

Rainy Day Funds (RDFs)
Presentation for House Ways and Means
Committee
January 29, 2014 - Draft

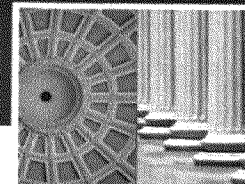
Stephen Klein
Legislative Fiscal Office
Discussion Presentation

Increasing attention on Rainy Day Funds, their size and utility:

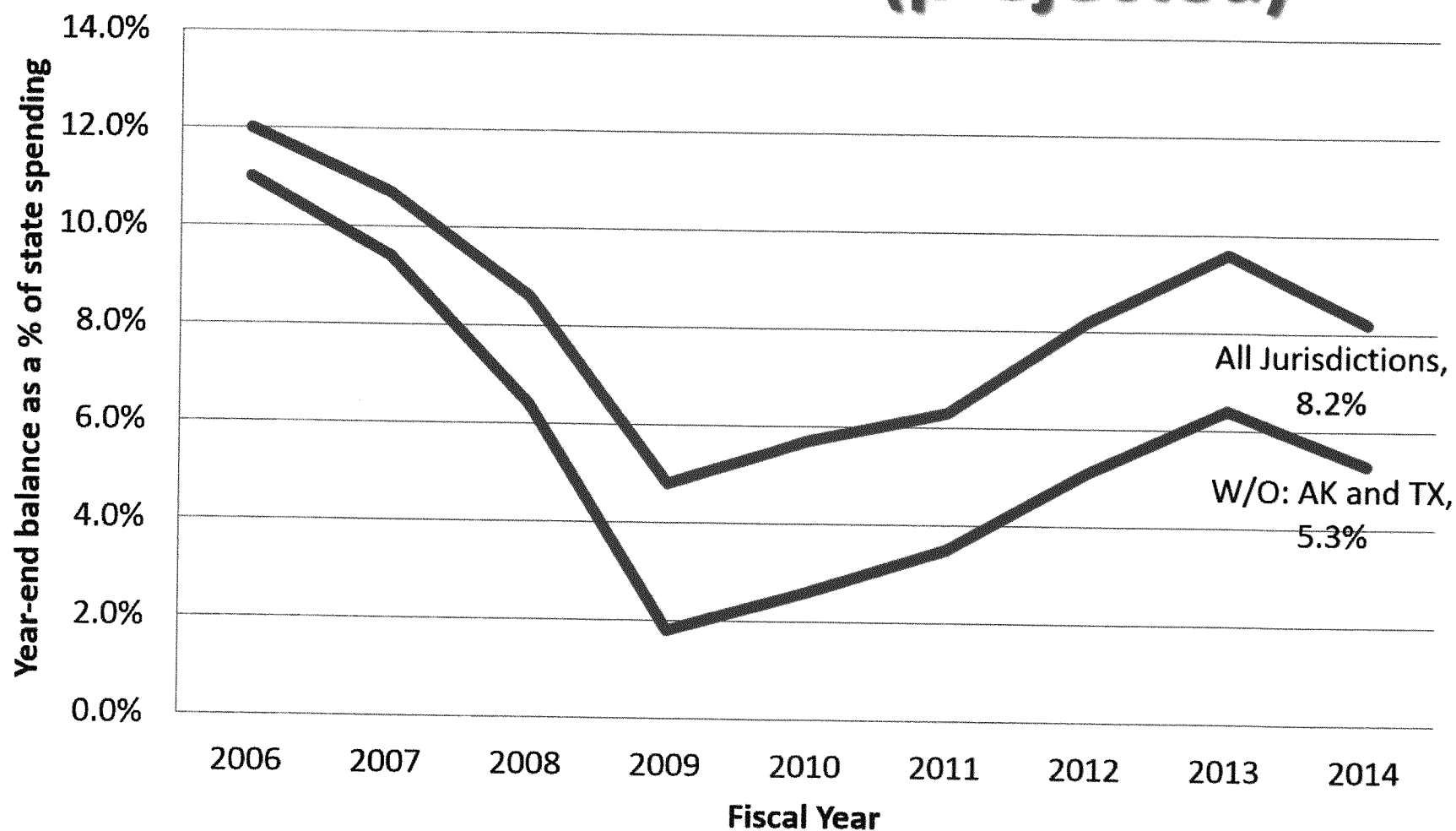
- “Proper Size of Rainy Day Funds”, Bo Zhao, New England Public Policy Center, Federal Reserve Bank of Boston December 3, 2013
- “Revenue Cyclicalality and State Policy Options”, Rick Mattoon and Leslie McGranahan, Federal Reserve Bank of Chicago, December, 2013
- Managing Uncertainty: State Options for Smoothing Revenue Volatility, Brenna Erford, Pew Charitable Trusts, December 2013
- “Why and How States Should Strengthen Their Rainy Day Funds Recession Highlighted Importance of Funds and Need for Improvements”, Elizabeth McNichol and Kwame Boadi, Center for Budget and Policy Priorities, February 2011



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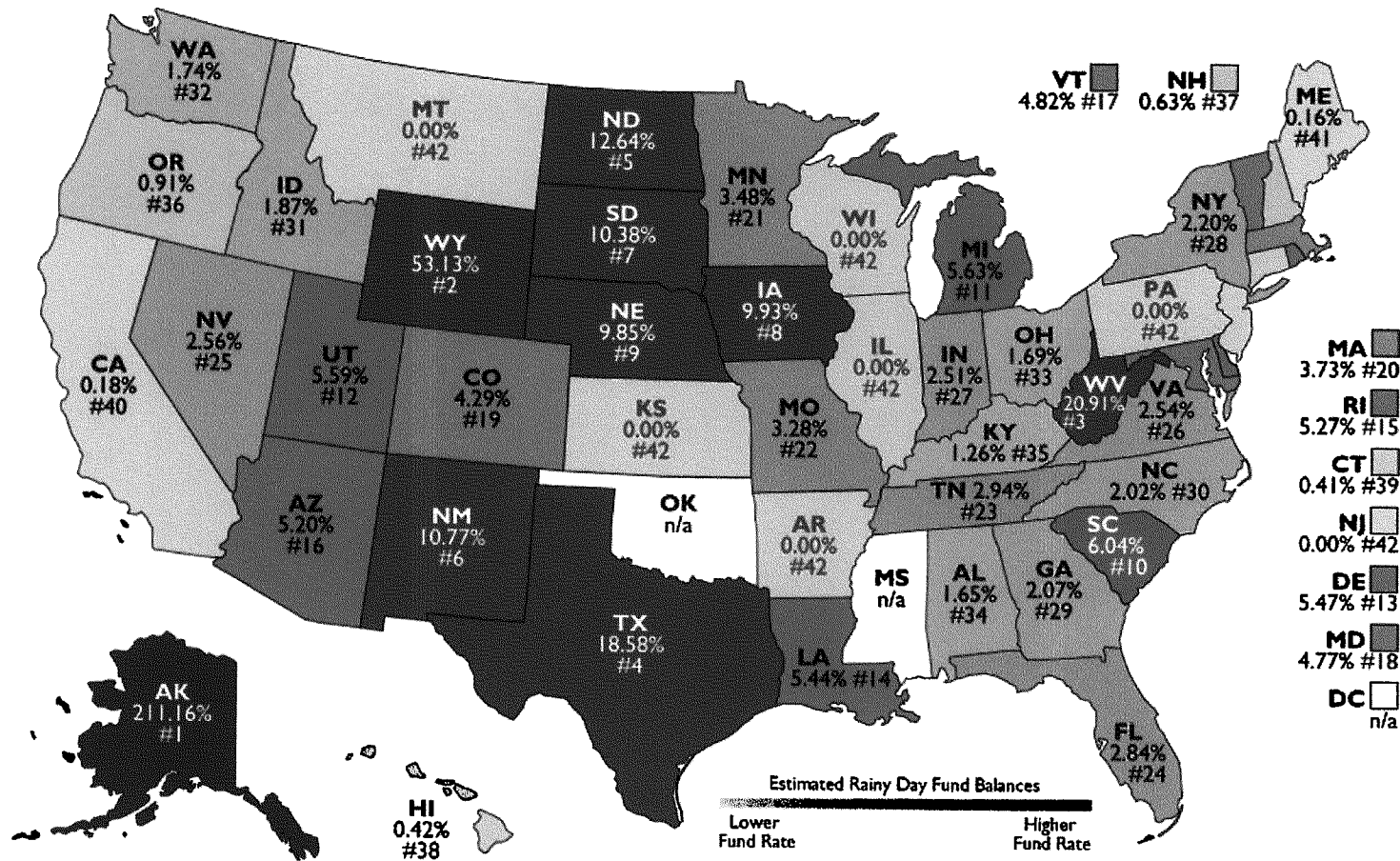


State Year-End Balances FY 2006 to FY 2014 (projected)



Source: NCSL survey of state legislative fiscal offices, various years.

Rainy Day Fund Balance as a Percent of Annual General Fund Spending (FY 2013)



Vermont Reserves

- General Fund/Transportation Fund Stabilization Reserve 5% of prior year Appropriations
- GF Rainy Day Fund \$9.5 million – Total GF 5.7%
- Education Fund 5% prior year net appropriation Est. 4.5-5%
- No reserve for Health Care Resources Fund

“Proper Size of Rainy Day Funds”, Bo Zhao, New England Public Policy Center, Federal Reserve Bank of Boston December 3, 2013

- Business cycles affect state budgets
- To close budget shortfalls states can
 - Raise Taxes and fees: procyclical
 - Cut spending: procyclical
 - Increase borrowing
 - Tap Rainy Day Funds countercyclical
- History
 - NY first adopted in 1945, NE states 1979-1988, **VT 1987**
(Stabilization reserve)
 - 1974-5 recession began wave adoption
 - 45 States have funds

“Proper Size of Rainy Day Funds”, Bo Zhao, New England Public Policy Center, Federal Reserve Bank of Boston December 3, 2013

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Size of RDFs

- GFOA recommends, 2 months operating expenditures 16 percent operating revenues
 - CBPP 2011 equal or >15%
 - Joyce (2001) nothing magical about 5%
 - Nature of NECPP Study: Use filter techniques to separate out cyclical & irregular components
- | | |
|------------------|---|
| VT: Linear trend | 17.1%; HP Filter 11.1%; CF Filter 11.3% |
| US: Linear Trend | 13.7%; HP Filter 11.7%; CF Filter 8.3% |

Managing Uncertainty: State Options for Smoothing Revenue Volatility, Brenna Erford, Pew Charitable Trusts, December 2013

Volatility:

- Influences timing and size of State budget surpluses and shortfalls
- Unpredictability impacts efforts to craft budgets
- Smoothing volatility across business cycles can lessen need for hard choices
- Variation among states on tax revenues alignment with economic performance
- Economic factors and tax policy impact volatility

Recommendations

- States should design reserve funds to smooth budgets across business cycles

Other States

- Limiting Expenditures and ways of building reserves from the current end of the year surpluses – examples from other states:
 - Massachusetts - Stabilization Fund includes inflows from deposits of judgments and settlements in excess of \$10 million, withholding on Lottery winnings taken as lump sum payments and interest earned by the Stabilization Fund.
 - Massachusetts now requires that any capital gains tax revenue collections that exceed \$1 billion annually be deposited in the state's reserves.
 - Washington state voters approved a measure that requires that any “extraordinary” revenue growth — that is, growth that exceeds the 5-year average by more than one-third — be deposited in the state's -rainy day fund.

Other States (2)

- In 2010 Virginia increased its rainy day fund cap to 15% of the average sales and income tax revenues over the past three years (+/- 12% total revenues), the state must make a deposit into the Rainy Day Fund when the growth in corporate income, individual income, and sales tax revenues exceeds the average growth rate over the previous six years. The size of the deposit must equal one-half of the revenue growth in excess of the previous six-year average.
- The Virginia fund may be accessed only if a revenue forecast overstates collections by more than two percent of the certified tax revenues for the prior fiscal year, and then only one-half of the projected shortfall may be covered by the fund. In addition, no more than one-half of the fund may be transferred to the general fund in any fiscal year.
- West Virginia has rainy day fund with a balance equal to 22 percent of the state's expenditures (Number 3 or 4 nationally) is funded automatically; half of all surpluses go to the fund. West Virginia has a two funds structure.