



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #171

### **Required General Fund Statutory Balance (Budget Management and Compensation Reserves)**

[LFB 2005-07 Budget Summary: Page 80, #3]

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#### **CURRENT LAW**

The required general fund statutory balance is for a fixed amount of \$75,000,000 for fiscal year 2005-06 and for an amount equal to 2% of total GPR appropriations plus compensation reserves for fiscal year 2006-07 (the 2006-07 requirement would equate to a required statutory balance of \$263.4 million under the funding levels recommended under AB 100). Further, that 2% statutory balance requirement continues for each succeeding fiscal year unless amended by further statutory enactment.

#### **GOVERNOR**

Provide that the required statutory balance for 2005-06 and for 2006-07 be set at a fixed amount of \$65,000,000 for each year. Further, provide that for fiscal years 2007-08 and 2008-09 (the 2007-09 biennial budget period) the required statutory balance also be specified as being a fixed amount of \$65,000,000 for each year, with the statutory 2% balance requirement then becoming effective for fiscal year 2009-10 and succeeding fiscal years.

#### **DISCUSSION POINTS**

1. The original provision for a required statutory balance amount was enacted as a part of Chapter 1, Laws of 1981, and first became effective for the 1983-85 biennial budget. The provision was enacted in response to the recession that occurred in the early 1980's and was an effort to ensure that a reserve was set aside in each biennium within the general fund in the event of economic downturn or other fiscal exigencies.

2. As originally enacted, the requirement was for a 1% statutory balance (or reserve) within the general fund. The 1% reserve amount was applied to total GPR appropriations for the biennium (rather than being applied separately to each year as under current law), but the biennial reserve amount was applied to the second fiscal year of the biennium. The following points review the changes in the statutory balance requirement that have occurred since the original creation of this requirement.

3. Due to a projected budget shortfall in 1986-87, a session law provision of 1985 Act 120 waived the 1% requirement for the 1975-87 biennium and set the statutory balance at a specific dollar amount of \$73.1 million, which was \$26.3 million below what would have been required had the 1% requirement applied.

4. In the 1987-89 budget, the Governor requested and the Legislature approved a provision to have the 1% statutory balance requirement apply separately to the total GPR appropriations for each fiscal year rather than having a single reserve amount for the entire biennium. Under this change, the required balance was \$53 million for 1987-88 and \$55 million for 1988-89. Had the change not been made, the statutory balance for the biennium (applied in fiscal year 1988-89) would have been \$108 million (an amount equal to 1% of total appropriations for the biennium instead of an annual reserve of 1% of total GPR appropriations in each fiscal year) rather than the \$55 million for 1988-89 that would be required under the proposed change. Thus, the change made in that biennial budget reduced the required balance for the biennium by one-half.

5. In the 1995-97 budget, the 1% statutory balance requirement was expanded to apply to compensation reserves, in addition to gross appropriations. For that biennium, this change resulted in the total required balance amount being increased by \$0.2 million in 1995-96 and by \$0.5 million in 1996-97.

6. In the 1999-01 budget, the Governor requested that for the second year of that budget (fiscal year 2000-01), the statutory balance requirement be increased to 1.1% and that it also be increased in increments of 0.2% per year for the next five years until it reached 2.0% for fiscal year 2005-06 and thereafter. As passed by the Legislature, no change in the 1% statutory balance would have occurred until fiscal year 2001-02 (the first year of the succeeding biennial budget), when it would have begun increasing by 0.2% per year, as recommended by the Governor. However, the Governor exercised a partial veto to make the statutory reserve for fiscal year 2000-01 be the 1.2% that was originally specified for fiscal year 2001-02, thereby leaving no specified reserve requirement for fiscal year 2001-02. The increased percentage requirements for the following years were then as follows:

<u>Fiscal Year</u>	<u>Balance Requirement</u>
2001-02	None Specified
2002-03	1.4%
2003-04	1.6%
2004-05	1.8%
2005-06*	2.0%

\*For fiscal year 2005-06 and thereafter.

7. In the 2001-03 budget, the Governor recommended that the required 1.4% statutory balance requirement for the second year of the budget (fiscal year 2002-03) be changed to 1.2% and further recommended that although no statutory reserve requirement existed for fiscal year 2001-02, an amount of reserve equal to 1.2% of GPR appropriations plus compensation reserves be provided. As passed by the Legislature, the budget bill contained a 2001-02 statutory reserve equal to 1.2% for 2001-02 but a fixed amount of \$90,000,000 for 2002-03. However, the Governor exercised a partial veto to delete the required fixed reserve amount of \$90,000,000, but through a partial veto in another area created a separate statutory section specifying that the required statutory balance for 2002-03 was 1.2%. The statutory reserve requirements of 1.6% for 2003-04, 1.8% for 2004-05 and 2.0% for 2005-06 and thereafter were left unaffected.

8. In the 2003-05 budget, the Governor recommended that the statutory reserve percentages of 1.6% for fiscal year 2003-04 and 1.8% for fiscal year 2004-05 be deleted and that instead the statutory balance requirements for those years be set at \$35,000,000 for 2003-04 and \$40,000,000 for 2004-05. In addition, however, the Governor recommended that a mechanism be created whereby those reserve amounts would be increased if additional monies became available as a result of certain excess revenues being received in the medical assistance trust fund. Further, the Governor recommended that the statutory balance requirement percentage of 2.0% for fiscal year 2005-06 and thereafter be modified so that the 2.0% requirement would not become effective until the second year of the 2005-07 biennial budget (fiscal year 2006-07). For fiscal year 2005-06, the Governor instead recommended that the statutory balance requirement be set at fixed dollar amount of \$75,000,000. The Legislature approved the Governor's recommendation except for the provisions relating to procedures for possibly increasing the statutory balance amounts for the 2003-05 biennium by the use of certain revenues from the medical assistance trust fund. Under the 2003-05 budget act then, the statutory balance amounts for fiscal year 2003-04 and succeeding fiscal years were as shown in the following table.

<u>Fiscal Year</u>	<u>Balance Requirement</u>
2003-04	\$35,000,000
2004-05	40,000,000
2005-06	75,000,000
2006-07*	2.0%

\*For fiscal year 2005-06 and thereafter.

9. In the 2005-07 budget, the Governor has recommended that the statutory reserve amounts be changed to be \$65 million for fiscal years 2005-06 and 2006-07. The 2005-06 amount is \$10 million less than would be required under current law and the 2006-07 amount is \$198.4 million less than the amount that would be required under current law [2% of gross GPR appropriations plus compensation reserves (a total of \$263.4 million under the funding levels of AB 100)]. In addition, the Governor has recommended that the 2% statutory balance requirement that would otherwise apply be delayed until the 2009-11 biennial budget (the 2% requirement would then first apply to fiscal years 2009-10 and thereafter) and that instead the statutory balance requirements for the 2007-09 budget continue to set at a fixed dollar amount of \$65 million for fiscal years 2007-08 and 2009-09. Under the Governor's recommendation, the statutory balance requirements for the next two biennia would compare with the requirements that existed for the current biennium as shown in the following table.

<u>Fiscal Year</u>	<u>Balance Requirement</u>
2003-04	\$35,000,000
2004-05	40,000,000
2005-06	65,000,000
2006-07	65,000,000
2007-08	65,000,000
2008-09	65,000,000
2009-10*	2.0%

\*For fiscal year 2009-10 and thereafter.

10. The Committee could consider the two parts of the Governor's recommendation separately, dealing first with the recommendations for statutory balance requirements for the current budget (2005-07) and then separately considering what the requirements should for succeeding biennia. These two components are discussed separately below.

**A. Alternative 2005-07 Statutory Reserve Requirements**

11. With regard to the statutory reserve requirements for 2005-07, the fixed dollar requirements as proposed by the Governor would, on a percentage basis, equal in each fiscal year about 0.5% of the total GPR appropriations plus compensation reserves funding levels as recommended under AB 100. The Committee could choose to establish a percentage reserve amount for 2005-06 and 2006-07 that would be instead approximately equal to the Governor's recommendation, or it could instead choose a higher or lower percentage amount. The dollar equivalencies for a number of different percentages (based on the AB 100 funding levels) are shown in the table below.

**Required AB 100 Reserve Amounts for Various Reserve Percentages**

Statutory Reserve %	Dollar Amount Required	
	2005-06	2006-07
0.25%	\$32,045,500	\$32,928,600
0.50%	64,091,000	65,857,300
0.75%	96,136,400	98,785,900
1.00%	128,181,900	131,714,600
1.25%	160,227,400	164,643,200
1.50%	192,272,900	197,571,800

12. Alternatively, the Committee could follow the Governor's fixed dollar amount approach by either approving the specification of the fixed dollar amount recommended by the Governor or by choosing higher or lower dollar amounts for 2005-06 and 2006-07. The percentage equivalencies for a number of different dollar amounts are shown in the table below.

**Percentage Equivalencies for Various Fixed Dollar Amount Reserve Requirements Based on AB 100 Funding Levels**

2005-06		2006-07	
Dollar Amount	% AB 100*	Dollar Amount	% AB 100*
\$25,000,000	0.20%	\$25,000,000	0.19%
35,000,000	0.27	35,000,000	0.27
45,000,000	0.35	45,000,000	0.34
55,000,000	0.43	55,000,000	0.42
65,000,000	0.51	65,000,000	0.49
70,000,000	0.55	70,000,000	0.53
75,000,000	0.59	75,000,000	0.57
80,000,000	0.62	80,000,000	0.61

\*Percent of total GPR appropriations plus compensation reserves under AB 100.

**B. Alternative Possible Statutory Reserve Requirements After 2005-07**

13. If the Committee continues to agree with the stated goal of establishing an on-going statutory reserve requirement of 2.0% of gross GPR appropriations plus compensation reserves, it could approve the remainder of the Governor's recommendation with regard to the statutory reserve requirement. This would mean that the statutory reserve requirement for 2007-08 and 2008-09 would be set at a fixed dollar amounts of \$65,000,000 for fiscal years 2007-08 and 2008-09 and that then, in fiscal year 2009-10, the reserve requirement would switch to the 2.0% requirement. For an indication of the dollar difference if the 2.0% requirement were to apply to the 2006-07 fiscal year, using the AB 100 GPR funding levels, the dollar amount of the reserve requirement would be \$263.4 million, or \$198.4 million more than the \$65.0 million recommended by the Governor.

14. The Committee could also consider two alternative approaches. One would be to leave the current law requirement for a 2.0% reserve in place for fiscal years after 2006-07. As before, this would not preclude the Governor or Legislature from recommending a different statutory reserve for succeeding years as a part of the 2007-09 biennial budget.

15. A second alternative would be to restore a timed series of step increases to reach the 2.0% statutory reserve requirement, similar to the original 1999 plan for stepped increases to reach the 2.0% goal. The Committee could provide that one of the two following stepped increase schedules be adopted beginning in fiscal year 2007-08.

**Stepped Statutory Reserve Increases to 2.0%  
Starting from Assumed 1.0% Base**

<u>Fiscal Year</u>	<u>Statutory Reserve Requirement</u>
2007-08	1.2%
2008-09	1.4
2009-10	1.6
2010-11	1.8
2011-12*	2.0

\*For fiscal year 2011-2012 and thereafter.

**Stepped Statutory Reserve Increases to 2.0%  
Starting from Assumed 1.4% Base**

<u>Fiscal Year</u>	<u>Statutory Reserve Requirement</u>
2007-08	1.6%
2008-09	1.8
2009-10*	2.0

\*For fiscal year 2009-10 and thereafter.

**ALTERNATIVES**

**A. 2005-07 Statutory Reserve Requirements**

1. Approve the Governor's recommendation.
2. Substitute one of the following dollar reserve requirements:
  - a. Statutory reserve of \$25,000,000 in each year.

<u>Alternative A2a</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	\$40,000,000

- b. Statutory reserve of \$35,000,000 in each year.

<u>Alternative A2b</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	\$30,000,000

- c. Statutory reserve of \$45,000,000 in each year.

<u>Alternative A2c</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	\$20,000,000

- d. Statutory reserve of \$55,000,000 in each year.

<u>Alternative A2d</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	\$10,000,000

- e. Statutory reserve of \$70,000,000 in each year.

<u>Alternative A2e</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	- \$5,000,000

- f. Statutory reserve of \$75,000,000 in each year.

<u>Alternative A2f</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	- \$10,000,000

- g. Statutory reserve of \$80,000,000 in each year.

<u>Alternative A2g</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	- \$15,000,000

3. Change the bill language to be one of the following percentage reserve requirements:

- a. Statutory reserve of 0.25% in each year.

<u>Alternative A3a</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	\$32,071,400

- b. Statutory reserve of 0.75% in each year.

<u>Alternative A3b</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	- \$33,785,900

- c. Statutory reserve of 1.00% in each year.

<u>Alternative A3c</u>	<u>Change to General Fund Balance</u>
<b>2005-07 FUNDING</b> (Change to Bill)	- \$66,714,600

**B. Statutory Reserve Requirements for After 2005-07**

1. Approve the Governor's recommendation.
2. Provide that the statutory reserve requirements for fiscal year 2007-08 and succeeding fiscal years shall be as follows:

**Stepped Statutory Reserve Increases to 2.0%  
Starting from Assumed 1.0% Base**

<u>Fiscal Year</u>	<u>Statutory Reserve Requirement</u>
2007-08	1.2%
2008-09	1.4
2009-10	1.6
2010-11	1.8
2011-12*	2.0

\*For fiscal year 2011-12 and thereafter.

3. Provide that the statutory reserve requirements for fiscal year 2007-08 and succeeding fiscal years shall be as follows:

**Stepped Statutory Reserve Increases to 2.0%  
Starting from Assumed 1.4% Base**

<u>Fiscal Year</u>	<u>Statutory Reserve Requirement</u>
2007-08	1.6%
2008-09	1.8
2009-10*	2.0

\*For fiscal year 2009-10 and thereafter.

4. Retain a 2.0% reserve requirement for fiscal year 2007-08 and succeeding years.

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