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ANALYSIS OF GEORGIA'S UNEMPLOYMENT INSURANCE TRUST FUND RESERVES

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 extended 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.

About the Author

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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