessionary periods. If the State freezes wages, then the State contribution to health insurance is also frozen. However, health care costs will typically continue to rise, resulting in stress on the system and negatively affecting the adequacy of reserves.

Option: Change the cost sharing arrangement.

- It is recommended that the GMS cost sharing agreement be changed to a premium standard of 70 percent for the State of Georgia and 30 percent by employees. The change should be phased-in over a three year period.
- It is recommended that the BOR cost sharing agreement by to a premium standard of 70 percent for the State of Georgia and 30 percent by employees. The change should be phased-in over a three year period.

Issue 5: GMS Health Insurance Premium Structure

Currently, the GMS premium structure draws distinctions between single participants and household participants. The household premium is independent of the number of dependents. There is no distinction between active employees and retirees. This relatively unrefined premium structure results in unnecessary cross-subsidization and violates the principle of premium equity, wherein participants should pay premiums that are proportional to the risk they bring to the insurance pool.

Option: It is recommended that the GMS adopt the BOR premium structure, which draws distinctions between active and retired employees, as well as households with two covered participants and households with more than two participants.

Issue 6: ERS Pension Options

Employees of the GMS and public education system are covered by a Defined Benefit pension plan. Participants become fully vested in the plan after 10 years of service. Separating employees with less than 10 years of creditable service receive no pension benefit. The 10 year cliff vesting rule may discourage high quality workers from applying for employment in the GMS or public school system.

Option: The ERS and TRS should offer a defined contribution option similar to the Optional Retirement Plan (ORP) offered to faculty in the University of Georgia System. The addition of this option would encourage highly qualified, mobile workers to apply for positions within the Georgia system. In addition, the State of Georgia would have no ongoing future liabilities for workers covered under this option, thereby reducing for funding risk, investment risk, and longevity risk.

Issue 7: Use of Federal Subsidies

Federal tax subsidies for health insurance and retirement savings are designed to encourage broader participation in benefits programs. The federal tax subsidies are akin to the federal government partially funding the health and retirement benefits of system participants.

Option: Aggressively pursue programs that offer federal tax subsidies. Educate all employees on the value of the federal subsidies.

- Retirement savings: encourage employee funding of 403(b) and 457 plans.
- Flexible Spending Accounts (FSA): encourage employees to fund health care expenditures through FSAs.
  – Provide guidance on estimating health care costs to reduce year-end reversions.
  – Offer Debit cards to increase efficiency and use of FSAs.

- Health Savings Accounts: consider adopting HSA eligible health insurance programs as the only option for select groups of employees and retirees. It is important to restrict the options available to these groups to avoid problems of adverse selection. Target groups include:
  – Short-tenure vested retirees
  – Less than full-time employees
  – Employees with less than 3 or 5 years of service.

The above options are primarily designed to ensure the solvency of health and retirement benefits for employees of the state of Georgia. Some of options (e.g. option 1) will bring Georgia in line with other states, while others will put Georgia at the forefront of innovations to employee benefit programs.

Introduction

This report analyzes the Health and Retirement Package offered to employees of the State of Georgia. The analysis covers the two primary state employment systems: the Georgia Merit system (GMS) and the Board of Regents (BOR) system. The GMS covers most state civil servants in the executive, legislative, and judicial branches of government, as well as most employees in the K-12 public school system. The BOR system covers most employees in the University System of Georgia.

Health and retirement benefits are offered to employees working at least half time for the State of Georgia. Under each system, employees become vested in a retirement pension benefit and a retirement health benefit after ten years of creditable service. For 2003, system-wide health revenues totaled $1,821 million and retirement contributions totaled $1,508 million. System-wide health expenditures totaled $1,895 million and system wide retirement benefits totaled $2,090 million.

Costs for active and separated employees have increased substantially over the past decade. Average annual growth of GMS health benefits was about 8.2 percent over the past five years. This is partly attributable to an aging workforce and a rapidly growing retiree population. The number of GMS health insurance beneficiaries grew at an average rate of about 2.86 percent over the past five years. However, the number of GMS retired beneficiaries under the age of 65 grew at an average annual rate of about 8.47 percent. Comparatively, average annual growth of BOR health benefits was slightly negative, with a 1 percent decline between 2002 and 2004. Overall, the number of BOR health insurance beneficiaries averaged less than 1 percent growth annually. However, the BOR health insurance retired beneficiaries under age 65 grew at an average annual rate of about 11.7 percent. The rapid growth in the retired under age 65 population will continue to put stress on the health and retirement system.

GMS employees are covered by the Employee Retirement System (ERS), whereas public school system employees and BOR employees are covered by the Teachers Retirement System (TRS). Since 1998, average annual growth of pension benefits has been about 12.5 percent, with approximately 13 percent and 12.1 percent growth in the TRS and ERS, respectively. The ratio of beneficiaries to contributing participants is growing rapidly over this time period. For the TRS, there were about 4.3 workers per beneficiary in 1998. By 2003, there were only 3.7 workers per beneficiary. Comparable ratios for the ERS were 3.3 and 2.6 workers to beneficiaries in 1998 and 2003, respectively. These trends are attributable to a quickly aging employee population.

Employee Census

For 2003, the GMS employed 82,527 and the BOR employed 36,150 full-time employees. Total full-time employment was 118,677, or approximately 1.4 percent of the Georgia's estimated population. Table 1.1 provides aggregate employment figures for employees of the GMS and BOR over the past five years.

TABLE 1.1. EMPLOYEE CENSUS: STATE OF GEORGIA

	1999	2000	2001	2002	2003	2004
Georgia Merit System						
Full-Time Employees	78,624	78,818	80,808	82,122	82,527	81,960
Average Age	42.50	42.82	42.91	43.11	43.33	43.48
Average Tenure	9.60	9.71	9.61	9.62	9.74	9.86
Average Salary	$31,104	$32,159	$33,356	$34,067	$33,940	$33,846
Board of Regents						
Full-Time Employees	33,126		35,269		36,150	
Average Age						
Average Tenure						
Average Faculty Salary	$54,674		$59,426		$63,689	

Employment in the GMS has been fairly stable. Total GMS employment has grown approximately 4.7 percent between 2000 and 2003. By comparison, overall state population grew an estimated 6.1 percent over the same period. As seen by Figure 1, all of this growth is attributable to an increase in female employment. Average tenure in the GMS has remained relatively constant over the past decade, rising from 9.4 years to 9.8 years (Figure 2). By contrast, average employee age has risen significantly, from about 40.5 years to about 43.5 years of age (Figure 3).

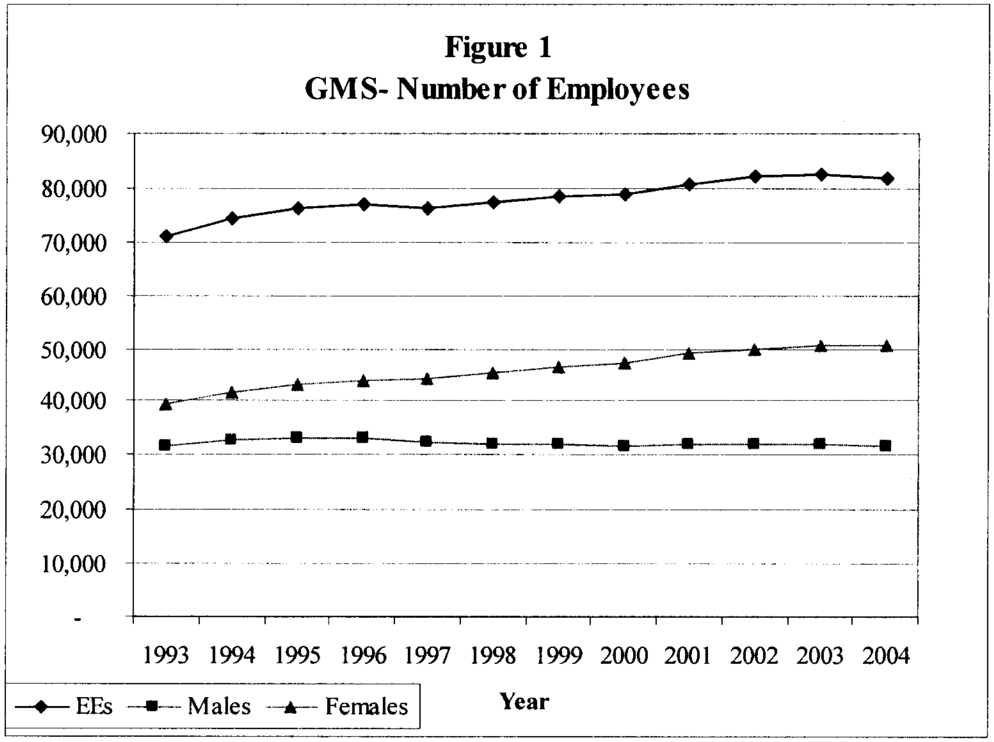
Figure 1
GMS- Number of Employees
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
-
1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
EEs
Males
Females

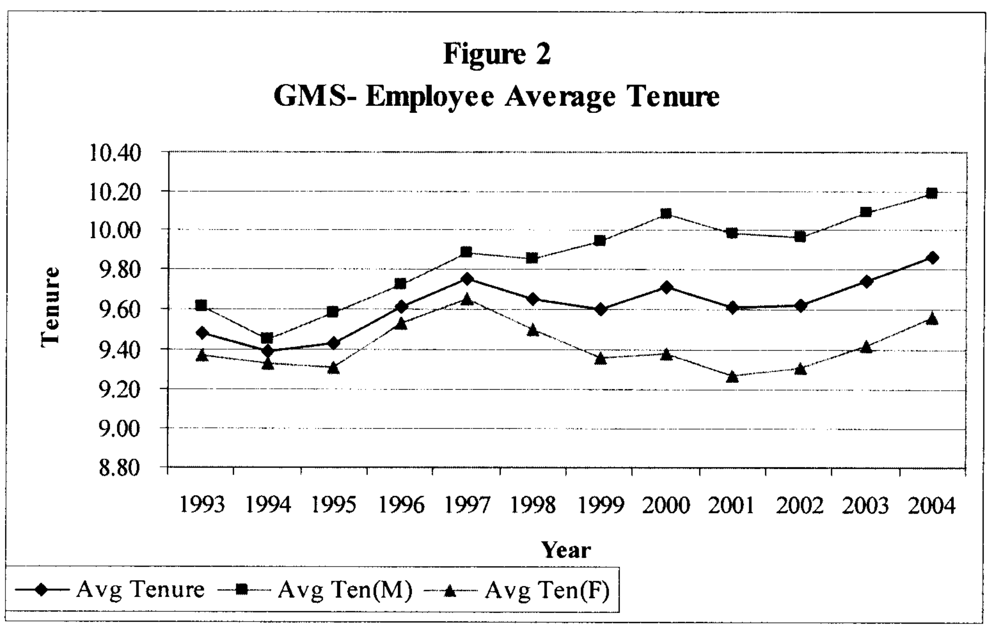
Figure 2
GMS- Employee Average Tenure
Tenure
10.40
10.20
10.00
9.80
9.60
9.40
9.20
9.00
8.80
1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004
Year
Avg Tenure
Avg Ten(M)
Avg Ten(F)

Figure 3
GMS- Employee Average Age

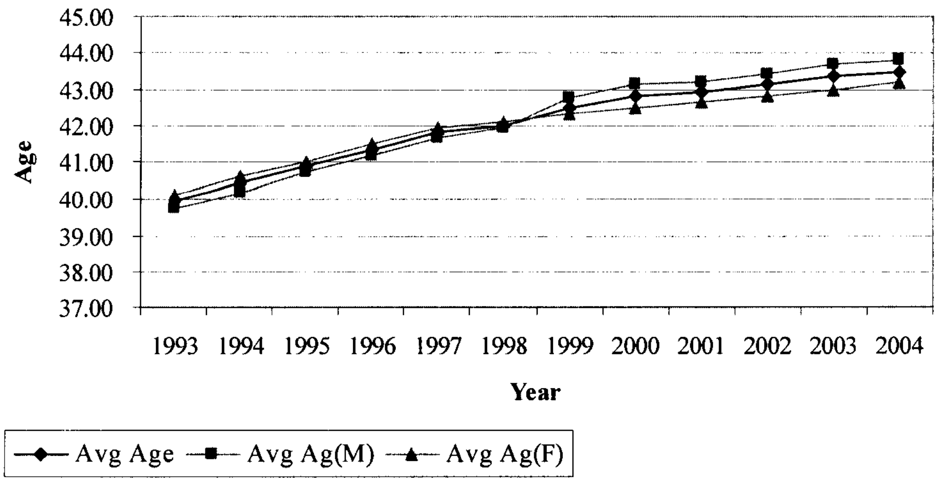

Figure 4
GMS- Employee Average Salary

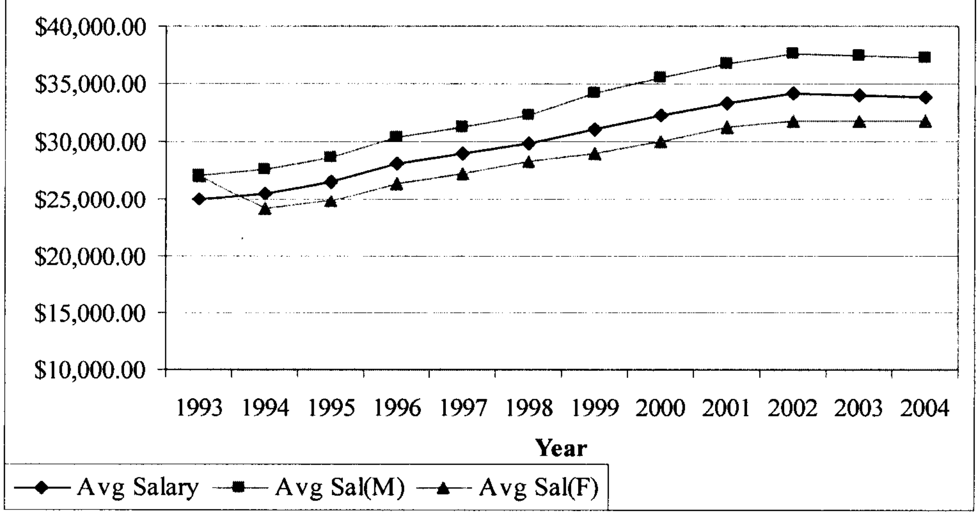

Figure 4 shows that average employee base salary has also increased substantially, from approximately $32,150 thousand to about $33,800 thousand per year, for a total 5.2 percent increase with average annual growth of 1.3 percent. Notably, average salaries have fallen for the past two years. Factoring in employee benefit costs, average compensation for GMS employees was approximately $50,300 in 2002. Benefits (including mandatory benefits) comprised about 35 percent of this average compensation cost.

Constructing an employee census was more difficult for the BOR since there are two main employment tracks: faculty and administrative staff. In addition, the BOR system provides only biannual reports on employment statistics. Total employment in 2002-2003 was approximately 36,150 employees, representing a 9.1 percent increase over 1998-1999. Average faculty salary was $63,689 in 2002-2003, representing an average annual increase of 7.9 percent and a total 16.5 percent increase relative to the 1998-1999 period.

Summary of Benefits

The range of benefits offered by the State of Georgia is broad and varied, with different employee groups receiving different packages. Table 1.2 provides a brief summary of health and retirement benefits offered to employees of the state of Georgia.

TABLE 1.2. EMPLOYEE COVERAGE AND PARTICIPATION: HEALTH AND RETIREMENT BENEFITS

	Group			
	Georgia Merit System		Board of Regents System	
	Universal Coverage	Voluntary Participation	Universal Coverage	Voluntary Participation
Health Insurance	Yes	Yes	Yes	Yes
Indemnity Plan	Yes	Yes	Yes	Yes
Managed Care	Yes	Yes	Yes	Yes
PPO	Yes	Yes	Yes	Yes
HMO	Yes	Yes	Yes	Yes
Defined Benefit Plan	Yes	No	Yes	Yes
Defined Contribution Plan	No	n.a	Yes	Yes
403(b)	n.a	n.a	Yes	Yes
457	n.a	n.a	Yes	Yes
Flexible Spending Account	Yes	Yes	Yes	Yes

Table 1.2 shows the range of benefits discussed in this report. With the exception of a defined contribution plan for GMS employees, all other types of health and retirement benefits have universal coverage. Similarly, with the exception of the GMS defined benefit plan, all benefits are provided on a voluntary basis. Under both systems, the range of managed care health insurance benefits is broad and can vary by geographic location. This report covers only those benefits offered state-wide.

This remainder of this report is comprised as follows. Section III provides an overview of the health and pension benefits offered to employees. Section IV discusses recent significant changes to benefit structure. Section V provides an inter-state comparison of benefits for Georgia and selected states. Section VI provides options for reforming the system, both from the standpoint of employee satisfaction and system savings. Section VII provides concluding comments.

Overview of Health and Pension Benefits

Both the GMS and the BOR offer health and retirement benefits to full-time active employees. Under each system, employees are offered coverage from the date of employment. For each system, participation in the health benefits program is elective and participation in the basic retirement benefits program is mandatory. In addition, each system provides additional elective retirement savings opportunities through an Internal Revenue Code Section 457 and/or 403(b) plan.

Separated employees with at least ten years of service are eligible for a retiree health insurance benefit and a retirement income benefit. The generosity of the retirement income benefit will depend on the beneficiary's career average salary, length of service and date of hire. By contrast, the generosity of the health insurance benefit is independent of the length of service beyond the basic ten year vesting requirement.

The GMS and the BOR systems are similar in generosity and structure. Significant differences include administrative structure, financial funding, retirement benefit formula, and retiree health insurance risk sharing. The main features of each system are discussed in the next sections.

A. Health Benefits

The BOR and GMS maintain separate health insurance systems. The range of options offered to participants within each system is similar, with the primary differences being the administrative role and the cost sharing arrangement for the separate systems. Each plan is discussed separately.

GMS Health Insurance

The GMS health benefit program is managed by the Georgia Department of Community Health (DCH). Participants have a choice between a traditional indemnity plan and range of managed care plans. All options include a dental benefit. Financing of the health insurance program is a mixture of self-insurance and full-insurance. The type of finance depends of the type of health benefit. The State of Georgia is responsible for insuring claims costs are paid for benefits covered under

TABLE 2. 2004 GMS HEALTH BENEFITS OPTIONS

Plan	Financing Status	Covered Lives
Managed Indemnity	Self-Insured	23,831
Preferred Provider Organization	Self-Insured	369,159
Health Maintenance Organizations		242,619
Cigna	Self-Insured	
United Healthcare	Self-Insured	
Kaiser Permanente	Fully Insured	
Blue Choice	Fully Insured	
Total		635,609

self-funded plans. The insurance provider bears responsibility for fully insured plans. Table 2 provides a list of the different types of insurance plans, financing status, and the number of covered lives for 2004.

GMS Coverage and Participation

Full-time employees, vested retired and disabled former employees are covered under the health insurance benefit program. Spouses and dependents of covered participants are also eligible for coverage. The program covers all state employees in the GMS and all public school employees.

Active employees working at least half-time are immediately eligible for full benefits. New employees must elect the type of coverage within 30 days of the date of hire. Retired employees are eligible for full benefits after 10 years of creditable service.

Participation in the health benefits program is elective. Covered individuals elect participation through the payment of premiums. Active employees select the type of coverage through payment of tax-exempt payroll deduction premium payments. The premium payments are made under an IRC Section 125 arrangement and therefore exempt from income and payroll taxes.[1] Active employees can also contribute salary in a tax-exempt Flexible Spending Account (FSA) to offset costs associated with deductibles and co-insurance.

Retired employees pay premiums via deduction from the state sponsored pension annuity. Base eligibility requires that the monthly annuity be sufficient to

[1] This special tax treatment applies to both employer (State of Georgia) and employee contributions.

fully cover the premium payment. These payments are made on an after-tax basis. Retirees are not eligible to contribute to a FSA.

Covered lives under the program have grown substantially over the past decade. Table 3 provides a recent history of covered lives under the program. The number of covered lives has grown at an average annual rate of 2.55 percent over the past decade. The most rapid growth has been in retirees under the age of 65, with average annual growth of 7.73 percent over the past 10 years and 8.47 percent over the past five years. Overall, the retiree population is growing as a percentage of total covered lives. Retirees comprised approximately 12 percent of the covered population in 1995, and comprise about 16 percent of the covered population in 2004.

GMS Health Benefits

Participating individuals have six base options for medical expense insurance benefit. Participants in the managed care program may add a "+ Choice" coverage option. This option allows the participant to receive medical care outside the managed care network, with the proviso that the provider agrees to the managed care fee schedule. Premiums, deductibles, and co-insurance arrangements vary by plan type. Table 4 provides information regarding the funding arrangements for the different plan options.

Each plan consists of two tiers. Tier one is single coverage. Tier two is family coverage. Base benefits are identical for each tier; with the exception that tier two provides additional benefits for spouses and dependent children.

The range of reimbursable services is typical for a large employer plan. Major benefits under all types of plans include emergency care, outpatient care, inpatient care, behavioral health, lab testing, dental care, home healthcare, hospice care, and a prescription drug benefit. A notable feature of outpatient care is the coverage of wellness checks. Neither the indemnity plan nor the PPO covers skilled nursing facilities. Table 4 provides information on the cost sharing of benefits under the plan.

The range of reimbursable services offered is identical for all participants. All participants face the same premium and fee schedules, regardless of work status

TABLE 3. GMS – HEALTH BENEFIT COVERED LIVES

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number										
Active Employees	451,154	459,503	465,254	474,727	481,807	493,807	493,081	515,281	528,867	541,302
Retirees – Under 65	27,014	28,650	30,964	32,727	35,159	38,420	42,085	45,169	48,663	52,782
Retires – Over 65	37,371	39,154	40,943	42,850	44,581	46,190	48,029	48,962	50,547	52,159
Total	515,539	527,307	537,161	550,304	561,547	578,417	583,195	609,412	628,077	646,243
Percent Change										
Active Employees		1.85%	1.25%	2.04%	1.49%	2.49%	-0.15%	4.50%	2.64%	2.35%
Retirees – Under 65		6.06%	8.08%	5.69%	7.43%	9.28%	9.54%	7.33%	7.74%	8.46%
Retirees – Over 65		4.77%	4.57%	4.66%	4.04%	3.61%	3.98%	1.94%	3.24%	3.19%
Total		2.28%	1.87%	2.45%	2.04%	3.00%	0.83%	4.50%	3.06%	2.89%

Covered lives in July for each year.

TABLE 4. HEALTH PLAN COST SHARING – 2004 GMS PLANS

Plan	------Premium------ Ind.	Family	-----Deductible---- Ind.	Family	---Co-Insurance--- Rate	Amount	Stop-Loss Limit Ind.	Family	Lifetime Maximum Ind.	Family
Indemnity										
Basic	$241.10	$522.10	$400	$1,200	90%		$2,000	$4,000	$2 million	
Premier	$246.36	$537.86	$400	$1,200	90%		$2,000	$4,000	$2 million	
PPO										
Basic	$64.96	$198.32								
+ Choice	$105.04	$272.70								
Premier	$70.22	$214.08								
+ Choice	$112.32	$292.82								
In-Network Services			$400	$1,200		$30	$1,000	$2,000	$2 million	
Out-of-network Services			$500	$1,500	60%		$2,000	$4,000	$2 million	
HMOs										
Cigna	$65.76	$161.04	n.a	n.a		$15	n.a	n.a	$2 million	
+ Choice	$117.56	$264.62								
United Healthcare	$65.76	$161.04	n.a	n.a		$15	n.a	n.a	$2 million	
+ Choice	$117.56	$264.62								
Kaiser Permanente	$74.24	$181.78	n.a	n.a		$15	n.a	n.a	n.a	
+ Choice	$132.72	$298.70								
Blue Choice	$63.26	$154.88	n.a	n.a		$15	n.a	n.a	$2 million	
+ Choice	$113.08	$254.52								

or length of service. Thereby, relatively short tenured employees, retirees, and disabled employees receive the same level of benefits as employees and retirees with long tenure.

The equivalence of benefits between active and former employee groups is a major issue for the GMS health benefit package. One problem is with compensation equity. Under the current system, an age 60 retiree with 10 years of service receives the same benefit as an age 60 retiree with 30 years of service. A more equitable benefit structure would provide more generous benefits for longer tenure retirees.

GMS Health Insurance Funding Structure

Ideally, a contribution structure should be designed meet two goals. First, the principle of premium adequacy suggests the structure should provide sufficient assets to meet actual and anticipated claims costs. Second, the principle of premium equity suggests that system participants should bear costs proportional to their risk profile.[2] In addition, the principle of benefit equity would suggest that longer tenure retirees receive relatively more generous benefits compared to retirees with shorter tenure.

Contributions are made by three groups: active employees, vested former employees, and the State of Georgia. The premiums paid by these three groups provide the funds for covering health insurance expenditures. There is no formal proportional standard for sharing costs. Rather, the GMS contribution by the state of Georgia is a fixed percentage of base covered salaries. By legislative formula, the state of Georgia contributes a constant 13.1 percent of base salary.[3] This compensation cost is specific to each government agency.

While this contribution arrangement may provide the desired target proportions of cost sharing, there is nothing to guarantee either the target proportion or the adequacy of contributions. For example, for years in which Merit system employees receive no COLA adjustments, the State of Georgia's contribution to the health insurance fund is approximately the previous year's contribution, regardless of

[2] See Black and Skipper (2000) for a discussion on premium adequacy and equity.

[3] The State of Georgia also makes a flat contribution for non-certified school service personnel. For FY 2004, the Department of Education paid $107 million to the system and each participating school system paid $162.72 per employee.

the actual increase in claims cost over the previous year. By contrast, several years of significant pay increases will result in a large increase in contributions by the State. As evidence of lack of a well defined cost sharing approach, a recent Segal Report[4] suggests that the State of Georgia contribution rate is approximately 84 percent in 2002. DCH data indicate that this share had fallen to 74.8 percent by 2004.

A second issue with the contribution structure is the cost sharing with the retiree population. As noted above, the State's obligation is limited to 13.1 percent of base salary. This implies that there is no attempt to share costs efficiently with retirees. Conceptually, this may be viewed as a form of wage tilt, whereby employees forego cash compensation early in their tenure for the promise of a more generous retiree benefit package. Given the lack of a dedicated trust account for funding these benefits, the State of Georgia is effectively back loading expected retiree health benefit liabilities. Maintaining this method of funding retiree benefits will continue to put increased stress on the solvency of the self-funded part of the system due to a slowly aging work force and a relatively young average retirement age.

The issue of cost sharing will be critical as new GASB standards[5] for pre-funding of retiree health benefits take effect. The impact of pre-funding retiree health benefits will put significant pressure on compensation costs for the State of Georgia. This issue is addressed more fully in Section IV.

GMS Cost and Program Solvency

Financing claims cost for the GMS system health insurance program can be split into two components: a self-insured component and a fully insured component. The fully insured component is specific to two health plans: KP and HMO Blue.[6] Both of these plans receive payment of a per capita basis. There is no issue of program solvency for the fully insured plans since they are the responsibility of the provider to cover any claims costs in excess of the premium payments. The ongoing

[4] See Segal (2004a).
[5] See Segal (2003).
[6] These plans first became available to Merit System employees in 1998.

concerns with these types of arrangements are controlling claims costs and program viability.

The DCH goal is a target reserve fund of two months of expected claims costs for self-funded plans. Given the cost sharing arrangement within the GMS program, there has been significant volatility in actual reserve ratio. Table 5 shows that the reserve fund has varied from a 6 month to a 2 month buffer since 2002. DCH estimates indicate that unless there are significant revisions in cost sharing, the self-funded reserve fund will be exhausted by 2006.

TABLE 5. GMS HEALTH BENEFIT PLAN SOLVENCY ($'S MILLIONS)

	1999	2000	2001	2002	2003	2004	2005
Projected Revenue							
Employee Premiums	302	338	365	425	426	510	550
State Contribution	807	893	1,111	1,178	1,228	1,268	1,268
Other Revenue*	38	240	57	24	31	[1]	[2]
Use from Fund Balance							
Total	1,147	1,471	1,534	1,628	1,685	101	213
Projected Expense	1,273	1,304	1,342	1,512	1,687	1,879	2,031
Net Revenue Less Expense	-126	167	192	116	-2	1,879	2,031
Prior Period Adjustment	-7	1	2	21	0	0	0
Fund Balance	-55	113	307	444	442	340	127
2 Month Reserve Target	161	158	176	209	231	257	278

*Other Revenue include Interest Revenue, Dividends Revenue, Miscellaneous Revenue, Drug Rebates and Appropriations.

[1] $30.53 million of Other Revenue was not included in the board presentation.

[2] Did not estimate Other Revenue for FY2004.

The primary issues with meeting the target reserve fund target center around the cost sharing agreement between the State of Georgia and the participants. First, the fixed percentage contribution by the State of Georgia can create a negative feedback effect in years where employee payroll is frozen.[7] This implies that State contributions to the reserve fund will be frozen at previous year's level even if claims costs increase by 10 percent.

Second, the State's contribution is set relative to active employee payroll, with the premium cost allocated to each agency's budget. When a retiring employee is replaced with a new hire, the system has added a potential new participant but the

[7] This will typically happen during recessions or periods of low GDP growth.

State of Georgia does contribute any more funds to the reserve fund. Given the aging of the current work force, this will place considerable stress on the viability of the reserve fund.

BOR Health Insurance

The BOR health benefit program is managed by the Human Resources Department of the BOR system. Participants have a choice between a traditional indemnity plan and range of managed care plans. The program also provides a carve-out benefit in the form of dental insurance. Financing of the health insurance program is a mixture of self-insurance and full insurance. The type of finance depends of the type of health benefit. The State of Georgia (through the BOR system) is responsible for insuring that claims costs are paid for benefits covered under self-funded plans. The insurance provider bears responsibility for fully insured plans. Table 6 provides a list of the different types of insurance plans, funding status, and the number of covered lives for 2004.

TABLE 6. 2004 BOR HEALTH BENEFITS OPTIONS

Plan	Financing Status	Covered Lives
Managed Indemnity	Self-Insured	25,311
Preferred Provider Organization	Self-Insured	38,506
Health Maintenance Organizations		22,572
Kaiser Permanente	Fully Insured	
Blue Choice	Fully Insured	
Total		86,389

Numbers for January 2004.

BOR Coverage and Participation

Full-time employees, vested retired employees, and vested disabled former employees are covered under the health insurance benefit program. Spouses and dependents of covered participants are also eligible for coverage. The BOR plan covers employees working at least half-time in the University System of Georgia.

Active employees working at least half-time are immediately eligible for full benefits. New employees must elect the type of coverage within 30 days of the date of hire. Retired employees are eligible for full benefits after 10 years of creditable service.

Participation in the health benefits program is elective. Covered individuals elect participation through the payment of premiums. Active employees elect the type of coverage through payment of tax-exempt payroll deduction premium payments. The premium payments are made under an IRC Section 125 arrangement and therefore exempt from income and payroll taxes. Active employees can also contribute salary in a tax-exempt Flexible Spending Account (FSA) to offset costs associated with deductibles and co-insurance.

Retired employees pay premiums via deduction from the state sponsored pension annuity. Base eligibility requires that the monthly annuity be sufficient to fully cover the premium payment. These payments are made on an after-tax basis. Retirees are not eligible to contribute to a FSA.

Table 7 provides a history of covered lives under the program. The number of covered lives under the program has remained fairly stable over the past five years. The number of beneficiaries financed through active employee premiums has fallen approximately 7 percent since 2000. By contrast, the number of beneficiaries covered retired premiums has increased by 39 percent and 24.5 percent for participants under 65 and over 65, respectively. Overall, retirees have risen from 16.7 percent to 22 percent of covered lives over the past four years. The implication is that while overall covered lives are stable, there has been a significant shift to beneficiaries with higher expected demand for health services. This shift, which should continue as the employee population ages, will require more resources from the BOR system.

TABLE 7. BOR – HEALTH BENEFIT COVERED LIVES

	1999	2000	2001	2002	2003
Number					
Active Employees		70,836	66,507	67,945	65,901
Retirees – Under 65		5,782	6,475	6,914	8,048
Retirees – Over 65		8,393	8,958	9,059	10,441
Total	84,271	85,011	81,940	83,918	84,390
Percent Change					
Active Employees			-6.11%	2.16%	-3.01%
Retirees – Under 65			11.99%	6.78%	16.40%
Retirees – Over 65			6.73%	1.13%	15.26%
Total		0.88%	-3.61%	2.41%	0.56%

Covered lives in December for each year.
Estimates are based on aggregates by program type.

BOR Health Benefits

Participants have four base options for a medical expense insurance benefit. Participants in a managed care program may add a "+ Choice" coverage option. This option allows the participant to receive medical care outside the managed care network, with the proviso that the medical services provider agrees to the managed care fee schedule. Premiums, deductibles, and co-insurance arrangements vary by plan type. Table 8 provides information regarding the funding arrangements for the different plan options.

Active employees can choose among multiple tiers for the number of covered lives. Tier one is single coverage. Tier two provides coverage for the employee plus one dependent, with premiums set for either spouse or child. Tier three provides family coverage. Base benefits are identical for each tier; with the exception that tier two provides additional benefits for spouses and dependent children.

Retirees may choose may opt for either single or single plus spouse coverage. In addition, the cost of the premium is higher for retirees not covered by the Medicare system. Retirees covered by Medicare pay substantially less in premiums since the BOR plan is supplemental to the Federal plan.

The range of reimbursable services is typical for a large employer plan. Major benefits under all types of plans include emergency care, outpatient care, inpatient care, behavioral health, lab testing, home healthcare, hospice care, and a prescription drug benefit. A notable feature of outpatient care is the coverage of wellness checks. Neither the indemnity plan nor the PPO covers skilled nursing facilities.

The BOR program offers a number of carve-out benefits to covered employees. These include dental insurance, vision insurance, and disability insurance. The BOR dental plan has a one-time option. The covered employee agree to participate in the plan when first eligible or loose the right to coverage forever. This is designed to avoid the moral hazard issue of employees only participating when there is a need for major restorative work. In addition the plan has a pre-existing conditions clause. Table 9 provides information on the structure of the BOR plan for 2004.

TABLE 8. HEALTH PLAN COST SHARING – 2004 BOR PLANS

Plan	-----Base Premium-----		+ Choice Premium		------Deductible------		---Co-insurance---		--Stop-Loss Limit---		Lifetime Maximum-	
	Employee	Employer			Ind.	Family	Rate	Amount	Ind.	Family	Ind.	Family
Indemnity												
Individual	$112.56	$337.56										
Individual Plus Child	$202.60	$607.80										
Individual Plus Spouse	$236.38	$709.10										
Family	$326.42	$979.24										
Services					$300	$900	80%		$2,000	$4,000	$2 million	
PPO												
Individual	$72.32	$216.92	$101.26	$216.92								
Individual Plus Child	$130.16	$390.48	$182.24	$390.48								
Individual Plus Spouse	$151.86	$455.56	$212.62	$455.56								
Family	$209.70	$629.10	$293.60	$922.70								
In-Network Services					$300	$900		$20	$1,000	$2,000	$2 million	
Out-of-network Svcs					$400	$1,200	60%		$2,000	$4,000	$2 million	
HMOs												
Blue Choice												
Individual	$53.52	$160.52	$90.98	$160.52								
Individual Plus Child	$96.32	$288.96	$163.74	$288.96								
Individual Plus Spouse	$112.38	$337.10	$191.04	$337.10								
Family	$155.18	$465.54	$263.80	$465.54								
Services					n.a	n.a		$15	n.a	n.a	$2 million	
Kaiser Standard												
Individual	$51.24	$153.72	$87.10	$153.72								
Individual Plus Child	$92.24	$276.70	$156.80	$276.70								
Individual Plus Spouse	$107.58	$322.84	$182.90	$322.84								
Family	$148.60	$445.78	$252.62	$445.78								
Services								$30	$2,000	$6,000	Unlimited	
Kaiser Premium												
Individual	$59.96	$179.90	$101.94	$179.90								
Individual Plus Child	$107.94	$323.80	$183.50	$323.80								
Individual Plus Spouse	$125.92	$377.78	$214.06	$377.78								
Family	$173.90	$521.68	$295.62	$521.68								
Services					n.a	n.a		$15	$2,000	$6,000	Unlimited	

TABLE 9. BOR DENTAL PROGRAM – 2004

Program	Premium	Deductible	Co-Insurance	Maximum Benefit
Blue Cross/Blue Shield		$50		$1,000
Single	$26.48			
Single + Child	$50.30			
Single + Spouse	$52.94			
Family	$84.70			
Services				
Preventive			100%	
Minor Restorative			80%	
Major Restorative			80%	

The range of reimbursable services offered is identical for all participants. All participants face the same fee schedules, regardless of work status or length of service. This implies that relatively short tenure retirees and disabled employees receive the same level of benefits as employees and retirees with long tenure.

The equivalence of benefits between active and former employee groups is a major issue for the BOR health benefit package. One problem is with compensation equity. Under the current system, an age 60 retiree with 10 years of service receives the same benefit as an age 60 retiree with 30 years of service. A more equitable benefit structure would provide more generous benefits for longer tenure retirees.

BOR Funding Arrangement

As noted above, a contribution structure should be designed meet several goals. First, the structure should provide sufficient assets to meet actual and anticipated claims costs. Second, system participants should share costs proportional to their risk profile. Also, benefit equity would suggest that longer tenure retirees receive relatively more generous benefits compared to short tenure retirees.

Contributions are made by three groups: active employees, vested former employees, and the State of Georgia. The premiums paid by these three groups provide the funds for covering health insurance expenditures. For the BOR system, the cost sharing objective is for the State of Georgia to finance approximately 75 percent of the health care premium, with participants paying the remainder. Prior to 1998, this objective was 77 percent to 23 percent cost sharing arrangement.

BOR Cost and Program Solvency

Financing claims costs for the BOR system health benefit program can be split between two components: a self-insured component and a fully insured component. The fully insured component is specific to two managed care plans: Kaiser Permanente and Blue Choice. Both of these plans receive payment on a per capita basis and there is no issue of program solvency for the state of Georgia. As with the GMS system, the ongoing concern is with self-insured programs.

TABLE 10. BOR HEALTH BENEFIT PLAN SOLVENCY ($'S MILLIONS)

	2002	2003	2004
Projected Revenue			
Employee Premiums	57	62	43
State Contribution	141	105	106
Other Revenue	2	3	2
Total	198	167	152
Projected Expense	187	208	146
Net Revenue Less Expense	11	-41	6
Fund Balance	46	56	62

The BOR did not provide information on a target reserve. The program has built up reserves in two of the past three years. Funding adequacy over the past three years appears strong, with the end-of-year fund balance well in excess of an average two month expense reserve.

B. Pension Benefits

There are a number of retirement systems for employees of the State of Georgia. The two main systems are the Employee Retirement System (ERS) and the Teachers Retirement System (TRS). Smaller plans include the Georgia Judicial Retirement System, the Legislative Retirement System, and the Public School Retirement System. Taken together, these systems provide Defined Benefit (DB) retirement program coverage for a majority of public employees.

In addition, most systems provide for elective participation in Internal Revenue Code Section 403(b) and/or Section 457 Defined Contribution plans. These plans provide additional retirement savings opportunities through the deferral of salary into tax-preferred savings accounts. These programs are not discussed since the State of Georgia makes no contributions, nor bears any liabilities, to these accounts.

ERS Retirement Program

All full-time GMS employees are covered by the Employee Retirement System (ERS). The ERS is a fully-funded contributory Defined Benefit (DB) program. As such, the State of Georgia bears the burden of investment risk for plan investments and longevity for plan beneficiaries. The system, established in 1950, is "maturing" in that the flow of lives through the system is still aging.

ERS Coverage and Participation

All full-time employees in participating departments and agencies are covered by the ERS. There is no age or service requirement for coverage. Table 11 provides information on the participant and beneficiary populations.

TABLE 11. ERS COVERAGE

	1997	1998	1999	2000	2001	2002	2003
Active Members	71,784	71,982	73,009	75,318	75,132	71,790	73,251
Average Salary	$27,554	$28,562	$29,477	$30,594	$31,906	$33,547	$33,986
Beneficiaries	20,981	22,007	23,126	24,488	25,889	27,229	28,570
Average Allowance	$15,972	$16,834	$17,813	$19,617	$20,815	$21,980	$22,957
Beneficiary/Active Ratio	29.2%	30.6%	31.7%	32.5%	34.5%	37.9%	39.0%

Two interesting trends emerge from the data. First, the ratio of beneficiaries to active employees is rising rapidly, increasing by 10 percentage points over the last seven years. This reflects a rapidly aging participant population. Second, average benefit allowances are growing at a substantially faster rate than average employee salaries. Over the past seven years, average salaries grew at an average rate of 3.6 percent while average allowances grew at a rate of about 6.2 percent. Combined, these two trends could eventually result in funding stress.

ERS Retirement Program Participation

Full-time employees of participating department and agencies are required to become members of the ERS, with the exception of employees who first become eligible for membership after age 60.

ERS Retirement Contributions and Earnings

The ERS maintains two basic retirement plans. The "Old Plan" covers employees hired before July 1, 1982, and returning employees who were fully vested under the program before the conversion date. The "New Plan" covers employees hired after July 1, 1982. Contributions and benefits vary slightly under the two plans.

The Old plan has a total employee/member contribution rate of 6.5 percent of monthly base salary less $7.00.[8] The employee's payroll deduction is 1.5 percent. Of this amount, 1.25 percent goes into the retirement account and 0.25 percent is a Group Term Life Insurance (GTLI) premium. Since July 1980, the employing agency contributes 5 percent less $7.00 of the employee contribution rate. Of this amount, 4.75 percent (less $7.00) goes into the retirement account and the remaining 0.25 percent goes towards the GTLI premium. These amounts are credited to an employee's account and are refundable. Employees under the age of 65 with at least 34 years of creditable service are not required to contribute.

In addition to employee contributions to the Old Plan, the State of Georgia also contributes an actuarially determined percentage of salary which is not applied to an individual member's account, and therefore is not refundable to the member. The State's contribution is calculated to ensure the plan remains fully funded.

The New Plan requires that covered members contribute 1.5 percent of base salary. Of this amount, 1.25 percent goes into the retirement account and 0.25 percent is the GTLI premium.

As with the Old Plan, the State of Georgia contributes an actuarially determined percentage of salary which is not applied to an individual member's

[8] The $7.00 is a Social Security offset adjustment.

account, and therefore is not refundable to the member. The State's contribution is calculated to ensure the plan remains fully funded.

Table 12 provides data on contributions, by source, to the system over the past five years. Under both plans, active employee accounts earn 4 percent interest (compounded annually) after one year of deposit.[9] Funds left on deposit by members who terminate employment do not earn interest. Members terminating employment before retirement may submit an application for refund of contributions and interest. GTLI premiums are not refundable.

TABLE 12. ERS CONTRIBUTIONS AND BENEFITS ($'S THOUSANDS)

	1998	1999	2000	2001	2002	2003
Contributions						
Members	$54,829	$55,618	$55,735	$55,887	$57,920	$55,456
Employers	$286,794	$304,461	$302,332	$315,505	$233,229	$246,172
Total Contributions	$341,623	$360,079	$358,067	$371,392	$291,149	$301,628
Benefits*						
Service	$297,841	$330,116	$381,015	$423,487	$467,732	$511,207
Disability	$41,356	$47,923	$60,169	$72,567	$84,142	$94,100
Survivor	$31,259	$33,907	$39,196	$42,836	$46,619	$50,565
Total Benefits	$370,456	$411,946	$480,380	$538,890	$598,493	$655,872
Benefits/Contributions	108.4%	114.4%	134.2%	145.1	205.6%	217.4%
Total Benefits Paid FY**	$357,434	$398,391	$460,358	$518,734	$574,602	$637,243
Benefits/Contributions	104.6%	110.6%	128.6%	139.7%	197.4%	211.3%
Other Expenses						
Administration	$3,762	$8,082	$7,099	$6,950	$7,971	$8,509
Refunds	$10,221	$8,810	$7,417	$7,563	$5,430	$5,253

*Annualized monthly benefits as of 6/30.
**Actual benefits paid during previous fiscal year (breakdown by group not available).

Contributions fell, on average, at a rate of about 1.9 percent while Benefits grew at average rate of about 12.1 percent. Combined, the ratio of benefits to contributions more than doubled over the 1998 to 2003 period.

[9] Interest is credited on June 30th.

ERS Retirement Benefits

Employees with at least 10 years of service are fully vested. Participants are eligible for normal retirement benefits upon attainment of age 65 and 10 years of creditable service or after 30 years of creditable service regardless of age. Vested employees are also eligible for early retirement, disability[10], and death benefits. Both plans offer a joint and survivor annuity option. The generosity of the actual benefit received depends on which plan covers the participant. Under both the New Plan and the Old Plan, the final benefit is a function of years of service, the average final compensation, and a benefit percentage.

Under the Old Plan, the Normal Retirement Allowance is based on average final compensation[11], creditable service, and benefit generosity parameters. For the Old Plan:

Old Plan Normal Retirement Allowance =

Benefit Factor *x* Average Final Compensation *x* Years of Creditable Service

There is a minimum normal retirement allowance benefit of 2 percent of average final compensation times years of creditable service. For employees with at least 29 years of creditable service, the benefit factor rises, on average 0.03 percent per year, with a maximum benefit factor of 2.20 percent for employees with at least 35 years of creditable service.

As an example, consider an employee with 35 years of creditable service and average final compensation of $3,000. This individual's benefit is

2.2% *x* $3,000 *x* 35 = $2,310

This benefit provides a retirement benefit equal to 77 percent of final average compensation.

[10] A participant is eligible for disability retirement after 13 years and 4 months of creditable service. In addition, the participant must be medically certified to be permanently disabled for the further performance of the duties of the position held at the time of the disability.

[11] Average final compensation is defined as the 24 consecutive calendar months of creditable service that yields the highest average.

Under the New Plan, the normal retirement allowance is equal to 2 percent of average final compensation times years of creditable service. Participants employed by the Uniform Division or Judicial Division may be eligible for additional minimum allowances. Under the New Plan:

New Plan Normal Retirement Allowance =
0.02 *x* Average Final Compensation *x* Years of Creditable Service

As an example, consider an employee with 35 years of creditable service and whose average final monthly compensation is $3,000. This individual's benefit is:

2% *x* $3,000 *x* 35 = $2,100

This provides a retirement benefit of 70 percent of average final compensation.

In addition to the normal retirement allowance, both plans provide for early retirement, disability, and death benefits. Table 13 provides an overview of these benefits.

TABLE 13. ERS SUPPLEMENTAL RETIREMENT BENEFITS

	Condition	Benefit: Age	Benefit: Service
Early Retirement	Age 60 and 10 years of creditable service or 25 years of creditable service.	7% reduction from NRA for each year less than age 60.	7% reduction from NRA for each year by which creditable service at retirement is less than 30 years.
Disability	13 years and 4 months of service and medically certified as permanently disabled for further performance of the duties of the position held at the time of the disability.	Immediate benefit with the amount depending upon service at the time of disability.	
	13 years 4 months to 18 years	75% of NRA at age 60	
	18 years to 22 years 9 months	100% of NRA at age 60	
	22 years 9 months to 27 years 6 months	75% of NRA at age 65	
	Over 27 years 6 months.	100% of age 65 benefit.	
Death	Less than 60, less than 13 years 4 months	Refund of contributions with interest	
	Less than 60, over 13 years 4 months	100% of NRA at age 60 with survivor option	
	Over 60, over 10 years	100% of NRA with survivor option	
	After Retirement.	Choice of joint and survivor annuity options.	

ERS Retirement Cost and Funding Adequacy

The ERS system is designed as a fully funded system.[12] The normal and supplemental costs of the program are functions of several factors. Table 14 provides data on the overall funding status of the system over the 1997 to 2003 period. As discussed in Section V, the system restored funding adequacy while using a conservative real interest rate assumption, relative to other states.

TABLE 14. ERS ACTUARIAL SOLVENCY ($'S MILLIONS)

	1997	1998	1999	2000	2001	2002	2003
Accrued Liabilities							
Active – Member Share	$757	$775	$784	$788	$787	$792	$786
Active – Employer Share	$4,242	$4,699	$4,896	$5,136	$5,487	$5,514	$5,400
Beneficiaries	$3,161	$3,620	$4,015	$4,650	$5,283	$5,689	$6,185
Total Liabilities	$8,159	$9,094	$9,696	$10,573	$11,557	$11,995	$12,371
Actuarial Value of Assets	$7,432	$8,614	$9,849	$11,000	$11,751	$12,124	$12,429
Assets/Liabilities	91.1%	94.7%	101.6%	104.0%	101.7%	101.1%	100.5%

TRS Retirement Plan

As with the ERS, the TRS requires participation in the base retirement program as a condition of employment. However, faculty and some administrators employed by the BOR may opt out of the TRS by selecting into the Optional Retirement Plan (ORP), which is a Defined Contribution (DC) plan. The TRS base plan is a Defined Benefit (DB) plan. Within the TRS, participants have a choice of options regarding the form of the benefit. The following discussion focuses on the TRS base plan since the State of Georgia faces no financial obligations to ORP beyond a basic contribution.

TRS Retirement Plan Participation

Most public education system employees who work at least on a half-time basis are required to participate in the TRS. This includes personnel who are

[12] A fully funded system requires that assets be sufficient to cover terminal liabilities. Terminal liabilities are defined as the current and future liabilities the plan would have if the plan was terminated today.

TABLE 15. TRS COVERAGE

	1997	1998	1999	2000	2001	2002
Active Members	173,599	180,417	186,822	190,911	192,654	199,029
Average Salary	$31,497	$32,990	$36,573	$37,812	$37,927	$38,275
Beneficiaries	39,278	41,420	43,732	47,105	50,767	54,222
Average Allowance	$18,093	$18,969	$19,920	$21,937	$23,210	$24,378
Beneficiary/Active Ratio	22.6%	23.0%	23.4%	24.7%	26.4%	27.2%

employed one-half time or more in specific positions of the state's public school systems, regional libraries, county libraries, and regional educational service agencies. All personnel employed one-half time or more by the Board of Regents of the University System of Georgia are required to participate, unless the employee is eligible for participation in an ORP administered by the Board of Regents. Table 15 provides data on TRS coverage over the 1997 to 2002 period.

The data indicate that the ratio of beneficiaries to retirees is growing rapidly. This is attributable to several effects, including an aging workforce, early retirement systems, and the strong popularity of the ORP for employees within the BOR system. Another notable factor is the increase in average allowances relative to average salaries, with average benefits growing from about 57 percent to about 64 percent of average salary over this period.

TRS Retirement Contributions and Earnings

Active employees covered by the TRS contribute 5 percent of base compensation[13] to TRSGA by payroll deduction. Contributions are made on a before-tax basis for purposes of calculating federal and state liability.

The employing agency of each active participant also contributes to the TRS. The employer contribution rate is 9.24 percent of the active participant's base compensation. Employer contributions fund group benefits for all TRS members. Table 16 provides data on contributions, by source, over the 1998 to 2003 period. Contributions grew at an average rate of 3.6 percent over this period.

[13] The TRS defines base salary as "earnable compensation." Earnable compensation is defined as the full regular compensation payable to a member for full normal working time.

TABLE 16. TRS CONTRIBUTIONS AND BENEFITS ($'S THOUSANDS)

	1998	1999	2000	2001	2002	2003
Contributions						
Members	$305,752	$330,517	$355,948	$369,006	$403,952	$438,998
Employers	$710,409	$776,178	$779,571	$808,480	$716,917	$768,763
Total Contributions	$1,016,161	$1,106,695	$1,135,519	$1,177,486	$1,120,869	$1,207,761
Benefits						
Service	$707,595	$786,963	$923,049	$1,058,683	$1,181,838	$1,323,871
Disability	$27,700	$30,302	$34,160	$37,118	$40,418	$43,545
Survivor	$38,760	$41,852	$48,063	$52,528	$57,178	$62,223
Supplemental	$4,949	$4,628	$4,334	$3,881	$3,582	$3,120
Death	$1,578	$1,446	$1,962	$1,166	$1,355	$1,881
Total Benefits	$780,582	$865,191	$1,011,568	$1,153,376	$1,284,371	$1,434,640
Benefits/Contributions	76.8%	78.2%	89.1%	98.0%	114.6%	118.8%
Other Expenses						
Administration	$6,637	$7,810	$9,058	$10,502	$15,966	$14,804
Refunds	$42,098	$42,911	$44,718	$58,831	$41,250	$40,883

Contributions grew at an annual average rate of 3.6 percent while benefits grew at an annual average rate of about 13 percent. Taken to together, the ratio of benefits to contributions grew by 56.4 percent over the 1998 to 2003 period.

TRS Retirement Benefits

TRS offers a defined benefit plan of retirement. The normal retirement benefit is a function of years of service, the average two highest salary years, and a 2 percent multiplier. Participants are offered two plans of retirement, Plan A and Plan B. Plan A is a single life annuity for the participant. Plan B is a joint and survivor's annuity that provides an annuity for the participant's beneficiary(ies) after the participant's death. A participant may wait until retirement to designate the preferred plan.[14]

The normal retirement allowance for an employee covered by the TRS is:

New Plan Normal Retirement Allowance =

0.02 *x* average final compensation *x* years of creditable service

[14] Beginning on July 1, 2004, participants may also elect to receive a partial lump-sum distribution (cash payment) in exchange for a reduced lifetime benefit.

TRS Retirement Costs and Funding Adequacy

The TRS system is a fully funded system. Table 17 provides data on the overall funding status of the system over the 1997 to 2002 period. Over this period, the system went from substantially under-funded to more than fully-funded. As discussed in Section V, the system restored funding adequacy while using a conservative real interest rate assumption, relative to other states.

TABLE 17. TRS ACTUARIAL SOLVENCY ($'S MILLIONS)

	1997	1998	1999	2000	2001	2002
Accrued Liabilities						
Active – Member Share	$3,409	$3,648	$3,898	$4,092	$4,252	$4,487
Active – Employer Share	$13,085	$15,208	$17,741	$18,126	$18,826	$19,304
Beneficiaries	$8,401	$9,943	$11,124	$12,658	$14,076	$15,915
Total Liabilities	$24,895	$28,799	$32,763	$34,876	$37,153	$39,707
Actuarial Value of Assets	$22,496	$27,895	$31,832	$35,676	$38,585	$40,502
Assets/Liabilities	90.4%	96.9%	97.2%	102.3%	103.9%	102.0%

Other Retirement Plans

The State of Georgia sponsors three smaller retirement programs. These programs are the Georgia Judicial Retirement System (GJRS), the Legislative Retirement System (LRS), and the Public School Employee Retirement System (PSERS).

The GJRS was created in 1998 and was meant to consolidate the retirement benefit systems of the Superior Court Judges Retirement System, the District Attorney's Retirement System, the Trial Judges and Solicitors Retirement Fund, and to provide benefits to certain employees of the Attorney General/ Legislative Counsel. Table 18 provides an overview of contributions and base retirement benefits for participants covered under the GJRS.

The LRS was created in 1967, merged with the ERS in 1971, and was reactivated in 1981. The LRS covers members of the General Assembly on an elective basis. If a member chooses not to participate when first eligible, the member may not choose to participate later. Table 18 provides an overview of contributions, vesting and base retirement benefits for participants covered under the LRS.

The PSERS was created in 1970 to provide certain public school employees with supplemental retirement benefits. Employees of public school systems who are not eligible for membership in the TRS must participate in the PSERS as a condition of employment. No employee can be a member of both PSERS and TRS at the same time. Table 18 provides an overview of contributions, and base retirement benefits for participants covered under the PSERS.

TABLE 18. OTHER RETIREMENT PROGRAMS

Program	-------Contributions------		-----------Base Benefit-----------
	Employee	Employer	
Legislative Retirement System	4% + $7.00	5% - $7.00	$28.00 x years of creditable service.
Judicial Retirement System			
Superior Court Judges	2.5%	5.0%	66.66% of salary, plus 1% for each year of service over 16, not to exceed 24.
Other Judges	7.5%	0.0%	
District Attorneys	2.5%	5.0%	
Other Court Employees	7.5%	0.0%	
Public School Employees Retirement System	$4.00	$0.00	$12.50 x years of creditable service.

Recent Changes to the State of Georgia Benefits System

There have been several recent changes to the benefit structure. These changes include a successful move into managed care health programs, consolidation of the administration of judicial retirement programs, and greater utilization of federal subsidies for health and retirement programs.

Most significant of these changes has been the move to aggressively steer health program participants into managed care programs. The goals are twofold. First, managed care offers opportunities to control cost through better negotiated fee arrangements. Second, managed care programs place significant emphasis on preventative care, with the objective of lowering demand for inpatient care. The push into managed care is a success story, with over 90 percent of GMS and over 60 percent of BOR system participants enrolled in a managed care program. This transition has taken pressure off the fully insured programs within the state. However, there is a potential downside of rural health care adequacy since network options may be limited in these areas.

Another notable change has been the consolidation of judicial pensions under a unified administrative framework. Consolidation can reduce administrative burdens, which increases the net return to the retirement fund. Pooling retirement assets can result in a larger asset base managed by a single trust. Thereby, scale economies will lower administrative costs per participant and increase the market power of the trust. Given the recent change, it remains to be seen if the consolidation will be able to leverage the gains.

Both the GMS and BOR systems offer participants the opportunity to set aside money for health expenditures in a Flexible Spending Account (FSA). FSAs allow participants to set aside money for health care expenditures. FSA funds that are used for qualified expenditures are tax-free. Any funds left in the FSA at year-end revert to the employer since the employer must pre-fund the entire FSA amount at the beginning of the year. In the past, the system offered participants the use of a FSA debit card for reimbursement. These cards were discontinued due to administrative problems. This may have been somewhat short-sighted since the delays in reimbursement will discourage use of the system, resulting in underutilization of the federal tax subsidy.

Another significant change was the transition of management of the prescription drug benefit to a Pharmacy Benefit Manager (PBM). Express Scripts acts as the PBM for both the GMS and the BOR. The objective of the PBM method is to actively manage prescription drug use, from both participant and medical service provider perspective. Given the recent nature of the change, no data was available for analyzing the effectiveness of the change to the PBM model.

Finally, there is a prospective change to retiree health insurance scheduled to take effect in 2006. Recent changes in GASB standards require state and local governments to report, account for, and contribute to the costs of non-pension related retirement benefits promised to current and future retirees. Accounting for these Other Post-Employment Benefits (OPEB) is designed to enhance the transparency of public sector labor costs. Compliance with the standards will likely result in significant measures of new unfunded liabilities for affected governments.

Inter-State Comparison

This section compares the relative status of the health and retirement system for employees of the state of Georgia with public employee systems of other states. In addition, we compare the compensation package of GMS employees with those of other Southeastern states. Overall, the State of Georgia is very competitive on compensation and the retirement systems are relatively sound. The health system in Georgia, as are the systems of many states, is currently under considerable funding pressure due to the relatively rapid growth of health care expenditures.

A. Compensation

The State of Georgia is very competitive in total compensation paid to employees. Table 19 provides information on average compensation for states in the Southeastern region. For 2002, Georgia's average state employee compensation ranked third highest among Southeastern States. The monetary average value of salary and elective benefits was $46,802. Assuming average mandatory benefits of 11.65 percent, average compensation was $50618. Excluding mandated benefits, an average of 70 percent ($32,744) was in cash salary and 30 percent ($14,058) was attributable to benefits costs. If mandated benefits are included, cash compensation comprised 65 percent of total compensation. Georgia ranked fifth in average cash salary, second in benefits, and third in total compensation.

The relative generosity of Georgia's average public sector compensation package can be attributed to higher costs of living and a more educated, skilled workforce.

TABLE 19. PUBLIC EMPLOYEE COMPENSATION – SOUTHEASTERN STATES 2002

		Benefits			Rank		
State	**Average Salary**	**Elective**	**Mandatory**	**Total**	**Elective**	**Mandatory**	**Total**
Georgia	*$32,744*	*$14,059*	*$3,815*	*$50,618*	*5*	*2*	*3*
Alabama	$32,948	$9,076	$3,838	$45,862	4	13	9
Arkansas	$29,831	$11,921	$3,475	$45,227	10	9	11
Florida	$30,215	$10,347	$3,520	$44,082	8	10	12
Kentucky	$33,801	$14,292	$3,938	$52,031	2	1	1
Louisiana	$29,985	$13,315	$3,493	$46,793	9	5	6
Mississippi	$26,560	$10,269	$3,094	$39,923	13	11	13
North Carolina	$33,453	$9,111	$3,897	$46,461	3	12	7
South Carolina	$31,191	$13,955	$3,634	$48,780	7	3	4
Tennessee	$28,686	$13,979	$3,342	$46,007	12	4	8
Texas	$32,237	$12,420	$3,756	$48,413	6	8	5
Virginia	$35,425	$12,150	$4,127	$51,702	1	7	2
West Virginia	$29,126	$13,304	$3,393	$45,823	11	6	10
SE Average	$31,246	$12,169	$3,640	$47,056			

Source: Ashmore (2003).

B. Health Benefits

Table 20 provides a comparison of State of Georgia health insurance enrollment with select other states. One of the most noticeable features is that, for 2002, Georgia was one of only twelve states that still offered an indemnity plan option. However, the share of participants in the indemnity plan was low relative to the national average.

The State of Georgia is competitive with respect to the level and cost sharing arrangement for premiums. Table 21 provides a comparison of premium levels and the cost sharing arrangement between participants and their respective State employer.

For the active employee group, premiums for single employees were relatively average and premiums for families were significantly below average. The share of premiums paid by employees is relatively high when measured against the national average and select states. This relatively high employee share could have offsetting effects. First, adequately set employee premiums may make participants more aware of health care costs, thereby holding down the growth of expenditures. However, if premiums are high relative to out-of-pocket expenses, then employees

TABLE 20. COMPARISON OF SELECT STATE HEALTH INSURANCE SYSTEMS – PLANS 2002

	Employee Enrollment				
	Number	Indemnity	PPO	POS	HMO
*Georgia**	*235,600*	*12%*	*57%*		*31%*
Florida	139,215		61%		39%
New York	174,571		76%		24%
North Carolina*	168,324	100%			
Ohio	54,404		72%		28%
Tennessee	137,972		50%	20%	30%
Virginia	92,952			94%	6%
National	2,895,621	19%	33%	16%	32%

Source: Segal (2004a).
*Covered lives are provided. Assumes 2.5 dependents per active employee and 0.5 dependents per covered retiree.

TABLE 21. COMPARISON OF SELECT STATE HEALTH INSURANCE SYSTEMS – PREMIUMS 2002

	Employee Premiums				Retiree Premiums (under age 65)			
	Single	State Share	Family	State Share	Single	State Share	Family	State Share
Georgia	*$305*	*84%*	*$565*	*73%*	*$305*	*84%*	*$565*	*73%*
Florida	$291	86%	$660	77%	$291	0%	$660	0%
New York	$338	90%	$765	82%	$338	90%	$765	82%
North Carolina	$244	100%	$610	40%	$244	100%	$610	40%
Ohio	$286	90%	$786	90%	na	na	na	na
Tennessee	$369	80%	$922	80%	$369	80%	$922	80%
Virginia	$295	93%	$797	70%	$295	100%	$797	100%
National Average	$308	90%	$768	78%	$383	57%	$815	47%

Source: Segal (2004a).

may view health care expenditures as primarily a fixed cost. If this is the case, employees will tend to over consume health care, driving up health care costs.

According to the 2003 Segal Report on Public Employee Health Benefits, the State of Georgia is relatively generous with respect to retiree premium cost sharing. Nationally, States pay an average of 57 percent for retiree single coverage and only 47 percent for retiree family coverage. According to the Segal Report, the State of Georgia pays 84 percent and 73 percent respectively. These figures are misleading given the nature of the cost sharing agreement for GMS employees, wherein the State of Georgia has no formal commitment to pay for retiree health insurance premiums.

Rather, Georgia's share of retiree premiums must be netted out of the 13.1 percent paid for GMS employees and the 25 percent paid under the BOR system.

C. Pension Benefits

Many public and private pension funds have experienced considerable funding and solvency stress over the past five years. The combination of the stock market correction and recession put a strain on pension assets and the ability of employers to fund accrued liabilities out of revenues. Even so, the State of Georgia has done an adequate job of restoring system balance while resisting the incentive to use overly optimistic valuation assumptions.

TABLE 22. INTERSTATE COMPARISON OF PUBLIC PENSION PLAN SOLVENCY – SELECT SYSTEMS (Values for September, 2002)

State	Method	Assumptions: Investment Return	Assumptions: Inflation	Funding Ratio
Georgia ERS	EA	7.00%	3.50%	101.7%
Georgia TRS	EA	7.25%	3.75%	102.0%
Florida RS	EA	8.00%	3.50%	115.0%
New York Teachers	AC	8.00%	3.00%	125.0%
New York ERS	AC	8.00%	3.00%	99.8%
North Carolina LG	EA	7.25%	3.75%	99.3%
North Carolina TSE	EA	7.25%	3.75%	111.6%
Ohio PERS	EA	8.00%	4.00%	102.6%
Ohio Teachers	EA	8.00%	3.50%	77.4%
Tennessee	FEA	7.50%	0.00%	99.6%
Virginia	EA	8.00%	3.00%	107.3%
National Average		8.00%	3.75%	92.9%

EA=Entry Age; AC=Aggregate Cost; FEA=Frozen Entry Age
Source: U.S. Census (2004).

Table 22 provides a comparison of the funding ratios and key assumptions for Georgia public pension funds and other select state pension funds. For the fiscal year ending in 2002, both of Georgia's primary pension funds were adequately funded. Both funds had assets in excess of 100 percent of estimated terminal liability. This is a laudable accomplishment, especially when measured against a National average of 92.9 percent funding adequacy. In addition, the assumption used in calculating funding adequacy are conservative relative to both the national average and to a select group of states. Both the ERS and TRS use a real interest rate assumption of 3.5 percent, compared to a national average of 4.25 percent and a high average rate of 7.5 percent for the State of Tennessee. The use of conservative estimates reduces the possibility of future funding shortfalls, and is a sign of competent fund management.

Issues and Options

Issue 1: No Consolidated Annual Labor Report

Many states produce consolidated annual labor reports that analyze a variety of factors, such as the level and growth of total compensation, the level and growth of benefits, average age and average tenure.

Option: It is recommended that the State Legislature adopt a requirement for the Governor's office to produce a consolidated annual labor report for the State of Georgia. The report should provide information on the structure of the labor force and the structure of employee compensation, including any cost drivers.

Issue 2: Retiree Health Insurance Funding

Recent changes to GASB requirements call for pre-funding of retiree health benefits. The goal is to ensure the funding adequacy of this rapidly growing benefit. While securing retiree well-being, the new GASB rules will place significant stress on affected governments.

Options: The State of Georgia has several options.

- Freeze provision of self-insured retiree health insurance. Current retirees will retain the option of self-insured health insurance. Future retirees must choose between a fully-insured managed care plan or no state sponsored insurance. In essence, the State of Georgia will opt out of the retiree health insurance business.
- Retain the current system and fully pre-fund retiree health insurance through state revenues. This option will place significant burdens of the state.
- Retain the current system and allow active employees to purchase into the fully-insured retiree health insurance pool. Active employees that desire to participate in a fully-insured retiree program, in contrast to a self-insured system. Under this option, retirees are responsible for pre-finding the retirement benefit.
- A mixture of all the above options. As discussed below, the State may decide to base the generosity of the benefit of employee tenure.

Issue 3: Retiree Health Insurance Benefit Generosity

All vested retirees receive the same options with respect to health insurance benefits. For example, a retiree with 10 years of creditable service receives the same retirement health benefit as a retiree with 35 years of creditable service.

Options: The State of Georgia should provide relatively more generous retiree health benefits to longer tenured retirees. If structured correctly, this change can significantly reduce pressure on the health insurance program. There are two main options.

- Do not restrict plan options but increase premiums and out-of-pocket expenses. Under this option, all retirees have the same program options. Shorter tenured retirees will pay comparatively higher premiums, deductibles, and co-payments relative to longer tenured retirees. To avoid administrative complexity, it is recommended that retirees by placed in five year pools, e.g. 10 to 14 years, 15 to 19 years, etc.
- Restrict the options of shorter tenured retirees. For example, retirees with 10 to 14 years of service are only eligible for a high deductible policy that is designed for use in conjunction with a Health Savings Account (HSA). Retirees with 15 to 19 years of service also have the option of a lower deductible self-insured managed care plan. Retirees with at least 20 years of creditable service can select from a full menu of options.

Issue 4: GMS Health Insurance Cost Sharing

Currently, the State of Georgia contributes 13.1 percent of active employee salary to the GMS health insurance system. This method can help insure budget balance during recessionary periods since the growth of the State's contribution is tied salary growth. However, this method also puts incredible stress on solvency of the self-insured funds. First, the state makes no real contribution for retiree health care. When an employee retires and is replaced with a new hire, the states contribution is 13.1 percent of the new employee's salary. This salary is often below the retiree's final salary. The resulting smaller State contribution must cover a share of the costs for both the active employee and the retiree. Second, this method creates a negative feedback effect on program solvency in recessionary periods. If the State freezes wages, then the State contribution to health insurance is also frozen. However, health care costs will typically continue to rise, resulting in stress on the system.

Option: It is recommended that the GMS cost sharing agreement be changed to a premium standard of 70 percent for the State of Georgia and 30 percent by employees. The change should be phased-in over a three year period.

Issue 5: GMS Health Insurance Premium Structure

Currently, the GMS premium structure draws distinctions between single participants and household participants. The household premium is independent of the number of dependents. There is no distinction between active employees and retirees. This relatively unrefined premium structure results in unnecessary cross-subsidization and violates the principle of premium equity, wherein participants should pay premiums that are proportional to the risk they bring to the insurance pool.

Option: It is recommended that the GMS adopt the BOR premium structure, which draws distinctions between active and retired employees, as well as households with two covered participants and households with more than two participants.

Issue 6: ERS Pension Options

Employees of the GMS and public education system are covered by a Defined Benefit pension plan. Participants become fully vested in the plan after 10 years of service. Separating employees with less than 10 years of creditable service receive no pension benefit. The 10 year cliff vesting rule may discourage high quality workers from applying for employment in the GMS or public school system since national average job tenure is approximately 7 years.

Option: The ERS should offer a defined contribution option similar to the ORP offered by the TRS. The addition of this option would encourage highly qualified, mobile workers to apply for positions within the Georgia system. In addition, the State of Georgia would have no ongoing future liabilities for workers covered under this option, reducing risks for funding, investments, and longevity.

Issue 7: Use of Federal Subsidies

Federal tax subsidies for health insurance and retirement savings are designed to encourage broader participation in benefits programs. The federal tax subsidies are akin to the federal government partially funding the health and retirement benefits of system participants.

Option: Aggressively pursue programs that offer federal tax subsidies. Educate all employees on the value of the federal subsidies.

- Retirement savings: encourage employee funding of 403(b) and 457 plans.
- Flexible Spending Accounts (FSA): encourage employees to fund health care expenditures through FSAs.
  – Provide guidance on estimating health care costs to reduce year-end reversions.
  – Offer Debit cards to increase efficiency and use of FSAs
- Health Savings Accounts: consider adopting HSA eligible health insurance programs for select groups of employees and retirees. Target groups include:
  – Short-tenure vested retirees
  – Less than full-time employees
  – Employees with less than 5 years of service.

Conclusion

This report analyzed the Health and Retirement Package offered to employees of the State of Georgia. The analysis covers the two primary state employment systems: the Georgia Merit system (GMS) and the Board of Regents (BOR) system. Health and retirement benefits are offered to employees working at least half time. Under each system, employees become vested in a retirement pension benefit and a retirement health benefit after ten years of creditable service.

Health Insurance costs for active and separated employees have increased faster than the rate of inflation over the past five years. Average annual growth of GMS health benefits was about 8.2 percent over the past five years. Comparatively, average annual growth of BOR health benefits was slightly negative, with a 1 percent decline between 2002 and 2004.

GMS employees are covered by the Employee Retirement System (ERS) and pubic school system employees are covered by the Teachers Retirement System (TRS). Since 1998, average annual growth of pension benefits has been about 12.5 percent, with approximately 13 percent and 12.1 percent growth in the TRS and ERS, respectively. The ratio of beneficiaries to contributing participants is growing rapidly over this time period. For the TRS, there were about 4.3 workers per beneficiary in 1998. By 2003, there were only 3.7 workers per beneficiary. Comparable ratios for the ERS were 3.3 and 2.6 workers to beneficiaries in 1998 and 2003, respectively. These trends are attributable to a quickly aging employee population.

Compared to other states in the Southeastern region, Georgia offers a very competitive overall benefit package, ranking 2nd in generosity of benefits and third in total compensation. There are several areas of concern, with the GMS having the most issues. The primary issues are lack of a comprehensive annual labor cost review and rapidly accelerating retiree health insurance obligations. Due to new GASB rules requiring pre-funding of all retirement benefits, it is recommended that the State of Georgia phase-out fully-insured retiree health insurance for all but the longest tenured employees.

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About the Author

David P. Richardson is the New York Life Professor in the Department of Risk Management and Insurance at Georgia State University. His research specializes in the economics of retirement and employee benefits. He previously worked in the U.S. Treasury's Office of Tax Analysis.

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