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State Revenue Volatility and Optimal Reserve Size Are Directly Linked.

Comparison of states provides insight into their ability to weather an economic downturn

The amount of money a state takes in fluctuates from year to year, with a range of factors influencing this volatility. Those factors can include specific tax revenue sources, the state's economic profile, federal budget changes, and unforeseen events such as natural disasters. Although each state's revenue swings may be unique, all face the challenges associated with managing these ups and downs.

Policymakers can use reserves to help offset revenue declines during down periods, such as recessions. But how much a state should hold in its reserves—its savings target—can vary as well, and for many reasons. For example, leaders in one state might have a higher risk tolerance than their peers, meaning they are more willing to save less than enough for the next downturn. Some may more routinely use other budget tools, such as raising revenue or cutting spending, to close a budget gap. These alternative approaches can reduce reliance on reserves.

However, revenue volatility remains a primary factor influencing optimal reserve size. In general, states with greater revenue volatility need to save relatively more than do those with less fluctuation. High revenue volatility means that tax collections tend to drop more dramatically during economic downturns.

Continue reading.

Route Fifty

By Mary Murphy and Steve Bailey

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