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State Fiscal Crisis
Georgia Has a Revenue Problem

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If a man loses his job and suddenly cannot pay for even his basic utilities, he does not have a spending problem. He has a revenue problem. The same is true for the state of Georgia. Current revenues are not sufficient to pay for our basic public services, causing deep cuts that will likely worsen in the coming year.

In July the Governor projected a 1 percent revenue decline in FY 2009 ($1.6 billion budget shortfall). Although revenue collections for the first five months of the fiscal year have shown a 1.3 percent decline, due to the further weakening of the economy expected throughout calendar year 2009, the Georgia State University Economic Forecasting Center projects a 6 percent revenue decline in the current fiscal year.[1] **A 6 percent revenue decline would result in a FY 2009 budget shortfall of $2.5 billion.** The Economic Forecasting Center also projects a 1 percent revenue decline in FY 2010. Meaning, Georgia potentially faces an additional FY 2010 budget shortfall of as much as $1 billion.

State spending is not a driving factor in these projected deficits, considering that Georgia ranks 49th in state spending per capita.[2] **The current budget shortfall is due to the combination of a historically weak economy and a shrinking tax base. In short, Georgia has a revenue problem.**

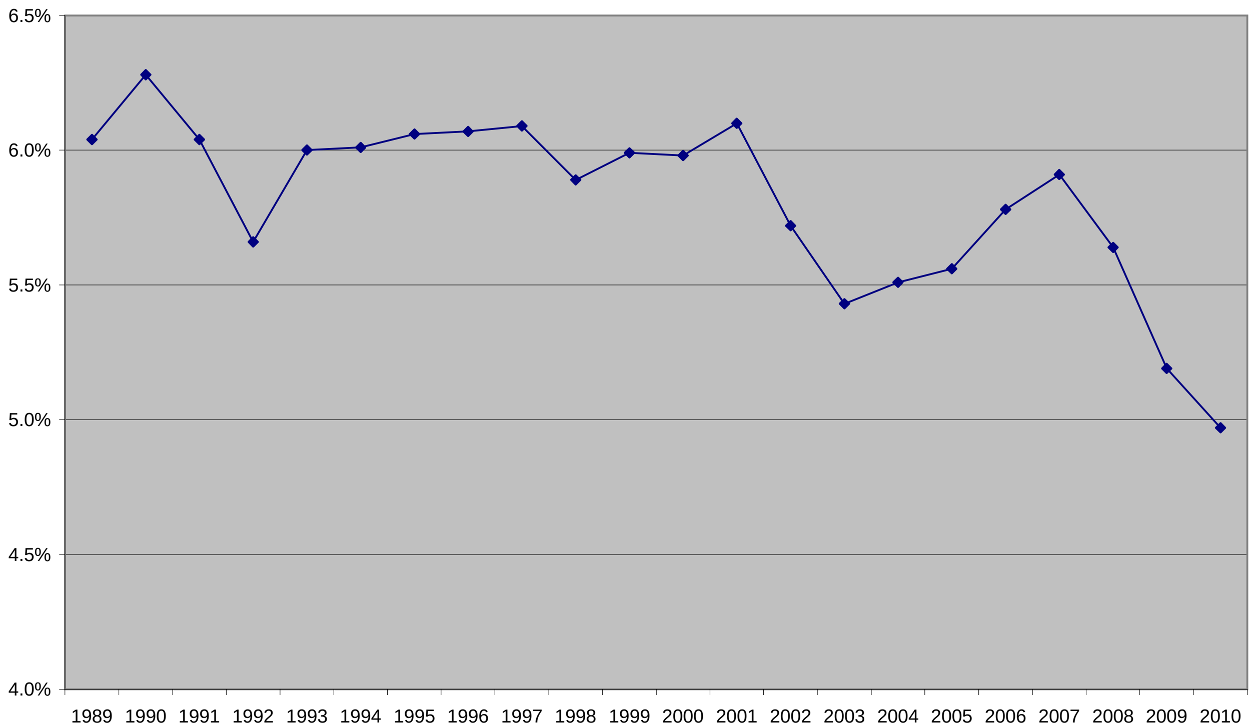
The Problem: State Revenue Decline

State revenue collections as a percentage of personal income have declined dramatically over the past eight years. In other words, as Georgians' incomes increased, the state taxes collected from Georgians did not keep pace.

As Chart 1 shows, the recession of 1992 showed the traditional V shaped pattern of revenue collections during a recession and recovery.[3] Revenues bottomed out quickly (5.7 percent of income) and then just as quickly recovered to previous levels (6.0 percent of income). Between FY 1993 and FY 2001, revenues as a percentage of income averaged 6.0 percent each year. During FY 2003 revenues decreased to a historic low (5.4 percent of income) and then took four years to reach a peak (5.9 percent of income) that was still lower than almost every year between 1993 and 2001. During the four years of economic recovery between FY 2004 and FY 2007, revenues as a percentage of income averaged only 5.7 percent.

The current recession appears to be a more exaggerated pattern of the 2001 recession. According to the Georgia State University Economic Forecasting Center, it is expected that revenues in FY 2009 and FY 2010 will decrease to a new historic low (5.2% of income in FY 2009 and 5.0% of income in FY 2010) with a relatively weak L shaped recovery in FY 2011 and beyond. Each recession is putting state revenues at a lower base. Without new revenues, it is unrealistic to think that an economic recovery will return state revenues to previous levels.

Chart 1
State Revenues as Percent of Personal Income FY 1989 - FY 2010



Sources: United State Bureau of Economic Analysis, United States Census Bureau, Governor's Budget Books, Georgia State University Economic Forecasting Center.

Short Term Cause: The Weak Economy

The Georgia State University (GSU) Economic Forecasting Center and the University of Georgia (UGA) Selig Center for Economic Growth have recently issued similar economic forecasts for the nation and the state.[4] Both Centers project a decline in U.S. gross domestic product (GDP) of over 3 percent in the 4th quarter of 2008, with continued GDP declines through the 2nd quarter of 2009. Both Centers forecast Georgia unemployment rates of over 8 percent by 2010. The Selig Center forecast for Georgia predicts a recession that will be "severe rather than mild and prolonged rather than short."[5] They project that the Georgia economy will bottom out in the 3rd quarter of 2009, and be very slow to recover afterwards. The GSU Economic Forecasting Center projects a very tepid recovery beginning in 2010.

The depth and length of this recession are expected to cause continued shortfalls in state revenue. With the increasing levels of unemployment will come declines in income tax revenue. Likewise, with consumer confidence at record lows, we can expect reduced sales tax collections. For state revenues, GSU Economic Forecasting Center projects a 6 percent decline in state revenues in FY 2009 and a 1 percent decline in state revenues in FY 2010.

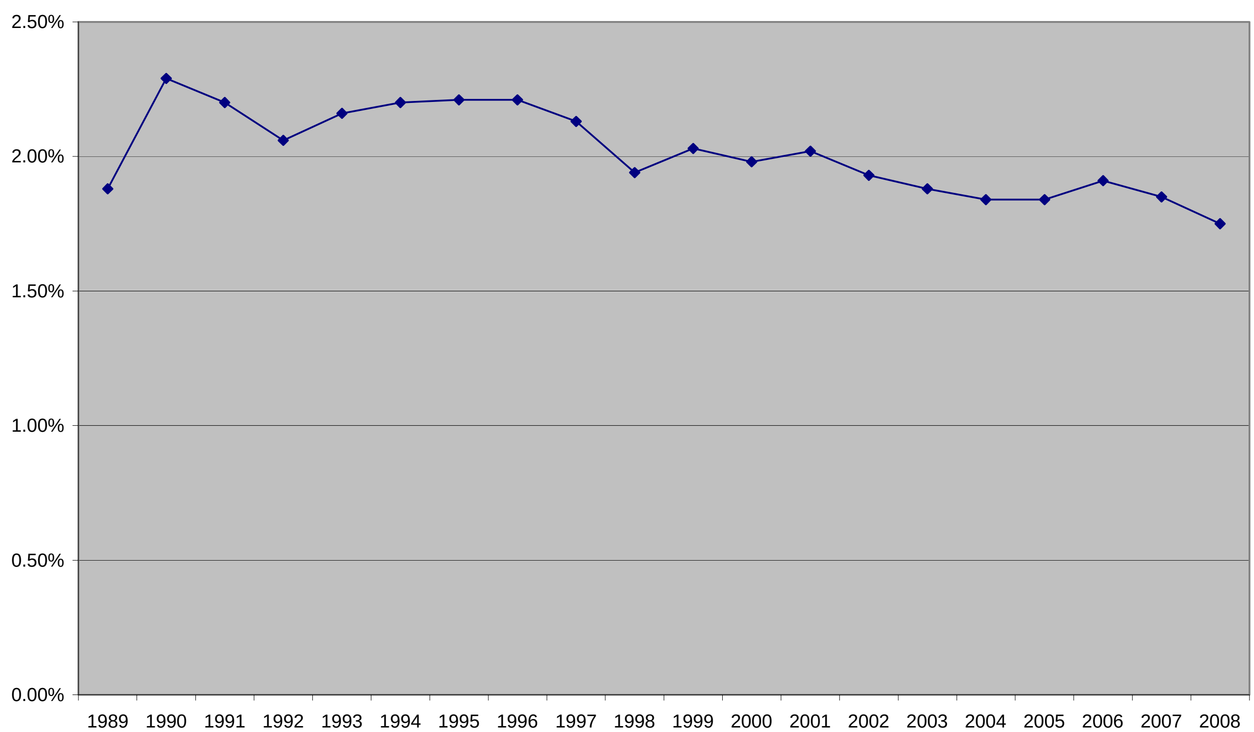
Long Term Cause: The Shrinking Tax Base

While the national economic crisis undoubtedly plays a large role in the current revenue shortfall, the shrinking of the tax base over the past decade is also a factor. As Chart 1 showed, even during the recovery years of 2004 to 2007, state revenues as a percentage of income lagged the 6.0 percent level seen in the 1990s. Meaning, Georgia had a revenue problem even before the current recession hit.

The weakening of the tax base has occurred over the past 10 years as Georgia eliminated the sales tax on food, increased income tax breaks for senior citizens, increased personal income tax deductions and exemptions, implemented various personal income tax credits, passed numerous special interest and business sales tax exemptions, and implemented numerous corporate income tax credits. In addition, the movement from a manufacturing to a service economy and the rise of Internet sales have further weakened the sales tax base. These tax policy decisions and a changing economy have cost the state a minimum of $1.5 billion each year.

Chart 2 illustrates the erosion of the sales tax base, a significant factor in the shrinking tax base. The removal of the sales tax on food between 1996 and 1998, the numerous sales tax exemptions implemented over the past 15 years, and the increase of Internet sales since 2000 have led to the downward curve of the sales tax, even during the economic recovery between FY 2004 and FY 2007.

Chart 2
State Sales Tax as a Percent of Income FY 1989 - FY 2008



Sources: United States Bureau of Economic Analysis, United States Census Bureau, Governor's Budget Books.

The inadequate revenue base has resulted in lagging funding for the physical and human infrastructure of the state even during times of economic growth. During the economic recovery between FY 2004 and FY 2007, Georgia collected hundreds of millions of dollars less than we would have if revenues as a percentage of income were at the FY 1993 to FY 2001 average of 6.0 percent (Table 1). As a result, most agency budgets were not able to fully recover from the 2002 recession. For example, between FY 2003 and FY 2008 the Board of Education and Board of Regents budgets included over $2.4 billion in funding formula austerity cuts and sustained budget reductions. In addition, due to funding limitations in Medicaid and PeachCare, the number of uninsured children in Georgia increased, and Georgia was unable to make adequate investments in such areas as a state trauma network, a community mental health system, or services for those with mental and physical disabilities.

In addition to hampering the recovery period, the shrinking tax base has caused the current revenue shortfall to be more severe. **If Georgia were to collect revenues at the same rate as during the bottom of the 1992 recession (5.7 percent), FY 2009 revenues would be $1.6 billion greater.** FY 2010 revenues would be $2.4 billion more.

Table 1
Revenues as a Percentage of Income
FY 2004 – FY 2007 and FY 2009 – FY 2010

	Revenues as Percentage of Income	Additional Funds if Revenues as % of Income equaled 6.0 percent
FY 2004	5.51%	$1,306,566,038
FY 2005	5.56%	$1,238,966,273
FY 2006	5.76%	$714,699,392
FY 2007	5.91%	$296,575,641
		Additional Funds if Revenues as % of Income equaled 5.7 percent
FY 2009	5.19%	$1,583,256,134
FY 2010	4.97%	$2,404,537,572

Sources: United States Bureau of Economic Analysis, United States Census Bureau, Governor's Budget Books, Georgia State University Economic Forecasting Center.

Recommendations

With Georgia potentially facing a $2.5 billion budget shortfall in the current fiscal year and an additional $1 billion shortfall next fiscal year, new revenues should be part of a balanced deficit reduction package. According to Peter Orszag and Nobel Prize winning economist Joseph Stiglitz, tax increases, particularly tax increases on higher-income families, are the least damaging mechanism for closing state fiscal deficits in the short run.[6]

Revenue raising options include:

- Increase cigarette taxes by $1 a pack to raise $450 million.
- Impose a temporary 1 percent surcharge on family income over $400,000 to raise an estimated $225 million. (Would impact less than 1 percent of taxpayers.)
- Reinstate the state estate tax to raise between $100 million and $150 million. (Would impact less than 1 percent of all estates.)

- Lower the cap on various tax credits and exemptions passed during the past two legislative sessions. For example, lower the $50 million cap on the tax credit for student scholarship organization donations to $2 million during the recession.
- Implement an income ceiling on the child care tax credit to save $20 million.
- Create a ceiling on vendor compensation for sales tax collection.

In the long term, Georgia needs to undertake fundamental tax reform and modernization that addresses the question: How do we fairly and equitably raise the funds necessary to provide the quality public services and infrastructure that Georgians demand? Such tax reform and modernization should include:

- Create a tax break budget to increase transparency and accountability for tax breaks. Like 39 other states, Georgia needs a tax break budget to detail the costs and benefits of tax breaks. A tax break budget would provide data that legislators and the public need to weigh Georgia's spending options.
- Eliminate unnecessary and ineffective tax breaks based on data gathered from a tax break budget.
- Expand the sales tax to cover some household services. The change from a manufacturing to a service economy and the rise of Internet sales have weakened the sales tax base. Broadening the sales tax to cover some services would help strengthen this declining revenue base.
- Modernize the income tax structure to the 21st century. The income tax has been relatively unchanged since the 1930's. The income tax should be modernized through increasing the standard deductions, broadening the tax brackets, establishing a new top income tax rate, and implementing a state Earned Income Tax Credit.

Revenue increases as part of a balanced deficit reduction package would be more beneficial to the economy than budget cuts alone. In the long term, fundamental tax reform and modernization would allow Georgia to make the investments in the human and physical infrastructure of the state that is necessary for Georgia to prosper.

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[1] Georgia State University J. Mack Robinson College of Business Economic Forecasting Center "*Forecast of Georgia and Atlanta*." November, 2008

[2] Governing Magazine. Measuring Performance: The State Management Report Card for 2008 http://www.pewcenteronthestates.org/uploadedFiles/Grading-the-States-2008.pdf

[3] 1989 – 2007 personal income data is from the Regional Economic Information System from the United State Bureau of Economic Analysis. 1989 – 2007 population data is from the United States Bureau of the Census. State revenues are from the FY 1989 – FY 2009 Governor's Budget Books. FY 2009 and FY 2010 personal income and population estimates are from the Georgia State University Economic Forecasting Center November 2008 Forecast of Georgia and Atlanta.

[4] Georgia State University J. Mack Robinson College of Business Economic Forecasting Center "*Forecast of Georgia and Atlanta*." November, 2008. The University of Georgia Terry College of Business Selig Center for Economic Growth "*Georgia Economic Outlook 2009*".

[5] The University of Georgia Terry College of Business Selig Center for Economic Growth "*Georgia Economic Outlook 2009*".

[6] Peter Orszag and Joseph Stiglitz, "Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?" Center on Budget and Policy Priorities, revised November 6, 2001, http://www.cbpp.org/10-30-01sfp.htm .