

FISCAL RESEARCH CENTER

AN ASSESSMENT OF THE STATE OF GEORGIA'S BUDGET RESERVES

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An Assessment of the State of Georgia’s Budget Reserves

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An Assessment of the State of Georgia's Budget Reserves

Introduction

In the 1970s, Georgia was one of the first states in the country to create a budgetary “reserve” fund, also called a Revenue Shortfall Reserve (RSR), “rainy day” fund or budget stabilization fund. Since then, this practice has been adopted by all but two states (Willoughby and Guo 2006). Although common, the amount that a state should have on hand at any given time is still much in dispute. This report examines Georgia’s budget reserves both in relation to likely needs in the event of an economic downturn and in relation to other states with high bond ratings.

The State Law

Under the Georgia State Code §45-12-93, the state must establish and maintain a Revenue Shortfall Reserve (RSR) in an amount equal to 4 percent of the net revenue from the preceding fiscal year. If, at the end of the fiscal year, the net revenues are less than appropriated expenditures, then these funds can be released to cover the revenue shortfall. This reserve cannot exceed 10 percent of the previous fiscal year’s net revenue.

There are some other caveats:

- The legislature can appropriate 1 percent of the RSR to fund K-12 needs.
- The Governor can release for appropriation any end of year balances that are in excess of 4 percent of the net revenues from the previous fiscal year.

Prior to 2005, this reserve was divided into a 3 percent required Revenue Shortfall Reserve (with a 5 percent cap) and a 1 percent Midyear Adjustment Reserve for use by the legislature in the supplemental appropriations bill.

The way that the RSR currently operates in Georgia is that this amount is not formally reported in the budget. The RSR is calculated at the end of the fiscal year out of any positive balance between revenues and expenditures. The State Auditor “sets this aside” and thus this money represents a surplus which is not reported as being available for appropriation during the coming fiscal year. Under the 2005 law,

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the Governor can choose to make amounts over 4 percent of the previous year's net revenue available for appropriation.

Also important is how the reserve interacts with the annual revenue estimate. In Georgia, the state must have a balanced budget. Also each year, the governor sets the total revenues that can be appropriated for the upcoming fiscal year. This revenue ceiling is based on a revenue estimate projecting growth in state revenues and the reserve funds available at the end of the fiscal year are dependent on the conservatism of the revenue estimate set by the governor for that fiscal year. If the governor chooses a revenue estimate that is conservative, then the state is more likely to maintain an end of year surplus and thus have RSR money to report. If the Governor uses a revenue estimate that turns out to be too high, then the state may end up spending more than it receives or cutting taxes more than it is able to support financially, and thus, create an end of year shortfall that requires tapping into the RSR.

The state also has several other important reserves, including a lottery for the education fund reserve (which requires a deposit of 10 percent of the annual lottery proceeds up to a cap of 50 percent) and debt reserves. These funds however are restricted to specific purposes and cannot be used generally to meet a general revenue shortfall.

Local Government Provisions in Georgia

Local governments in the state do not have a mandatory reserve although many have adopted a reserve policy. For instance, DeKalb County has a policy of keeping a reserve equal to 5 percent of their tax funded budget, while the City of Alpharetta has a two month reserve (or approximately 16 percent of total expenditures). Local governments also have to meet the state mandated balanced budget requirement.

Studies of local governments in the Carolinas, Michigan and Minnesota show that local governments tend to carry much larger fund balances (at times above 50 percent of expenditures) than states (Marlowe 2005). In part, localities keep high fund balances because their revenues are more volatile during the year, and they are dependent on uncertain federal and state funds.

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Purposes of Reserve Funds

Reserve funds can serve a number of objectives, but they primarily ensure that the state or locality does not have to make major cuts within a fiscal year if there is an emergency, a problem with a revenue forecast, or an unanticipated downturn in revenues or increase in expenditures. Reserves can also help ease funding across multiple fiscal years in cases of an economic downturn; however, most states (and taxpayers) are unwilling to hold reserves in amounts sufficient to fully smooth a multi-year downturn (Sjoquist 1998; National Association of State Budget Officers 1995, 2004). Also, in so far as the reserve represents “cash on hand” at the end of a fiscal year, it can also provide a positive cash balance cushion for states early in the fiscal year, so that they do not have to issue short term debt.

Because of the importance in maintaining fiscal stability, bond rating agencies also consider the amount of a state's reserve to be important when determining ratings for general obligation debt (National Association of State Budget Officers 2004).

Literature in Brief

The appropriate amount for a revenue stabilization fund has long been a subject of discussion in the public finance literature. The Government Finance Officer's Association (GFOA) recommends that state and local government set aside between 5 to 15 percent of general fund operating revenues as reserves, or at least one to two months of general fund operating expenditures (Government Finance Officers Association 2002). The National Conference of State Legislatures also recommends at least a 5 percent reserve relative to expenditures (Cornia and Nelson 2003).

These recommendations are reflected in actual balances -- the average balance across states between 1979 and 2003 was 5.2 percent of state expenditures (National Association of State Budget Officers 2004), and the most common state target for these funds is 5 percent. In 1995, 13 states had a maximum of 5 percent according to a National Conference of State Legislators Report five had a 10 percent cap and others had caps that ranged from 2 to 7.5 percent (Eckl 1995). A few states of course have no reserve requirements. An assessment of NASBO's numbers for

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2005 and 2006, shows state reserves averaging 5 and 6 percent of expenditures for these years respectively. In general, states will vary in the adequacy of this amount based on the volatility of their tax revenues and the volatility of expenditure demands.

Recent state experiences with the economic downturn in the early 2000s as well as a number of studies have pointed out that if the purpose of the rainy day fund is to smooth expenditures over multiple years, a 5 percent reserve is unlikely to be sufficient.

Willoughby and Guo observed that although most states used their rainy day funds during the 2002-04 economic downturn, these funds appear to have been depleted by the first year. Most states had to resort to other means of balancing the budget. Among the ways that states tried to balance the budgets: 31 states made “non-routine” transfers from other funds to finance operating expenses – such as drawing down on funds used for self-insurance or federal relief funds. 24 increased fees and charges, and 20 increased tax enforcement. 36 made targeted spending cuts, and 32 made across the board spending cuts (Willoughby and Guo 2006).

Sobel and Holcombe (1996) examined states' expenditure shortfalls during the 1990-1991 recession. They found that on average states would have needed 16.75 percent to 17.47 percent of 1988 expenditures in reserve to have avoided fiscal stress during the downturn. However, this average amount does not capture individual state dilemmas. Based on their calculations, the state of Georgia would have had to have around 39 percent of 1988's expenditures in reserve in order to have smoothed state expenditures throughout the recession.

Sjoquist (1998) also examined the recession of the early 1990s and estimated that if Georgia wanted to maintain a growth rate of 9.69 percent across that period (which was comparable to expenditure growth in previous periods) the state would have needed a reserve of 48.9 percent of 1989 net revenues. To maintain expenditure smoothing at even half of this amount (around 4.6 percent), the state would have needed reserves equal to 16.9 percent of 1989 revenues.

A study of California in the 1980s concluded that the state would need a 10 percent reserve to buffer against a downturn in the economy and a 3 percent reserve to buffer against errors in revenue forecasts (Vasche and Williams 1987).

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A study of Indiana concluded that the state needed a reserve of around 13 percent to avoid a change in state expenditure and revenue patterns. Another study of Ohio concluded that the state would need to have a reserve greater than 11 percent of appropriations (Cornia and Nelson 2003).

Finally, an analysis in Utah looked at the underlying risk of Utah's tax and expenditure "portfolio" to estimate the probability of a shortfall. This research found that Utah faced a 5 percent probability of having a shortfall of \$135 million or more (approximately 4 percent of the state's expenditures) in a given year (Cornia and Nelson 2003).

In effect, these analyses suggest that the GFOA recommendation of 5-15 percent surplus is in the ballpark for cushioning a state in a single year; however, truly smoothing revenues and expenditures at their historic growth rates during a multi-year downturn would require significantly more funds.

Examining Georgia's Experience and Needs

Cash Flow Requirements

One consideration is whether the state needs a cash cushion during the fiscal year in order to avoid having to issue short term debt to meet immediate demands for outlays. According to the State Department of Treasury, Georgia has not had to issue short term debt such as tax anticipation notes. The state has had sufficient cash on hand, even when the revenue shortfall reserve was depleted, to meet state obligations at any point in time during the year.

Avoiding Mid-Year Cuts and Smoothing Revenues Over Time

The following analysis considers Georgia's revenues and the amounts that would have been required to keep revenue available for budgeting constant in real dollars or to have smoothed a drop in revenues in keeping with historic growth rates.

Using a budget reserve to avoid mid-year cuts during an unanticipated downturn is in part dependent on the accuracy and conservatism of the initial revenue estimate. However, recently, the state experienced some difficult periods during unanticipated downturns in the economy. Two notable downturns occurred in the

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early 1990s and the early 2000s. In 1991 and 1992, the net revenues collected grew at a rate below the inflation rate. In real terms, the revenues decreased 2 percent and 1 percent in each year. In 2002 and 2003, the effect was more dramatic with a 7 percent decrease in real net revenues each year. By way of contrast, growth rates between 1989 and 2005 averaged 5.85 percent. (See Table 1 and Figure 1)

1991-1992

In 1991, the state experienced a 2 percent decline in revenues in real dollars. To keep funding levels constant in 1991, the state would have had to set aside to approximately 3 percent of 1990 net revenues in a reserve. The next year, revenues also declined (in real terms) and again, to accommodate the decline, the state would have needed an additional 3 percent reserve on hand to keep revenues constant (so a total 6 percent reserve in 1990).

This 6 percent reserve, however, assumes that the state originally *guessed correctly* that there would be a downturn and therefore did not budget the money at the beginning of the year based on a projected increase in growth (however modest). If the state had guessed a moderate growth rate based on Georgia's historic 5.85 percent average, then the state would have needed to have set aside over 5 percent of 1990 net revenues to make it through the following year's downturn (see Table 2). Without these set asides the state would have to cut planned expenditures or raise taxes in 1991. The state would have had to set aside 20 percent of 1990 net revenues to smooth revenue growth throughout the downturn until the actual revenues caught up with anticipated growth rates.

TABLE 1. GROWTH IN NET REVENUE FOR THE STATE OF GEORGIA

FY	Net Revenue¹	Nominal Growth Rate	Deflator²	Real Net Revenue (1977 Dollars)	Real Net Revenue (2000 Dollars)	Real Growth Rate
1977	\$ 1,925,775,139		39.69	\$ 2,049,053,081	\$ 4,851,552,222	
1978	\$ 2,218,055,593	15%	42.24	\$ 2,218,055,593	\$ 5,251,700,232	8%
1979	\$ 2,507,484,726	13%	45.78	\$ 2,313,568,922	\$ 5,477,847,572	4%
1980	\$ 2,809,997,680	12%	50.76	\$ 2,338,020,370	\$ 5,535,741,376	1%
1981	\$ 3,109,631,979	11%	55.75	\$ 2,355,705,744	\$ 5,577,615,115	1%
1982	\$ 3,378,009,362	9%	59.41	\$ 2,401,289,686	\$ 5,685,544,421	2%
1983	\$ 3,572,370,035	6%	61.78	\$ 2,442,277,970	\$ 5,782,592,565	2%
1984	\$ 4,010,602,173	12%	64.96	\$ 2,607,771,269	\$ 6,174,431,796	7%
1985	\$ 4,607,813,413	15%	66.97	\$ 2,905,942,952	\$ 6,880,414,235	11%
1986	\$ 5,020,725,086	9%	68.18	\$ 3,110,382,457	\$ 7,364,466,573	7%
1987	\$ 5,421,318,773	8%	70.06	\$ 3,268,376,704	\$ 7,738,550,264	5%
1988	\$ 5,890,910,203	9%	71.90	\$ 3,460,445,798	\$ 8,193,313,124	6%
1989	\$ 6,467,686,421	10%	74.14	\$ 3,684,467,500	\$ 8,723,730,319	6%
1990	\$ 7,196,336,132	11%	77.14	\$ 3,940,124,406	\$ 9,329,050,327	7%
1991	\$ 7,258,196,887	1%	79.79	\$ 3,842,103,921	\$ 9,096,966,783	-2%
1992	\$ 7,371,963,588	2%	81.72	\$ 3,810,067,208	\$ 9,021,113,313	-1%
1993	\$ 8,266,576,008	12%	83.79	\$ 4,166,881,544	\$ 9,865,944,227	9%
1994	\$ 8,906,515,809	8%	86.00	\$ 4,373,929,620	\$ 10,356,172,890	5%
1995	\$ 9,625,658,475	8%	88.36	\$ 4,601,051,243	\$ 10,893,929,780	5%
1996	\$ 10,446,184,459	9%	90.49	\$ 4,875,563,323	\$ 11,543,893,270	6%
1997	\$ 11,131,393,549	7%	92.14	\$ 5,102,447,460	\$ 12,081,087,866	5%
1998	\$ 11,718,182,319	5%	93.47	\$ 5,294,990,106	\$ 12,536,971,958	4%
1999	\$ 12,696,109,796	8%	96.08	\$ 5,581,034,328	\$ 13,214,240,152	5%
2000	\$ 13,781,937,492	9%	100.00	\$ 5,820,801,300	\$ 13,781,937,492	4%
2001	\$ 14,688,987,803	7%	102.54	\$ 6,049,982,445	\$ 14,324,570,724	4%
2002	\$ 14,005,479,208	-5%	105.51	\$ 5,606,466,058	\$ 13,274,454,972	-7%
2003	\$ 13,624,846,657	-3%	109.85	\$ 5,238,512,855	\$ 12,403,250,514	-7%
2004	\$ 14,584,644,741	7%	114.72	\$ 5,369,536,347	\$ 12,713,475,428	3%
2005	\$ 15,813,996,666	8%	121.18	\$ 5,511,533,377	\$ 13,049,682,436	3%
Average Growth Rate 1977-2005 (Current Dollars)		7.91%		Average Growth Rate 1977-2005 (Real Dollars)		3.68%
Average Growth Rate 1990-2005 (Current Dollars)		5.85%		Average Growth Rate 1990-2005 (Real Dollars)		2.65%

¹From the Report of the State Auditor; net revenues are the amounts used to calculate the total reserves (see Note 5 in each report). Numbers from 1989-1997 are from Sjoquist, 1998, which took numbers from the same source.

²From the Bureau of Economic Analysis, National Income Product Account charts, Government Expenditures Indices, Table 3.9.4.

FIGURE 1. CHART OF REVENUES OVER TIME

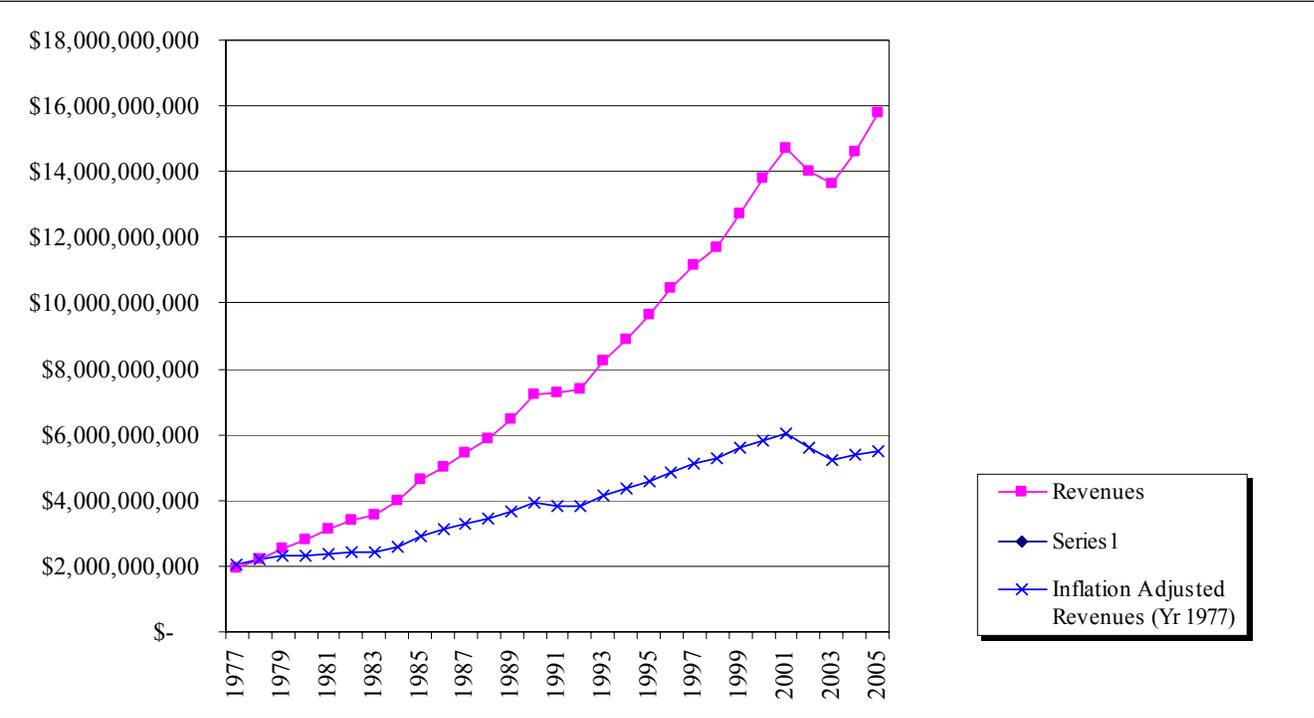


TABLE 2. ESTIMATES OF RESERVE REQUIRED TO SMOOTH AVAILABLE REVENUES

-----Using RSR to Ensure-----						-----Using RSR to Ensure-----					
FY	Net Revenue	Growth Rate	Inflationary Increase Only During Recession	% Growth	Reserve Amount Required in Previous Years to Make Up Shortfall	Reserve as % of Previous Year's Net Revenue	Average Growth Rate During Recession	% Growth	Reserve Amount Required in Previous Years	Reserve as % of Previous Year's Net Revenue	
1989	\$ 6,467,686,421		\$ 6,467,686,421				\$ 6,467,686,421				
1990	\$ 7,196,336,132	11%	\$ 7,196,336,132	11%	\$ -		\$ 7,196,336,132	11%	\$ -		
1991	\$ 7,258,196,887	1%	\$ 7,443,369,385	3%	\$ 185,172,498	3%	\$ 7,617,237,010	6%	\$ 359,040,123	5%	
1992	\$ 7,371,963,588	2%	\$ 7,623,606,637	2%	\$ 251,643,049	3%	\$ 8,062,755,630	6%	\$ 690,792,042	9%	
1993	\$ 8,266,576,008	12%	\$ 8,266,576,008	8%	in sum	6%	\$ 8,534,331,840	6%	\$ 267,755,832	3%	
1994	\$ 8,906,515,809	8%	\$ 8,906,515,809	8%	\$ -		\$ 9,033,489,702	6%	\$ 126,973,893	1%	
1995	\$ 9,625,658,475	8%	\$ 9,625,658,475	8%	\$ -		\$ 9,625,658,475	7%	in sum	20%	
1996	\$ 10,446,184,459	9%	\$ 10,446,184,459	9%	\$ -		\$ 10,446,184,459	9%	\$ -		
1997	\$ 11,131,393,549	7%	\$ 11,131,393,549	7%	\$ -		\$ 11,131,393,549	7%	\$ -		
1998	\$ 11,718,182,319	5%	\$ 11,718,182,319	5%	\$ -		\$ 11,718,182,319	5%	\$ -		
1999	\$ 12,696,109,796	8%	\$ 12,696,109,796	8%	\$ -		\$ 12,696,109,796	8%	\$ -		
2000	\$ 13,781,937,492	9%	\$ 13,781,937,492	9%	\$ -		\$ 13,781,937,492	9%	\$ -		
2001	\$ 14,688,987,803	7%	\$ 14,688,987,803	7%	\$ -		\$ 14,688,987,803	7%	\$ -		
2002	\$ 14,005,479,208	-5%	\$ 15,113,424,834	3%	\$ 1,107,945,626	8%	\$ 15,548,120,526	6%	\$ 1,542,641,319	11%	
2003	\$ 13,624,846,657	-3%	\$ 15,735,397,695	4%	\$ 2,110,551,038	15%	\$ 16,457,502,392	6%	\$ 2,832,655,735	21%	
2004	\$ 14,584,644,741	7%	\$ 16,432,861,043	4%	\$ 1,848,216,302	14%	\$ 17,420,072,382	6%	\$ 2,835,427,641	19%	
2005	\$ 15,813,996,666	8%	\$ 17,358,944,541	6%	\$ 1,544,947,875	11%	\$ 18,438,941,376	6%	\$ 2,624,944,710	17%	
					in sum ¹	45%			in sum ²	69%	
	Avg Growth (Nominal)	5.85%	Rounded to 6%								

¹The 2005 net revenue projected here *in real dollars* is equal to the 2001 net revenue collected. Revenues still have not caught up with 2001 amounts in real terms.

²As of 2006, the state still has not caught up with revenue growth equal to a 6 percent per year growth rate – so this amount is “capped” at four years.

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2002-2003

In the 2002-2003 downturn, the situation was considerably worse than the previous downturn. As shown in Table 2, in 2002, the state's revenues plummeted by 5 percent in actual dollars, which would have required a reserve of 8 percent for that year alone to keep revenues constant, and 11 percent to keep funding at the historic 5.85 percent growth rate. (8 percent of the state's budget is a little bit less than all of the state funds budgeted for the Department of Human Resources). Inadvertently, the state actually had these amounts on hand since a considerable surplus had accumulated beyond the actual RSR. In total, in 2001, the year prior to the downturn, the state had 12 percent in total reserves (see Table 3 or Figure 2). In 2002, the state still retained 8 percent in reserves, which helped buffer the drop in revenues which occurred again in 2003 (a 3 percent drop).

If the state wanted to keep revenues constant throughout the entire downturn, the state would have had to set aside approximately 45 percent of 2001 net revenues. *In fact, as of 2005, revenues had not yet caught back up to 2001 dollars (in real terms).*¹ If the state were to try to keep revenues smooth at 6 percent growth for the period between 2002 and 2005, the state would have had to set aside well over 69 percent of net revenues in 2001. State revenues actually have not yet caught up to this historic growth rate, so the full amount is substantially larger.

In sum, a 5 percent reserve would have kept revenue growth at historic levels in 1991 for the first year of the downturn. However, a five percent reserve would have been depleted immediately in the 2002 downturn and likely would have to be supplemented with mid-year cuts. The shock of cuts in 2003 would have also been much greater. A 10 percent reserve would have ensured that the state easily overcame the downturn of the early 1990s and would have ensured that the state had an equivalent (if slightly worse) experience in this last downturn.

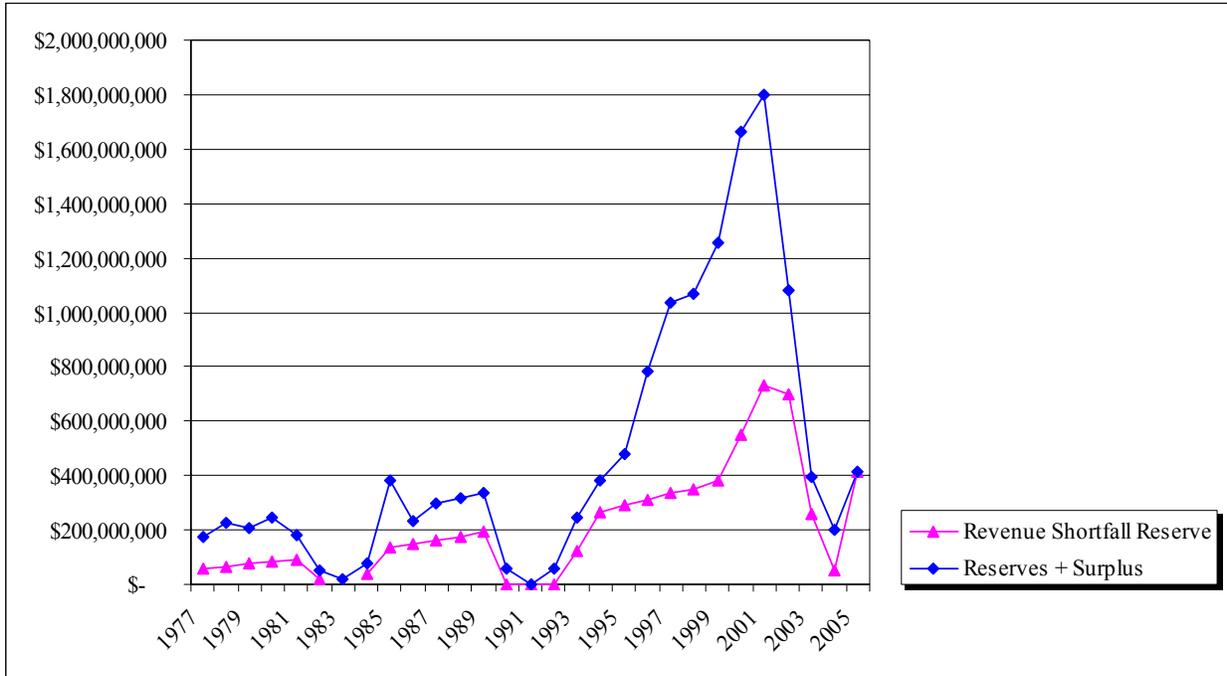
¹ To calculate real or constant dollars, I am using indices associated with government expenditures as the basis for calculating inflation. These numbers capture expenditures on items such as health care which are growing at a faster rate of inflation than the economy in general. If I were to use the Consumer Price Index for the south, the state would only have had to set aside 26 percent of net revenues in 2001 to keep spending constant and 6 percent in 2002, 11 percent in 2003 rather than 8 percent in 2002 and 15 percent in 2003. However, the numbers for the 1991-92 recession would increase slightly to 7 percent of net revenues.

TABLE 3. HISTORIC COMPARISON OF GEORGIA'S RESERVES¹

FY	Revenue Shortfall Reserve	% Net Rev.	Midterm Adjustment	% Net Rev.	Surplus	Total	Total as % Revenue
1977	\$ 57,773,254	3%			\$ 118,619,171	\$ 176,392,425	9%
1978	\$ 66,541,667	3%			\$ 160,956,383	\$ 227,498,050	10%
1979	\$ 75,224,541	3%			\$ 133,828,294	\$ 209,052,835	8%
1980	\$ 84,299,930	3%			\$ 158,675,993	\$ 242,975,923	9%
1981	\$ 93,288,959	3%			\$ 87,254,220	\$ 180,543,179	6%
1982	\$ 17,439,162	1%	\$ 33,780,093	1%	\$ -	\$ 51,219,255	2%
1983		0%	\$ 22,413,128	1%	\$ -	\$ 22,413,128	1%
1984	\$ 38,240,758	1%	\$ 40,106,021	1%	\$ -	\$ 78,346,779	2%
1985	\$ 138,234,402	3%	\$ 46,078,134	1%	\$ 197,279,886	\$ 381,592,422	8%
1986	\$ 150,621,753	3%	\$ 50,207,250	1%	\$ 34,784,478	\$ 235,613,481	5%
1987	\$ 162,639,563	3%	\$ 54,213,187	1%	\$ 81,455,890	\$ 298,308,640	6%
1988	\$ 175,727,306	3%	\$ 58,909,019	1%	\$ 85,282,821	\$ 319,919,146	5%
1989	\$ 194,030,593	3%	\$ 64,676,864	1%	\$ 78,130,438	\$ 336,837,895	5%
1990	\$ -	0%	\$ 55,163,169	1%	\$ -	\$ 55,163,169	1%
1991	\$ -	0%	\$ -	0%	\$ -	\$ -	0%
1992	\$ -	0%	\$ 61,346,055	1%	\$ -	\$ 61,346,055	1%
1993	\$ 122,640,698	1%	\$ 83,463,736	1%	\$ 37,102,806	\$ 243,207,240	3%
1994	\$ 267,195,474	3%	\$ 89,065,158	1%	\$ 28,192,147	\$ 384,452,779	4%
1995	\$ 288,769,754	3%	\$ 96,256,584	1%	\$ 94,742,679	\$ 479,769,017	5%
1996	\$ 313,385,534	3%	\$ 104,461,844	1%	\$ 363,354,921	\$ 781,202,299	7%
1997	\$ 333,941,806	3%	\$ 111,313,935	1%	\$ 588,907,843	\$ 1,034,163,584	9%
1998	\$ 351,545,470	3%	\$ 117,181,823	1%	\$ 601,483,714	\$ 1,070,211,007	9%
1999	\$ 380,883,294	3%	\$ 126,961,098	1%	\$ 750,527,063	\$ 1,258,371,455	10%
2000	\$ 551,277,500	4%	\$ 137,819,375	1%	\$ 973,442,868	\$ 1,662,539,743	12%
2001	\$ 734,449,390	5%	\$ 146,889,878	1%	\$ 917,836,322	\$ 1,799,175,590	12%
2002	\$ 700,273,960	5%	\$ 140,054,792	1%	\$ 239,732,975	\$ 1,080,061,727	8%
2003	\$ 260,600,570	2%	\$ 136,248,467	1%	\$ -	\$ 396,849,037	3%
2004	\$ 51,577,479	0%	\$ 145,846,447	1%	\$ -	\$ 197,423,926	1%
2005	\$ 414,804,625	3%		0%	\$ -	\$ 414,804,625	3%

¹Table from 1977-1997 based on Sjoquist (1998). The remaining years are the same numbers taken from the Report of the State Auditor for each year.

FIGURE 2. GEORGIA'S RESERVES AND SURPLUSES OVER TIME



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Comparison to Other States with a Triple-Triple Bond Rating

Georgia might also want to consider how it compares to other states with triple A bond ratings from Moody's and Standard and Poor's. Table 4 shows six other states that have triple-A bond rating (all but one have AAA's from both credit rating agencies). These states on average maintain a 5 percent reserve. The numbers only include amounts set aside in a *formal budget stabilization fund* not total surpluses. One can see states like Virginia going down in 2004 as a result of the recession and then systematically rebuilding their rainy day funds in FY05 and FY06. Georgia, however, has not yet refilled its reserves although the state is expected to make a substantial stride in this direction based on the FY 2006 surplus. Georgia's numbers according to NASBO are lower than those reflected in Table 3, because 1 percent of the state's reserves can be spent on education and so are not formally reserved for budget stabilization. Because one percent is not really part of the revenue shortfall reserve, Georgia's mandated budget reserve numbers are on the low end of states with AAA bond ratings.

Future Considerations

There is no magic in this analysis. Policymakers need to consider how well they want to be covered in case of a downturn -- as opposed to spending money on a variety of other priorities or reducing taxes. Having modest reserves between 5-15 percent can buffer the state against small variations -- such as revenue estimates that are short or single year fluctuations. This amount also appears to be useful in "buying time" for the state policymakers to adapt to changing circumstances. A five percent reserve is also in keeping with those of other states with high bond ratings.

The state's current *policies* are not far off from best practice recommendations for budget stabilization funds. The 2005 changes to increase the reserve ceiling is a positive shift. However, the state may want to further consider ensuring a minimum reserve of at least 5 percent rather than a de facto 3 percent minimum. This change would put the state more in the middle of those states with AAA bond ratings.

TABLE 4. COMPARISON OF GEORGIA TO OTHER STATES WITH AAA BOND RATINGS ¹

Region and State	State Law ²	-----FY 04-----		-----FY 05-----		-----FY 06-----	
		---Budget Stabilization Fund--		---Budget Stabilization Fund--		---Budget Stabilization Fund--	
		as % Expenditures	as % Revenues	as % Expenditures	as % Revenues	as % Expenditures	as % Revenues
Delaware	5% cap	5%	5%	5%	5%	5%	5%
Maryland	5% min	5%	5%	5%	5%	6%	6%
Minnesota	5% min	7%	7%	9%	9%	6%	7%
Missouri	5% cap	3%	3%	3%	3%	3%	3%
Virginia	10% cap	3%	3%	3%	4%	7%	7%
Utah	8% cap	2%	2%	4%	4%	4%	4%
Average		4%	4%	5%	5%	5%	5%
Georgia ³	3-4%min	0%	0%	2%	2%	1%	1%

¹Table based on National Association of State Budget Officers Annual Fiscal Survey of the States. In some cases, the numbers for FY 05 and 06 have not been adjusted because the final audited reserve is not yet known (for Georgia this is the case).

²Based on NCSL 1995 report; these policies may have changed over the past 10 years.

³Note that for Georgia, NASBO only counts revenues set aside in the *actual revenue shortfall reserve* – not revenues from the mid-year adjustment or for any educational reserves. In Table 4, we count the unreserved surplus as well as the reserves. For FY06, the reserves have not yet been set for Georgia, so NASBO is using the previous year’s reserves.

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Also, the current reserve is dependent on the accuracy of the revenue estimate as well as the conservatism of the Governor (and all future Governors) in picking a particular revenue ceiling. The state may want to consider a more formal mechanism to set the reserve fund aside – such as a formula that mandates a reserved amount of revenues which is only accessible during times of fiscal downturn or slow growth (a similar recommendation is made in Sjoquist, 1998).

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Carolyn Bourdeaux is an Assistant Professor who works in the areas of public finance and governance at the Andrew Young School of Policy Studies at Georgia State University. Her recent research has focused on performance-based management and budgeting. Her previous research has included a report on tax allocation districts in Georgia and the implications of using special district governments to develop infrastructure intensive services.

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