North Carolina Savings Reserve Account

Fiscal Brief

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North Carolina Savings Reserve Account Created in 1991

Executive Summary

North Carolina is one of 48 states with a savings reserve account that can help balance the state budget during an economic downturn or an unforeseen event. The State's goal is to maintain a reserve equal to 8% of the prior year's General Fund operating budget. By statute, the North Carolina Savings Reserve Account receives one-fourth of any unreserved fund balance remaining in the General Fund at the end of a fiscal year. Funds in the Savings Reserve Account remain part of the unappropriated General Fund balance until appropriated by the General Assembly.

The General Assembly relied significantly on the Savings Reserve Account to balance the budget during the most recent recession. Since its inception in 1992, the State has also used the Account to help North Carolina recover from major storm damage, stabilize the State Health Plan, and settle a major tax lawsuit.

Introduction

Benjamin Franklin once said that "… in this world nothing can be said to be certain except death and taxes." [1] Another certainty over the past two centuries has been the fluctuation of U.S. economic activity known as business cycles. Business cycle expansions and contractions have occurred 33 times in the United States since 1857[2]. In more recent history, there have been 11 business cycles since 1945[3]. The economic contractions known as recessions are defined as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real Gross Domestic Product (GDP), real income, employment, industrial production, and wholesale-retail sales."[4] As the economy contracts, so do state revenues. The National Conference of State Legislatures (NCSL) reports that state tax collections are particularly sensitive to economic conditions because 70% of state tax revenues are from the sales tax, individual income tax, and corporate income tax[5]. (In North Carolina, 90.4% of General Fund tax revenue in FY 2010-11 was from these three taxes.[6]) States also face increased demand for social welfare programs during recessions. One strategy that states use to mitigate these inevitable economic downturns is to maintain a savings reserve account (commonly referred to as a rainy day fund).

Savings Reserve Account

Whether called savings reserves, budget stabilization funds, or rainy day funds, these state revenues are set aside for use during a period of recession or other economic difficulty. North Carolina established its first such reserve in 1990. The General Assembly appropriated $141 million to a Budget Stabilization Reserve in FY 1990-91 "to provide a mechanism to stabilize the annual funding availability for carrying out State programs and providing financial assistance to local government units." [7] This legislation was meant to be a short-term measure until a General

[1] Letter to Jean-Baptiste Leroy, Nov. 13, 1789, reprinted in *The Works of Dr. Benjamin Franklin, Volume VI*, page 232, published by Wm Temple Franklin (1817).

[2] National Bureau of Economic Research (NBER), "US Business Cycle Expansions and Contractions", www.nber.org, December 5, 2011.

[3] Ibid.

[4] Ibid.

[5] Corina Eckl, Todd Haggerty, and Julie Lays, "NCSL Fiscal Brief: How State Tax Policy Responds to Economic Recessions", National Conference of State Legislatures, January 5, 2011.

[6] North Carolina General Assembly Fiscal Research Division, "2011 Annotated Committee Report on the Continuation, Expansion and Capital Budgets", Appendix Page A-14.

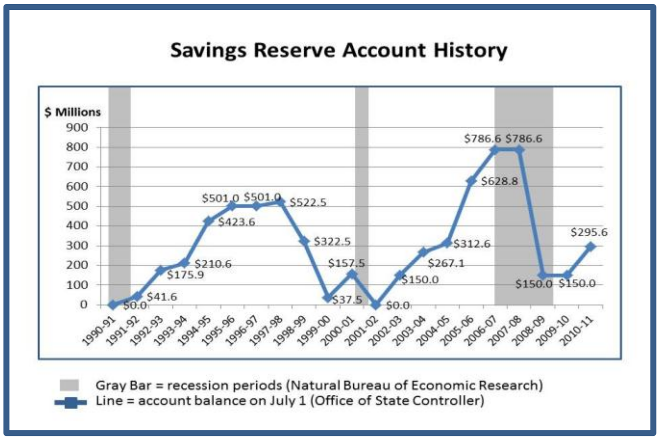
[7] S.L. 1989-1066, Section 10; in 1987, SB 994 was introduced to create a General Reserve Fund but the bill failed to pass.

Assembly interim committee could recommend a more permanent savings fund for consideration by the 1991 General Assembly. This Budget Stabilization Reserve was not spent in FY 1990-91 and reverted to the General Fund balance on June 30, 1991.

In 1991, the General Assembly established a Savings Reserve Account.[8] This Account receives "one-fourth of any unreserved fund balance, as determined on a cash basis, remaining in the General Fund at the end of the fiscal year."[9] The General Assembly set the funding goal for the Account "equal to or greater than 8% of the prior year's General Fund operating budget".[10] Spending from the Account is restricted to an "act of appropriation of the General Assembly".[11]

While deposits to and spending from the Account are set by statute, the General Assembly has made many exceptions to the authorizing legislation. It has used "notwithstanding language" (i.e., an exemption from current law) to prevent the automatic deposit of year end fund balances. In 1999, 2001, 2002, and 2008 the General Assembly allotted no funds for the Savings Reserve Account.[12] On the spending side, the legislature has granted the Governor authority to use funds from the Account five times in the past twenty years.[13]

For FY 1991-92, the General Assembly appropriated $41.6 million for the new Savings Reserve Account. As expected, the Account grew during periods of economic growth and declined as funds were used during recessionary periods.



While the Account's funds have been used to balance current year budgets, some have been spent on unanticipated or unplanned for events. Specifically, the legislature used the Account:

- To finance hurricane recovery efforts – Hurricane Floyd in 1999 ($286 million) and 6 hurricanes in 2004 ($153.4 million).[14]
- To help pay refunds to taxpayers in 1999 when the State lost an intangibles tax dispute in the Smith – Shaver cases ($200 million).[15]
- To repay the Highway Fund and Highway Trust Fund in 2006 for lost revenue from capping the variable rate of the gas tax ($22.9 million).[16]
- To help stabilize the State Health Plan in 2009 ($250 million).[17]

A complete history of the Savings Reserves Account can be found in Appendix I.

Savings Reserve Accounts – National

Forty-eight states have some form of savings reserve account, budget stabilization fund, or rainy day fund; Kansas and Montana are the exceptions.[18] Of the 48, nine states have more than one savings reserve account.[19] Most of these accounts are statutorily created, including North Carolina's, but 12 states have funds with constitutional authorization.[20] Many of these statutory or constitutional provisions specify

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[8] S.L.1991-689, Section 346; formerly G.S. 143-15.3.

[9] G.S. 143C-4-2 replaced the original Savings Reserve Account statute in 2006 (S.L. 2006-203, Section 3).

[10] G.S. 143C-4-2 (c). The savings goal was increased from 5% to 8% in 2006.

[11] G.S. 143C-4-2 (b).

[12] S.L. 1999-237, Section 6(d); S.L. 2001-250, Section 7; S.L. 2002-126, Section 2.2(m); and S.L. 2008-107, Section 2.2(c1).

[13] S.L. 1991-689, Section 184.4; S.L. 2001-457, Section 2; S.L. 2002-12, Section 2; S.L. 2003-283, Section 4; and S.L. 2010-123, Section 1.3.

[14] S.L. 1999-463, Section 3.1 and S.L. 2005-1, Sections 4.1 and 7.

[15] S.L. 1999-327.

[16] S.L. 2006-66, Section 2.2(g).

[17] S.L. 2009-16, Section 1(a).

[18] National Conference of State Legislatures, "NCSL 2012 Rainy Day Fund Report", Appendix A (not yet published).

[19] Ibid.

[20] Ibid.

how funds are to be deposited into these accounts (such as a percent of the end-of-year general fund surplus) and set limits on the size of the accounts (40 states cap their reserve account as a percent of total appropriations or revenues).[21] The account size caps range from 2% of General Fund disbursements in New York to 20% of total General Fund appropriation in Nevada. [22] North Carolina's 8% goal is at the midpoint of the range among states.

While some states give their governors authority to transfer funds from these reserve accounts as needed, 16 states require a supermajority vote of the legislature to approve a withdrawal from these funds.[23] Additionally, 15 states require repayment of funds that are withdrawn from these reserve accounts.[24]

National bond rating agencies set no firm percentage that a savings reserve account balance should maintain, but the Federal Reserve Bank of Boston found that these companies value such funds because they "may reduce the default risk associated with state-issued debt and improve bond ratings and reduce borrowing costs."[25] Fitch Ratings looks at whether a state or local government has "prudent reserves" and has a "framework for use and replenishment of reserves" when it judges the financial performance of a government entity. [26] Failure to follow the guidelines of bond rating agencies can result in the downgrade of a state's bond rating. For example, depletion of reserve funds was mentioned as one of the reasons that Fitch Ratings and Moody's Investors Services downgraded Hawaii's General Obligation bonds in 2011[27]. (North Carolina has a AAA rating from all three major bond rating agencies. [28])

Savings Reserve Accounts – Recent Use

A NCSL report found that budget deficits are the most common reason that states withdraw cash from savings reserve accounts.[29] That was especially true during the 2007-2009 recession. In FY 2008-09, 26 states used their savings reserve accounts to help balance their budgets.[30] Again in FY 2009-10, 23 states drew down their savings reserve accounts to help with continued budget problems.[31] As the economy improved, only seven states withdrew funds from savings reserve accounts in FY 2010-11.[32]

Fund balances in savings reserve accounts reflect their use during the recent recession. Prior to the recession, savings reserve account balances on average equaled 4.8% of general fund expenditures across the U.S. in FY 2007-08. However, if the large savings reserve accounts in Texas and Alaska are excluded, then the average fund balance as a percentage of expenditures that year drops to 3.6%.[33] Savings reserve account balances dropped to a low of 1.6% of general fund expenditures in FY 2009-10 and slowly have grown higher in the past two fiscal years.[34]

	Fund balance/ Expenditures	Fund balance/ Expenditures Excluding TX and AK
FY 2007-08	4.8%	3.6%
FY 2008-09	4.4%	2.3%
FY 2009-10	4.4%	1.6%
FY 2010-11	4.0%	1.7%
FY 2011-12	4.5% (projected)	2.0% (projected)

North Carolina's largest Savings Reserve Account balance as a percentage of the prior year total current operations budget was in Fiscal Year 1996-97 when the Account balance reached 5.12%. (See Appendix

[21] Ibid.

[22] Ibid.

[23] Ibid.

[24] Ibid.

[25] Darcy Rollins, "Evidence and Analysis of the Relationship of Rainy Day Funds and Municipal Bond Ratings"(Memo), New England Public Policy Center at the Federal Reserve Bank of Boston, September 25, 2005.

[26] Karen Ribble, "The Basics of Bond Ratings, presentation to the California Debt and Investment Advisory Commission", Fitch Ratings, April 30, 2009.

[27] Malia Zimmerman, "Fitch, Moody's GO Bond Rating Downgrade to Impact Hawaii Taxpayers", Hawaii Reporter, June 21, 2011.

[28] Department of State Treasurer, "State of North Carolina Debt Affordability Study, Feb.1, 2012", page 1.

[29] Daniel G. Thatcher, "State Budget Stabilization Funds", www.ncsl.org, September 26, 2008, page 2.

[30] National Governors Association (NGA) and the National Association of State Budget Officers (NASBO), "The Fiscal Survey of States, December 2009", Table A-5a.

[31] NGA and NASBO, "The Fiscal Survey of States, Fall 2010", Table 12.

[32] NGA and NASBO, "The Fiscal Survey of States, Fall 2011", Table 14.

[33] NGA and NASBO, "The Fiscal Survey of States, December 2009", Table A-1. Alaska and Texas deposit oil and gas tax revenues in their savings reserve accounts.

[34] NGA and NASBO, "The Fiscal Survey of States, Fall 2011", Table 30.

II) The current Account balance is 1.56% of the FY 2010-11 current operations budget.

Conclusion

Over two decades, the Savings Reserve Account has enabled the General Assembly and the Governor to stabilize the General Fund budget during economic downturns. It has also helped State leaders deal with unforeseen events (natural disasters) and unplanned expenditures (loss of court suits). While the Savings Reserve Account has proven to be an important budgetary tool, it has also been a critical factor in the equation for maintaining North Carolina's AAA bond rating.

Appendix I

Savings Reserve Account History
G.S. 143C-4-2

Fiscal Year	Beginning Balance as of June 30	Legislative Action (Earmark or Appropriation)	Authorized or Mid-year Adjustments	Ending Balance as of July 1
1990-91[1]	0	141,000,000	(141,000,000)	0
1991-92	0	41,593,253	0	41,593,253
1992-93	41,593,253	134,332,565	0	175,925,818
1993-94[2]	175,925,818	155,678,246	(121,000,000)	210,604,064
1994-95	210,604,064	213,005,569	0	423,609,633
1995-96	423,609,633	77,342,029	0	500,951,662
1996-97	500,951,662	0	0	500,951,662
1997-98	500,951,662	21,568,899	0	522,520,561
1998-99[3]	522,520,561	0	(200,000,000)	322,520,561
1999-00[4]	322,520,561	967,311	(285,965,824)	37,522,048
2000-01	37,522,048	120,000,000	0	157,522,048
2001-02[5]	157,522,048	90,000,000	(247,522,048)	0
2002-03	0	150,000,000	0	150,000,000
2003-04	150,000,000	116,666,064	391,343	267,057,407
2004-05[6]	267,057,407	199,125,000	(153,541,447)	312,640,960
2005-06[7]	312,640,960	316,151,631	0	628,792,591
2006-07[8]	628,792,591	180,790,087	(22,933,000)	786,649,678
2007-08	786,649,678	0	0	786,649,678
2008-09[9],[10],[11]	786,649,678	(250,000,000)	(386,649,678)	150,000,000
2009-10	150,000,000	0	0	150,000,000
2010-11[12],[13]	150,000,000	183,650,000	(38,008,589)	295,641,411

[1] Funds reverted to General Fund on June 30, 1991.

[2] $121 million transferred to General Fund availability for the FY 1993-94 budget (S.L. 1993-561, Section 8).

[3] $200 million transferred to a settlement fund (Smith/Shaver cases) to pay refunds to taxpayers who had paid intangibles tax on stocks for the 1990 to 1994 tax years (S.L. 1999-327).

[4] $286 million transferred to the Hurricane Floyd Reserve Fund (S.L. 1999-463, Section 3.1).

[5] General Assembly allowed the Governor to use the Savings Reserve Account to balance the budget in FY 2001-02. (S.L. 2002-12, Section 2).

[6] $153,541,447 was appropriated from the Savings Reserve Account pursuant to S.L. 2005-1, Sections 4.1 and 7 (SB 7) Hurricane Recovery Act of 2005.

[7] Earmarking as per G.S. 143-15.3; a subsequent adjustment was made by the Office of Budget and Management and Office of the State Controller to reflect actual, year-end reversions.

[8] S.L. 2006-66, Section 2.2(g) created the Reserve for Motor Fuels Tax Ceiling and authorized a transfer of $22,933,000 from the Savings Reserve Account.

[9] S.L. 2009-16, Section 1(a) appropriated $250 million to stabilize the State Health Plan.

[10] Executive Order #6 moved $386,649,678 from the Savings Reserve Account to cover the FY 2008-09 budget shortfall.

[11] S.L. 2009-215, Section 7 appropriated the funds used by the Governor in FY 2008-09 to cover the budget shortfall.

[12] S.L. 2011-145, Section 2.2(a) set the transfer amount to the Savings Reserve Account at $185 million. S.L. 2011-345, Section 5 reduced this amount to $183.65 million.

[13] S.L. 2010-123, Sec. 1.3 authorized the Director of the Budget to use $38,008,589 from the Savings Reserve Account to offset the loss of Enhanced FMAP Funds.

Appendix II

Savings Reserve Account as a Percentage of Budget

Fiscal Year	Savings Reserve Account Ending Balance as of July 1	Total General Fund Current Operations	General Fund Expenditure	Balance as % of Prior Year Current Operations	Balance as % of Prior Year Expended Budget
1990-91	$0	$7,726,424,607	$6,877,865,221	0.00%	0.00%
1991-92	$41,593,253	$7,825,332,308	$7,184,089,741	0.54%	0.60%
1992-93	$175,925,818	$8,114,332,346	$7,552,787,565	2.25%	2.45%
1993-94	$210,604,064	$9,125,534,906	$8,575,733,017	2.60%	2.79%
1994-95	$423,609,633	$9,952,333,177	$9,482,528,320	4.64%	4.94%
1995-96	$500,951,662	$9,793,062,378	$9,570,832,269	5.03%	5.28%
1996-97	$500,951,662	$10,450,411,229	$10,309,508,861	5.12%	5.23%
1997-98	$522,520,561	$11,258,582,548	$11,108,886,722	5.00%	5.07%
1998-99	$322,520,561	$12,327,025,974	$12,177,442,547	2.86%	2.90%
1999-00	$37,522,048	$13,441,610,285	$13,297,649,285	0.30%	0.31%
2000-01	$157,522,048	$13,878,542,760	$13,220,036,214	1.17%	1.18%
2001-02	$0	$14,705,809,843	$13,708,199,020	0.00%	0.00%
2002-03	$150,000,000	$14,320,664,876	$13,824,364,493	1.02%	1.09%
2003-04	$267,057,407	$14,871,621,783	$14,676,583,520	1.86%	1.93%
2004-05	$312,640,960	$15,897,680,933	$15,753,167,545	2.10%	2.13%
2005-06	$628,792,591	$17,161,861,310	$16,977,479,186	3.96%	3.99%
2006-07	$786,649,678	$18,673,708,783	$18,455,735,426	4.58%	4.63%
2007-08	$786,649,678	$20,441,301,149	$20,145,647,198	4.21%	4.26%
2008-09	$150,000,000	$21,239,049,461	$19,629,407,644	0.73%	0.74%
2009-10	$150,000,000	$19,034,299,596	$18,507,766,990	0.71%	0.76%
2010-11	$295,641,411	$18,974,565,403	$18,502,920,072	1.55%	1.60%
2011-12	$295,641,411	$19,700,747,946		1.56%	1.60%

Source: 2011 Annotated Committee Report of the Continuation, Expansion and Capital Budgets, Page A-12, Fiscal Research Division (Compiled from Office of the State Controller Year-end Close Out Reports)

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