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Iowa's Expenditure Limitation Process

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ISSUE

This ***Issue Review*** provides an overview of Iowa's Expenditure Limitation law and recent statutory and session law changes that have changed the process.

CODE AUTHORITY

Sections 8.22A, 8.54 – 8.57, Code of Iowa

BACKGROUND

The expenditure limitation law was created in 1992 through the enactment of SF 2351 (Expenditure Limitation Act) and was first used for development of the FY 1994 budget. In addition to placing a 99.0% limit on expenditures, the law required the General Assembly and the Governor to use certain revenue estimates of the Revenue Estimating Conference (REC), created the Cash Reserve Fund, established a mechanism to eliminate the Generally Accepted Accounting Principles (GAAP) deficit, amended provisions of the Economic Emergency Fund, and redirected the flow of the General Fund surplus to fund the reserve funds and the GAAP deficit.

REVENUE ESTIMATING CONFERENCE

Section 8.22A, Code of Iowa, establishes the REC, which is a three-person panel with two individuals representing the legislative and executive branches and a third person chosen by the other two. The following outlines the revenue estimating process:

- The REC meets on a quarterly basis to review and establish estimates for General Fund revenues, refunds, and accruals of revenue collected but not remitted by June 30.
- The REC estimate established at the meeting prior to December 15 is required to be used by the Governor and the General Assembly in preparation of the General Fund budget for the fiscal year beginning on July 1.

- If the REC sets a higher revenue estimate after the December meeting, but prior to the end of the regular Legislative Session, the Governor and the General Assembly are required to use the lower December estimate.
- If the REC sets a lower revenue estimate after the December meeting, but prior to the end of the regular Legislative Session, the Governor and the General Assembly are required to use the lower estimate. The Governor has 14 days to re-submit a budget using the lower estimate.
- Use of the lower estimate also applies to the General Assembly during a Special Session that is held before the start of the new fiscal year.
- The estimate is adjusted for any proposed law changes enacted during the Legislative Session. This becomes the Adjusted Revenue Estimate, which is used for establishing the budget for the next fiscal year.

EXPENDITURE LIMITATION

Section 8.54, Code of Iowa, defines the Adjusted Revenue Estimate as the *appropriate revenue estimate* for the General Fund for the following fiscal year as determined by the REC, adjusted by subtracting estimated tax refunds, and adding any new revenues considered to be eligible for deposit into the General Fund.

The term *"appropriate revenue estimate"* is used to indicate that the REC estimate used in establishing the State budget becomes the estimate to which the expenditure limitation is applied. This estimate is also used for calculating the percentage goals of the reserve funds and the Senior Living Trust Fund General Fund surplus appropriation.

In calculating the expenditure limitation, the base revenues (those set by the REC) are multiplied by 99.0% and all new revenues are multiplied by 95.0%. The results are added together to arrive at the expenditure limitation.

CURRENT FISCAL YEAR

The REC also estimates revenues for the remaining months of the current fiscal year; however, the expenditure limitation provisions do not apply to the fiscal year in progress. Significant changes in the revenue estimate for the current fiscal year that occurs in December or later months affects the State budget process in the following ways:

- Excess revenues are eligible to fund supplemental appropriations. In FY 2006, the General Assembly passed supplemental appropriations totaling $85.0 million.
- A significant increase in the revenue estimate can also increase the projected General Fund surplus for the current fiscal year. The surplus has been used in recent years by the General Assembly and the Governor to fund appropriations in succeeding fiscal years, which has assisted in balancing the General Fund budget. Under current statute, the surplus is to be distributed between the Senior Living Trust Fund and the reserve funds.
- If the REC lowers the current year estimate to a level that a deficit is projected, the Governor may order across-the-board cuts to General Fund appropriations or the General Assembly may implement deappropriations. In FY 2002 and FY 2003, Iowa's economy experienced a severe downturn causing tax receipts to drop significantly. As a result, the REC lowered estimates to a level that required significant deappropriations.

DISTRIBUTION OF SURPLUS REVENUES

Senior Living Trust Fund (SLTF) – Section 8.57(2)(a), Code of Iowa, establishes a mechanism to transfer a portion of the General Fund surplus to the SLTF. The process works as follows:

- If the year-end surplus is equal to or greater than 2.0% of the Adjusted Revenue Estimate used for establishing the current year budget, then, an amount equal to 1.0% of the Adjusted Revenue Estimate is appropriated to the SLTF. This appropriation is made prior to the appropriation to the Cash Reserve Fund.
- If the surplus is less than 2.0%, the SLTF and the Cash Reserve Fund each receive 50.0% of the surplus.
- The SLTF receives a portion of the surplus until the aggregate of all transfers, appropriations, and reversions to the SLTF, beginning July 1, 2004, equals $300.0 million.

Cash Reserve Fund (CRF) – Sections 8.56 and 8.57, Code of Iowa, establishes the CRF and dictates the flow of surplus revenues to the CRF, as well as uses of the Fund.

- A portion of the surplus is transferred to the CRF until the Fund reaches 7.5% of the Adjusted Revenue Estimate.
- If the CRF is not at the maximum of 7.5% of the Adjusted Revenue Estimate, a General Fund appropriation of up to 1.0% of the Adjusted Revenue Estimate is made to the Fund.
- The General Assembly may appropriate from the CRF for nonrecurring, emergency expenditures if the appropriation is for a nonrecurring emergency expenditure, the appropriation in the bill is the only subject matter, and the appropriation does not cause the Fund's balance to be less than 3.75% of the Adjusted Revenue Estimate. An appropriation that reduces the balance below 3.75% must be approved by a three-fifths majority in both Chambers and signed by the Governor.
- The CRF excess is transferred to the GAAP Deficit Reduction Account if a GAAP deficit exists; otherwise the excess is transferred to the Economic Emergency Fund.
- Cash Reserve Fund interest is credited to the Rebuild Iowa Infrastructure Fund.

Economic Emergency Fund (EEF) – Section 8.55, Code of Iowa, establishes the EEF and specifies the flow and uses of the funds.

- The EEF receives the excess revenue from the CRF until the Fund reaches 2.5% of the Adjusted Revenue Estimate.
- Excess revenue from the EEF is transferred to the SLTF until the $300.0 million limit is reached.
- Once the $300.0 million transfer limit to the SLTF is reached, the EEF excess is deposited into the General Fund and is not subject to the expenditure limitation.
- Up to $50.0 million of the EEF may be automatically appropriated for the purpose of preventing a deficit in the General Fund; however, all of the following conditions must be met:
  - Either the fourth quarter REC estimate was, or actual year-end receipts were 0.5% less than the third quarter REC estimate.

  - The Governor implemented across-the-board reductions during the fiscal year that were not sufficient to prevent the deficit. This condition does not apply if the Governor could not implement the reductions due to the lateness of the realization of the deficit.
  - The year-end General Fund balance was negative.
  - The Governor must notify the Legislative Fiscal Committee and the Legislative Services Agency that a deficit occurred and that across-the-board reductions were insufficient to eliminate the deficit.
- In the event that an appropriation is made to eliminate a year-end deficit, a standing appropriation from the General Fund is made to the EEF in the succeeding fiscal year to reimburse the EEF.
- The EEF can be used for General Fund cash flow purposes.
- Economic Emergency Fund interest is credited to the Rebuild Iowa Infrastructure Fund.

SIGNIFICANT CHANGES TO THE EXPENDITURE LIMITATION LAW

There have been numerous changes to the expenditure limitation law since being enacted. The significant changes are summarized below:

- In FY 2001, changes were made to provisions of the Economic Emergency Fund to allow up to $50.0 million from the Fund to be used for deficit reduction if certain conditions are met.
- In FY 2003, the requirement directing excess moneys of the Economic Emergency Fund to be transferred to the General Fund was changed to require the excess be transferred to the Endowment for Iowa's Health Account and the Senior Living Trust Fund until a certain level of transfers are reached. The Senior Living Trust Fund amount was originally set at $51.0 million and changed to $300.0 million in the 2006 Legislative Session. The requirement to transfer funds to the Endowment was repealed in FY 2005.
- In FY 2005, the Cash Reserve Fund percentage goal was increased from 5.0% to 7.5% and the Economic Emergency Fund decreased from 5.0% to 2.5%.
- In FY 2005, a provision was added to require the use of the expenditure limitation during special sessions that commence prior to the end of the fiscal year. Prior to this change, the General Assembly was not required to adhere to the expenditure limitation during a special session.

CONCLUSION

While the 99.0% expenditure limitation has been followed, other provisions of the law have been notwithstood (temporarily suspended) by the General Assembly and the Governor to help balance the budget. Provisions notwithstood in recent Legislative Sessions include:

- For FY 2006 and FY 2007, the provision requiring the General Assembly to use the December REC estimate was notwithstood to allow the use of later estimates that were higher than the respective December estimates. This allowed the General Assembly to appropriate an additional $84.2 million in FY 2006 and $45.7 million in FY 2007.

- During the 2005 and 2006 Legislative Sessions, the General Assembly notwithstood the requirement to have the General Fund surplus transferred to the Cash Reserve Fund, and instead transferred approximately $160.0 million from each year's surplus to the Property Tax Credit Fund to fund property tax credits for the subsequent fiscal years (FY 2006 and FY 2007).
- For FY 2006, the General Assembly notwithstood the requirement that an appropriation of up to 1.0% of the Adjusted Revenue Estimate be made to the Cash Reserve Fund if the Fund is not at 7.5% of the Adjusted Revenue Estimate. During the 2005 Legislative Session, the estimated balance in the Cash Reserve Fund was approximately 6.0% of the Adjusted Revenue Estimate. If this provision had not been notwithstood, an appropriation of $49.9 million would have been required for FY 2006.
- For FY 2002 through FY 2004, the General Assembly notwithstood the requirement to have the interest from the reserve funds transferred to the Rebuild Iowa Infrastructure Fund and instead directed the funds to the General Fund. This provided additional General Fund revenue of $31.1 million in FY 2002, $15.5 million in FY 2003, and $7.6 million in FY 2004.

The expenditure limitation law has allowed the State to establish two reserve funds that have provided the following benefits:

- Provided cash flow for State expenditures so the General Fund maintains a positive cash balance throughout the fiscal year.
- Provided sources of revenue that policymakers have used to assist in balancing the budget during fiscal years that experience significant tax revenue declines. This allowed lawmakers to maintain funding for government services without raising taxes. In FY 2002, $195.0 million was transferred from the CRF and EEF to the General Fund due to a revenue shortfall. Transfers of $66.1 million and $45.5 million were made at the close of FY 2001 and FY 2003, respectively, to balance General Fund budgets when accrued receipts were below estimates resulting in deficits.

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