Informational Paper 72

Budget Stabilization Fund and the General Fund Reserve Requirement

Wisconsin Legislative Fiscal Bureau
January, 2007

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Prepared by

Dave Loppnow

Wisconsin Legislative Fiscal Bureau
One East Main, Suite 301
Madison, WI 53703

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Introduction

This paper provides a brief discussion of issues relating to budget stabilization funds. In addition, survey data is presented on the balances in other state's "rainy day" funds. Further, the paper summarizes current law governing the budget stabilization fund in Wisconsin. Finally, information is presented on the statutory reserve requirement for the state's general fund.

Budget Stabilization Fund

Advantages of a Budget Reserve. Many writers on best practices relating to state budget management include budget reserves as a desirable factor. These reserves can take the form of undesignated balances within a state's general fund or as balances held in a separate "rainy day" or budget stabilization fund.

A budget reserve offers several advantages to a state. If monies are available in a budget reserve, they can be used if revenues are less than projected or expenditures exceed budgeted amounts. This can mitigate the effects of a mild economic downturn on a state's finances. If the revenue shortfall is more severe, a budget reserve can allow state policy makers more time to consider a response to the imbalance, before they are forced to adjust state revenues or expenditures to maintain a balanced budget.

A budget reserve can be used to support a state's cash position, which may reduce or eliminate the need for short-term borrowing for cash-flow purposes. Depending on the timing of cash receipts and expenditures, a state's general fund can be in a negative cash position at times during the fiscal year, even though it shows a positive accounting balance at the end of the fiscal year. If there is a budget reserve, these monies can be used to support spending from the general fund on the days that its cash balance would otherwise be negative.

A state's bond rating may also be influenced by the presence or absence of a budget reserve. Although bond credit rating agencies consider many financial, economic, and organizational aspects of a state in their rating analysis, the availability of budget reserves is viewed as a positive factor. Rating agencies will not specify the amount of weight they place upon budget reserves in discussing their ratings. However, most states with a strong bond rating do have some form of budget reserve.

Another factor that a budget reserve could affect is a state's financial position when calculated under generally accepted accounting principles (GAAP). In general, under GAAP, monies held in a budget reserve would count into the state's ending balance. If, for example, Wisconsin held $500 million in a budget reserve, these monies would reduce the state's GAAP deficit by a corresponding amount.

Disadvantages of a Budget Reserve. There are policymakers who disagree with the idea of a "rainy day" fund. From this point of view, the potential benefits from a budget reserve are outweighed by other factors.

As a matter of policy, other uses for these funds are viewed as having a higher priority than funding a budget reserve. In this case, either reducing state taxes or increasing state spending may be preferred uses of monies that otherwise could fund a budget reserve. Underlying this approach is the concern that monies accumulated as a reserve represent over-taxation, and could better be used by the state to either support higher priority spending programs, or to reduce taxes.

Priorities in Wisconsin. The question of competing priorities has been evident in Wisconsin. Wisconsin has not allocated significant monies to its budget stabilization fund since its creation in 1986. Instead, in times of economic downturns, Wisconsin has used one-time sources of revenue or fund transfers and across-the-board budget reductions to state operations to balance its budget.

Although the state does have a required statutory reserve, this generally has been set at 1% or less of annual general fund spending and provides only limited support in the case of a revenue shortfall. During years of strong revenue growth in the 1990s, monies that could have been used to fund a budget reserve were allocated to significantly increase state school aids, reduce the individual income tax, and provide a one-time sales tax rebate.

With regard to the state's general fund cash-flow, rather than using monies in a budget reserve, the state has issued operating notes to borrow for short-term cash-flow purposes in many years. In addition, the state borrows cash balances from certain other state funds that are used on a temporary basis to support the general fund's cash-flow. These forms of external and internal short-term cash-flow borrowing have allowed the general fund to make payments in a timely manner.

For bond rating agencies, the state has attempted to hold its general fund debt service below 4% of annual general fund revenues, and is generally viewed by rating agencies as having a moderate debt load. However, the state has not established a significant budget reserve and has foregone the potential positive effect such an action might have on its bond rating.

For budgetary purposes, the state uses a statutory basis of accounting and maintains a balanced general fund budget using that accounting approach. When the state's comprehensive annual fiscal report for 2004-05 was presented using GAAP, the state's general fund had a deficit of approximately $2.1 billion.

Other States. Survey data from the National Conference of State Legislatures indicates that 45 states are identified as having a general "rainy day" or budget stabilization fund or reserve of some kind. Five states are reported having more than one such fund. The mechanisms governing how revenues to these funds are provided, the amount of fund balances permitted, and the specific procedures for transfer of moneys from the funds vary considerably among the states. In contrast, however, the conditions under which transfer of moneys from the budget stabilization funds to the states' general funds are permitted are much more similar. Generally, if there are restrictions established on the withdrawal of moneys from the funds, they tend to focus on the occurrence of revenue downturns or the development of projected deficit conditions in the states' general funds.

Wisconsin's Budget Stabilization Fund. Wisconsin's budget stabilization fund was created by 1985 Act 120. The creation of this fund occurred after the state had endured a difficult economic downturn during the early 1980's. During that recession, the state increased general fund taxes, including both permanent increases as well as temporary surcharges. In addition, the state reduced budgets in a number of the state's programs and agencies. This was the case in many states at the time and it was during this period that many of the states created "rainy day" or budget stabilization funds. Generally, these funds were established for the purpose of setting aside funds for a time period when state revenues might grow more slowly than estimated or actually decrease from the prior year.

As created in Act 120, revenues to the fund were to come by direct appropriation from the general fund. A separate appropriation to accomplish this was created. However, no funds were appropriated in Act 120. Act 120 did, however, require that the Secretary of the Department of Administration recommend to the Governor and Legislature an amount of general purpose revenues (GPR) that should be transferred into the fund in the succeeding (1987-89) biennial budget. However, no such recommendation was ever provided.

From the time of creation of the fund by 1985 Act 120 until the enactment of the 2001-03 biennial budget, the funding mechanism for the budget stabilization fund remained unchanged. But no funds were ever appropriated to the fund and the only revenues to the fund consisted of small amounts of donations.

The 2001-03 biennial budget substantially changed the underlying funding structure for the fund. As enacted into law, 2001 Act 16 created another mechanism for providing monies to the fund, in addition to donations and appropriations. Act 16 established an automatic procedure for the transfer of funds to the budget stabilization fund when general fund tax revenues exceed the level of such revenues as estimated in the general fund condition statement for that biennium as included in the biennial budget act. Under the provisions created by Act 16, in each fiscal year, if actual general fund tax revenues exceed those projected revenues, 50% of the additional tax revenues are required to be transferred to the budget stabilization fund. The Act also created an appropriation to allow the Secretary of the Department of Administration to make the required transfer of such excess tax revenues to the budget stabilization fund.

The transfer of excess revenues provision, however, is subject to two limitations. First, if the balance in the budget stabilization fund prior to any such transfer exceeds 5% of general fund expenditures for that fiscal year, no transfer is to be made. Second, if such a transfer would cause the balance in the general fund to be reduced below the required statutory balance, then the transfer amount must be reduced as needed to maintain the required statutory reserve in the general fund. No transfers under this Act 16 provision have occurred to date.

Finally, in 2003 Act 33, two additional mechanisms involving the sale of surplus land and buildings and of surplus state agency supplies and equipment (surplus property) were created to provide for additional potential sources of revenue to the budget stabilization fund. Under those provisions, the net proceeds from the sale or lease of surplus state land or buildings (net revenues remaining after paying off any outstanding debt on the land or buildings) are to be deposited in the budget stabilization fund. Also, the net proceeds from the sale of any surplus property are to be deposited in the budget stabilization fund.

Since Act 33, the largest revenue source to the fund has been the sale of surplus property. As a result of these various revenue streams, plus interest earnings, the June 30, 2006, balance in the budget stabilization fund as shown in the state's Annual Fiscal Report was $638,000.

Use of Moneys in the Fund. When the budget stabilization fund was established, language was created regarding the permissible uses of moneys in the funds. The use of the fund was specifically limited by the statement that "Moneys in this fund are reserved to provide state revenue stability during periods of below-normal economic activity when actual state revenues are lower than estimated revenues under s. 20.005(1) [the general fund condition statement as established under the biennial budget act]." This statutory provision remained unchanged until modified in 2001 Act 16.

Under the provisions of 2001 Act 16, the language governing the fund itself [s. 25.60] was modified to delete any references to use of the fund. Act 16 also modified language dealing with fiscal emergencies [s. 16.50(7)] to provide that when a Governor submits his or her recommendations for dealing with a fiscal emergency, the Governor must include a recommendation as to whether moneys should be transferred from the budget stabilization fund to the general fund as a part of those overall recommendations. There is now no other statutory language governing uses of moneys in the budget stabilization fund.

The appendix briefly describes the topic covered by each of the statutory provisions relating to the budget stabilization fund.

General Fund Reserve Requirement

Section 20.003(4) of the statutes requires that no bill directly or indirectly affecting GPR may be enacted by the Legislature if the bill would cause the estimated general fund balance on June 30 of any fiscal year to be less than a required amount. That required amount may vary from year to year. However, the application of the requirement is the same, as it applies to the biennial budget bill and to any other bills that the Legislature may consider for passage.

Under this provision, the general fund must have an overall balance between revenues and appropriations sufficient to allow for the deduction of the required statutory balance (shown as a deduction from the gross balance) and still have a positive balance. Table 1 shows an example of how the required statutory balance appears in the general fund condition statement.

As shown in Table 1, the gross balance is $300 million and the required statutory balance is $230 million, which represent 2% of gross appropriations plus compensation reserves. Thus, $70 million is available for other legislation without violation of the reserve requirement.

Although the statutes establish a required reserve amount, as a practical matter, such a statutory limit is not binding. If a bill would reduce the balance in the general fund below the required amount, the Legislature can include a provision in the bill that specifies that the statutory reserve requirement does not apply to the bill under consideration.

Table 1: Sample General Fund Condition Statement ($ in Millions)

Opening Balance, July 1	$100
Revenues	
Taxes	$11,200
Departmental Revenues	300
Total Available (opening balance plus revenues)	$11,600
Appropriations and Reserves	
Gross Appropriations	$11,400
Compensation Reserves	100
Less Lapses	-200
Total Expenditures	$11,300
Balances	
Gross Balance	$300
Less Required Statutory Balance	-230
Net Balance, June 30	$70

History of the Statutory Balance Requirement. Prior to the 1983 session of the Legislature, there was no requirement for a statutory balance or reserve within the general fund. In the 1981 session of the Legislature, the first act passed dealt with shortfalls in 1980-81. A statutory provision contained in that legislation (Chapter 1, Laws of 1981) created s. 20.003(4) dealing with the required general fund balance.

This section provided that, beginning with the 1983-85 biennial budget, no bill directly or indirectly affecting general purpose revenues could be enacted by the Legislature if the bill would cause the estimated general fund balance in the condition statement for that biennium to be less than 1% of total general purpose revenue appropriations for that biennium. However, by the time of the enactment in that 1981 session of the biennial budget bill, the deteriorating fiscal situation led to reducing the 1% statutory reserve requirement to be 0.5% of total GPR appropriations, still effective beginning with the 1983-85 biennial budget.

1983-85 Budget. The 1983-85 biennial budget had a statutory balance in the second fiscal year of the biennium equal to 0.5% of total GPR appropriations for the biennium. In the budget adjustment bill for that session, the statutory balance percentage was changed back to the requirement, as first enacted, for a reserve equal to 1% of GPR appropriations for the biennium.

1985-87 Budget. The 1% statutory reserve requirement remained unchanged for the 1985-87 biennial budget. However, later in that biennium, due to a projected budget shortfall for the second year (1986-87) of that budget, 1985 Act 120 created a session law provision to suspend the 1% statutory reserve requirement for the 1985-87 biennium and to instead provide that the statutory amount of reserve be equal to $72.9 million. This amount was $26.5 million less than what would have been required had the 1% statutory reserve requirement remained in effect.

1987-89 Budget. In 1987-89, the statutory provision was modified in 1987 Act 27 to set a statutory balance at 1% of appropriations for each "fiscal year" rather than a single statutory balance for the "fiscal biennium". Under this change, the required balance was $53.0 million for 1987-88 and was $55.5 million for 1988-89. Had the change not been made, the statutory balance would have been $108.5 million for 1987-89 -- 1% of biennial (rather than annual) appropriations. Thus, the change contained in 1987 Act 27 reduced the required balance to approximately one-half of what it would have been without the modification.

1995-97 Budget. In 1995 Act 27, the 1% annual statutory reserve requirement was modified by including GPR compensation reserves in addition to gross GPR appropriations. This change increased the required balance amount by $0.2 million in 1995-96 and by $0.5 million in 1996-97.

1999-01 Budget. In the 1999-01 biennial budget (1999 Act 9), a gradual increase in the statutory reserve percentage was adopted. As initially proposed by the Governor, the increase would have been as shown in Table 2.

Table 2: Governor's 1999-01 Budget Proposal

Fiscal Year	Required Reserve
1999-00	1.0%
2000-01	1.1
2001-02	1.2
2002-03	1.4
2003-04	1.6
2004-05	1.8
2005-06 and thereafter	2.0

In the budget as passed by the Legislature, the statutory reserve increase to 1.1% proposed for 2000-01 would not have been implemented (the requirement would have remained at 1.0% for that year), but the remainder of the proposed increases to 2.0% in 2005-06 were adopted. However, the Governor made a partial veto to this section, which made what would have been the 1.2% requirement for 2001-02 instead apply to 2000-01. The result of this partial veto, however, also eliminated the statutory reserve requirement for 2001-02. The remainder of the scheduled increases were not affected and the statutory reserve percentages were as shown in Table 3.

Table 3: 1999 Act 9

Fiscal Year	Required Reserve
1999-00	1.0%
2000-01	1.2
2001-02	None specified
2002-03	1.4
2003-04	1.6
2004-05	1.8
2005-06 and thereafter	2.0

2001-03 Budget. In the Governor's 2001-03 biennial budget recommendations, it was proposed that the statutory reserve requirement of 1.4% for 2002-03 be reduced to 1.2%.

As passed by the Legislature, the statutory reserve requirement for 2002-03 was set at a fixed dollar amount of $90 million. The Governor executed a partial veto of this provision to delete the reference to the fixed dollar amount of required statutory reserve and, in connection with a related veto, establishing a requirement for 1.2% statutory reserve for that fiscal year. The remainder of the staged increases in the statutory reserve requirement were continued unchanged from prior law. The statutory reserve requirements for 2001-03 and beyond, as affected by 2001 Act 16, were as shown in Table 4.

Table 4: 2001 Act 16

Fiscal Year	Required Reserve
2001-02	None*
2002-03	1.2%
2003-04	1.6
2004-05	1.8
2005-06 and thereafter	2.0

*No actual statutory reserve percentage; the 2001-03 budget as enacted had an amount in the condition statement balance equal to 1.2% of gross GPR appropriations plus compensation reserves for fiscal year 2001-02.

2003-05 Budget. The Governor's 2003-05 biennial budget contained a provision to modify the statutory reserve requirement for the two fiscal years of the biennium. Instead of a statutory reserve of 1.6% for 2003-04 and of 1.8% for 2004-05, a dollar amount of statutory reserve of $35 million for 2003-04 and $40 million for 2004-05 was proposed. Under the Governor's budget recommendations, a 1.6% statutory reserve for 2003-04 would have required an additional reserve amount of $139.4 million and a 1.8% statutory for 2004-05 would have required an additional reserve amount of $173.4 million.

The Governor's budget recommendations included the further proposed change in the statutory reserve language to delay the scheduled increase in that required reserve requirement to 2.0% in 2005-06 until 2006-07 and to provide that the statutory reserve requirement for 2005-06 instead be set at $75 million. The Legislature concurred in those recommendations. The reserve requirements for 2003-05 and thereafter under 2003 Act 33 were as shown in Table 5.

Table 5: 2003 Act 33

Fiscal Year	Required Reserve
2003-04	$35 million
2004-05	$40 million
2005-06	$75 million
2006-07 and thereafter	2.0%

2005-07 Budget. The Governor's 2005-07 biennial budget included a modification to the statutory reserve requirement for four fiscal years. Instead of a statutory reserve of $75 million in 2005-06 and 2.0% beginning in 2006-07 and thereafter, a requirement for a $65 million statutory reserve would be established for each fiscal year from 2005-06 through 2008-09. Beginning in 2009-10, a 2% statutory reserve would apply. The Legislature approved these recommendations.

Table 6 presents a history of the required statutory balance requirement since its beginning in 1984-85.

Table 6: History of Required General Fund Statutory Balance ($ in Millions)

Year	Amount	Requirement
1984-85	$86.3	1% of biennial gross appropriations
1985-86	0.0	No requirement for the first fiscal year of the biennium
1986-87	72.9	Set dollar amount
1987-88	53.0	1% of annual gross appropriations
1988-89	55.5	1% of annual gross appropriations
1989-90	58.1	1% of annual gross appropriations
1990-91	62.9	1% of annual gross appropriations
1991-92	66.6	1% of annual gross appropriations
1992-93	69.6	1% of annual gross appropriations
1993-94	73.6	1% of annual gross appropriations
1994-95	78.8	1% of annual gross appropriations
1995-96	82.6	1% of annual gross appropriations and compensation reserves
1996-97	92.0	1% of annual gross appropriations and compensation reserves
1997-98	98.1	1% of annual gross appropriations and compensation reserves
1998-99	99.4	1% of annual gross appropriations and compensation reserves
1999-00	113.9	1% of annual gross appropriations and compensation reserves
2000-01	134.3	1.2% of annual gross appropriations and compensation reserves
2001-02	0.0	No requirement
2002-03	134.4	1.2% of annual gross appropriations and compensation reserves
2003-04	35.0	Set dollar amount
2004-05	40.0	Set dollar amount
2005-06	65.0	Set dollar amount
2006-07	65.0	Set dollar amount
2007-08	65.0	Set dollar amount
2008-09	65.0	Set dollar amount
2009-10 and thereafter	TBD	2.0% of annual gross appropriations and compensation reserves

TBD: To be determined.

APPENDIX

Statutory Citations Relating to Budget Stabilization Fund

Statutory Citation	Topic
s. 13.48 (14)(c)	Procedures for transfer of net proceeds of land and/or building sales to the budget stabilization fund.
s. 16.518	Procedures for transfer of up to 50% of excess tax revenues to the budget stabilization fund.
s. 16.72(4)(b)	Procedures for transfer of net proceeds from sale of state agencies' surplus supplies, materials and equipment to the budget stabilization fund.
s. 20.875 (1)(a)	Sum sufficient appropriation for transfer of up to 50% of excess tax revenues from the general fund to the budget stabilization fund under s. 16.518 of the statutes.
s. 20.875 (2)(q)	Sum certain appropriation for transfer of moneys from the segregated budget stabilization fund to the general fund.