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Georgia Caps Tax Rate It Hasn't Raised in 30 Years: Muni Credit.

This month, Georgia became the first U.S. state to make raising its income-tax rate unconstitutional, a move that could hamstring its ability to raise revenue in tough economic times.

Voters approved a ballot measure Nov. 4 that caps the top rate at its current 6 percent, forbidding lawmakers from even temporarily raising the levy that accounts for about half of Georgia's revenue.

Georgia's fiscal management has earned it top bond grades and borrowing costs among the lowest of states tracked by Bloomberg. Yet the experience of the recession that ended in June 2009 shows the risk of writing off any fiscal tool: Most states resorted to tax increases to balance budgets during the crisis, according to the Tax Policy Center.

"It's like taking a weapon out of your revenue-raising arsenal," said Brenda Ojendyk, a senior research analyst for Chicago-based Nuveen Asset Management. "You don't want to do that if you don't have to."

The tax cap adds Georgia to a list of Republican-dominated governments pushing cuts and limits for income, business and estate taxes paid disproportionately by the rich. The reductions create risks for budgets: In Kansas, a 2013 law reduced income-tax revenue by almost one-third, according to Moody's Investors Service.

Georgia Alone

In locking a cap into its constitution, Georgia has taken it further than most, said Dan Close, a senior vice president at Nuveen who manages two Georgia bond funds with $388 million in assets.

"This is the first voter-approved constitutional amendment limiting income taxes in the country," Close said.

Moody's also flagged the cap as a challenge, because it bans the state from raising its biggest revenue source. Levies on individual income account for 47 percent of Georgia's $19.7 billion general fund for fiscal 2015, it said in a report. The state also gets revenue from sales, corporate and excise taxes.

Eric Kim, an analyst with Fitch Ratings, said the limit is more hypothetical than real, since the state hasn't increased income taxes in decades. The top rate hasn't changed since at least 1980, said Nick Genesi, a Revenue Department spokesman.

Limiting Response

The concept of using a constitution to freeze income taxes hasn't arisen in other states, which is a good thing, said Michael Leachman, director of state fiscal research in Washington for the Center on Budget and Policy Priorities, which analyzes the ways fiscal decisions affect the poor.

“It’s a terrible idea, just really awful fiscal management,” he said. “When recessions hit, you want to be able to respond with all the tools available.”

Thirty-three states raised taxes either temporarily or permanently in response to the 18-month recession, according to the Tax Policy Center, a joint venture of the Urban Institute and Brookings Institution.

Georgia responded by cutting education and other spending and by tapping reserves, which dropped from $1.5 billion in 2007 to $116 million in 2010, according to the Atlanta-based Georgia Budget and Policy Institute, which opposed the tax cap.

Pleasing Business

None of the biggest credit-rating companies have changed their outlook on Georgia’s $10.8 billion in debt because of the cap, although Moody’s warned that Kansas and North Carolina faced challenges after cutting income-tax rates. In North Carolina, tax collections on individual income fell 6.2 percent in fiscal 2014, while the revenue dropped 32 percent in Kansas.

Georgia’s borrowing costs are on a par with benchmark rates. The state’s 10-year tax-exempt debt yields about 2.3 percent, data compiled by Bloomberg show. Only North Carolina and Virginia boast lower yields among the 20 states followed by Bloomberg.

Republican State Senate President Pro Tem David Shafer sponsored the bill putting the tax cap on the November ballot, where it was approved by 74 percent of voters.

In an e-mailed statement, Shafer said the cap will bring jobs to a state with the nation’s highest unemployment rate, at 7.7 percent in October, compared with a national average of 5.8 percent.

“Leading economists have told us that the business certainty promised by the constitutional amendment will encourage existing businesses to expand here and new businesses to locate here,” the statement said.

No Panacea

Backers included the Georgia Chamber of Commerce and Christine Ries, an economist at the Georgia Institute of Technology in Atlanta, who said the cap will force Georgia to rely more on sales taxes, which she said business prefers.

“What this is saying is not that we will never raise taxes,” Ries said. “It means if they do raise taxes it will be on consumption, not income. A signal like this is extremely important in attracting new companies.”

Opponents call the move a stunt, since no one was proposing raising the income tax, anyway.

Republican lawmakers put it on the ballot “so they can go back to the constituents and say they did something to limit taxes,” said Senate Democratic Leader Steve Henson.

They also say jobs claims are exaggerated.

“This idea that it’s going to be some big boon to the economy is just self-evidently, wildly overblown,” said Leachman of the Washington-based budget and policy center.

Emory University economist Paul Rubin, who backed the limit, also said benefits will be moderate.

“It will add a little bit of certainty but it’s not a world-breaker, because taxes weren’t that high,” Rubin said.

“People aren’t going to say, ‘Ah, let’s move to Georgia because they capped their taxes,’” he said.

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