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Rainy Day Fund Strategies: A Call to Action

Prepared by:
William Glasgall

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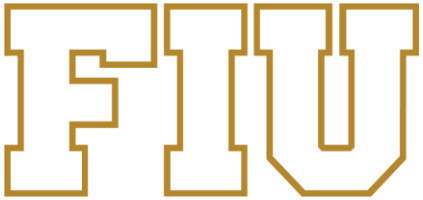
Working for Effective Government

About The Volcker Alliance

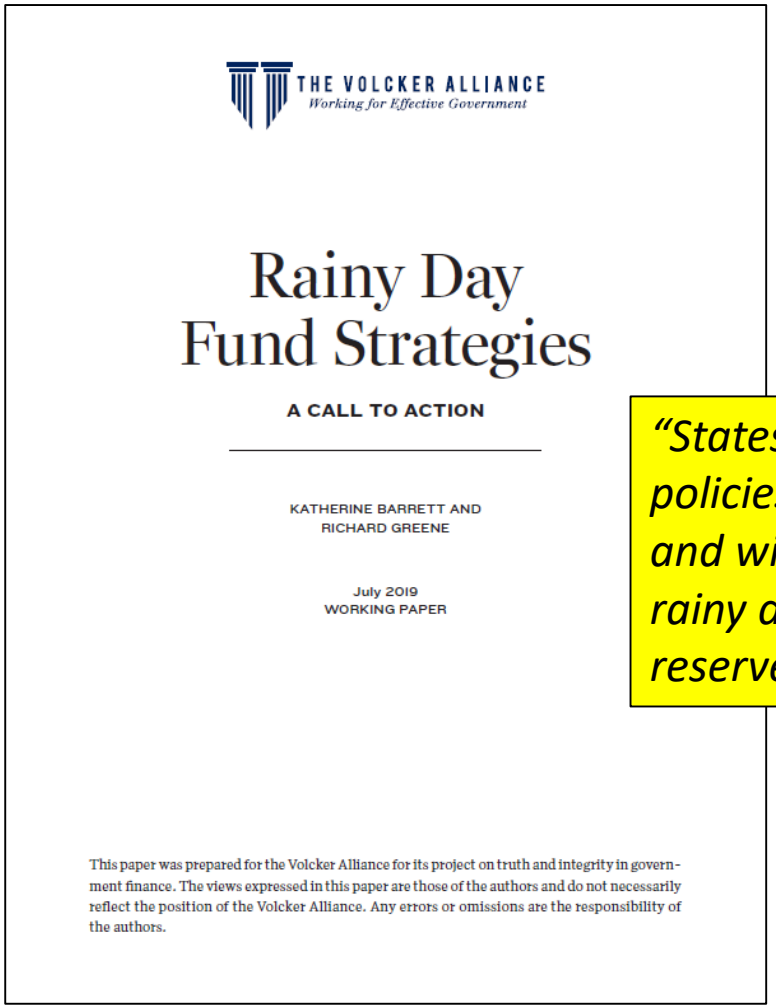
The Volcker Alliance was launched in 2013 by former Federal Reserve Board Chairman Paul A. Volcker, who served in the federal government for almost 30 years.

The mission of the Volcker Alliance is to advance effective management of government to achieve results that matter to citizens.

State Budget Research Network



Best Practices and Guiding Philosophy



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Rainy Day
Fund Strategies

A CALL TO ACTION

KATHERINE BARRETT AND
RICHARD GREENE

July 2019
WORKING PAPER

This paper was prepared for the Volcker Alliance for its project on truth and integrity in government finance. The views expressed in this paper are those of the authors and do not necessarily reflect the position of the Volcker Alliance. Any errors or omissions are the responsibility of the authors.

"States should enact clear policies for deposits into and withdrawals from rainy day and other reserves."

Click on image to download this working paper from VolckerAlliance.org

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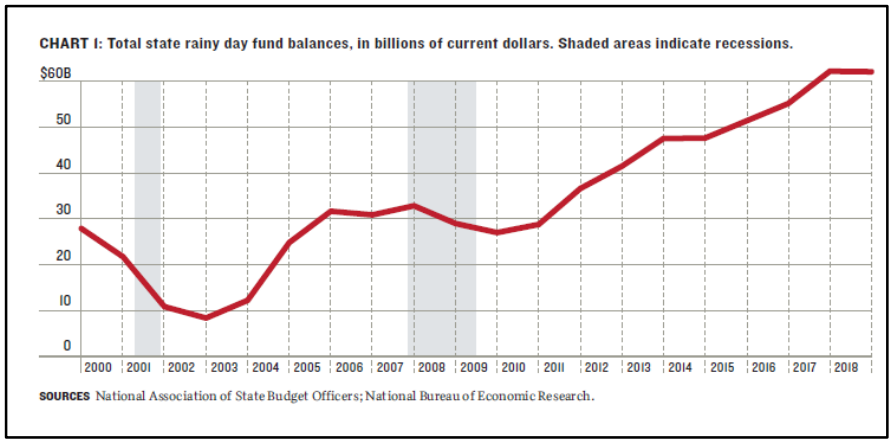
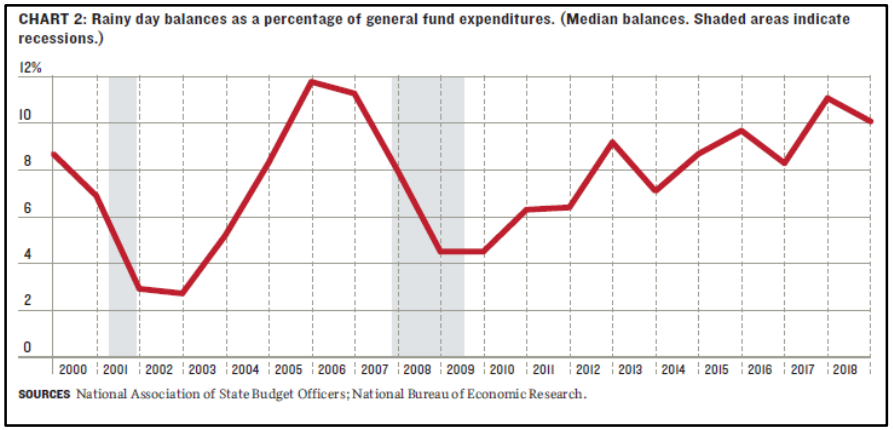
Even in Stressed States, Rainy Day Funds Surge

Three-year Volcker Alliance average reserve trend is higher for 2nd year. State rainy day balances total $68.2 billion, ~ 10% of general fund spending. Balance is highest in 18 years and triple 2011 level.

Sources: Volcker Alliance, NASBO, NBER





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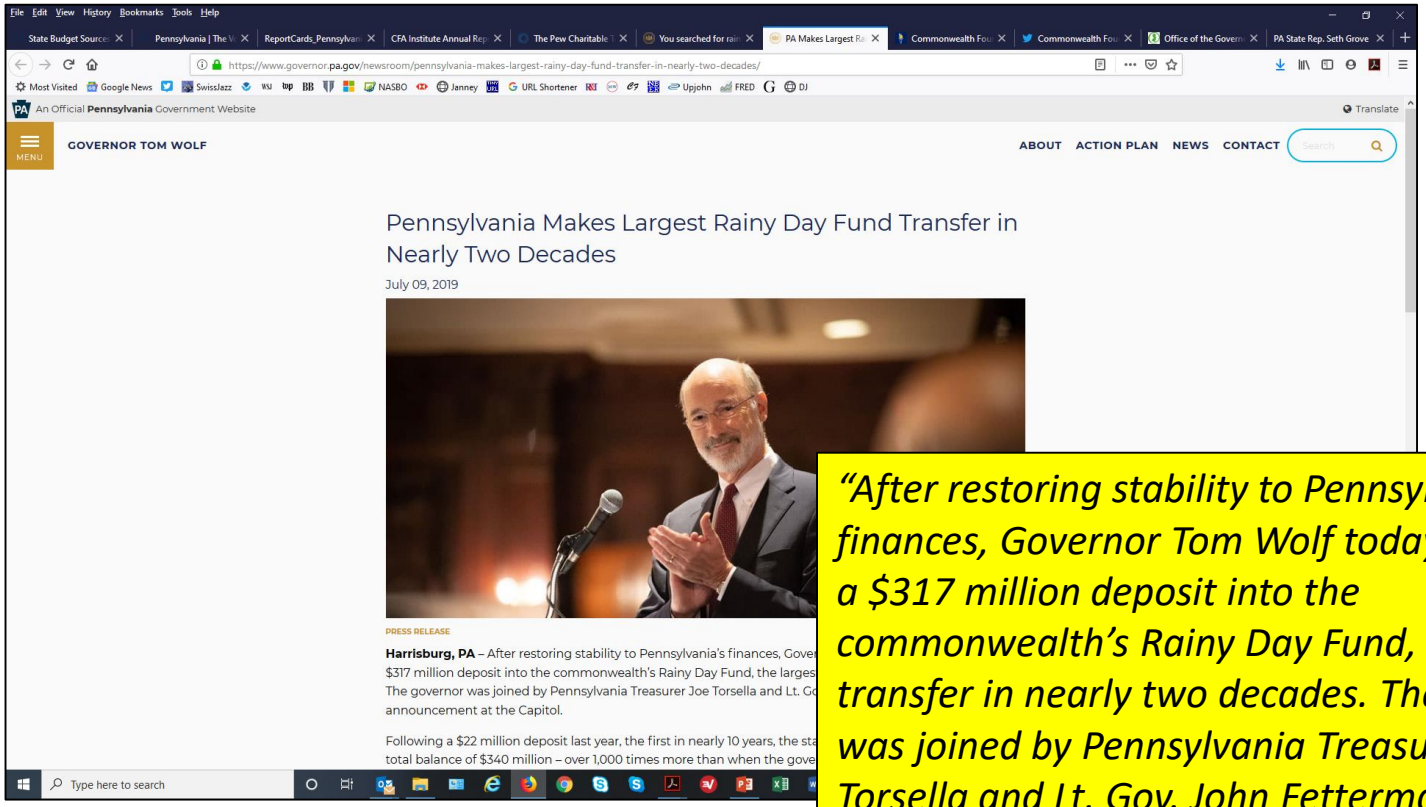
Pennsylvania Bolstering Rainy Day Fund



"After restoring stability to Pennsylvania's finances, Governor Tom Wolf today announced a $317 million deposit into the commonwealth's Rainy Day Fund, the largest transfer in nearly two decades. The governor was joined by Pennsylvania Treasurer Joe Torsella and Lt. Gov. John Fetterman for the announcement at the Capitol. Following a $22 million deposit last year, the first in nearly 10 years, the state's savings account will have a total balance of $340 million – over 1,000 times more than when the governor took office."

New Jersey Makes First Rainy Day Deposit Since Fund Was Drained in 2009

State of New Jersey
Governor Phil Murphy

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Governor Murphy Takes Action on Fiscal Year 2020 State Budget

06/30/2019

Budget Makes Critical Investments in the Middle Class, NJ TRANSIT, Property Tax Relief, and Education

Governor Also Takes Action to Ensure Fiscal Responsibility

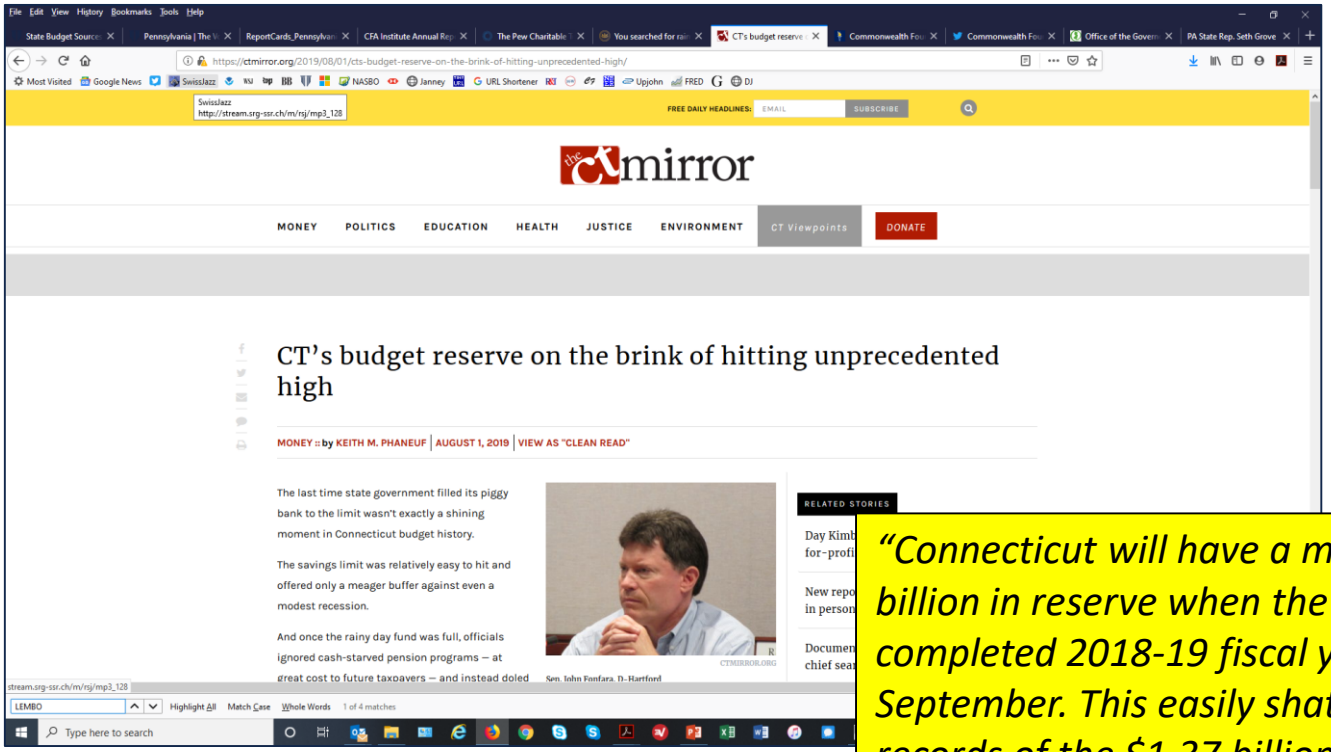
TRENTON – Governor Phil Murphy today signed the Fiscal Year 2020 Appropriations Act into law, growing core investments in education, N
priorities, while taking decisive action to promote the fiscal responsibility that was lacking in the Legislature's spending plan and set up New
economic downturn.

"The budget enacted today is a victory for working families in New Jersey in many different ways—it supports middle-class priorities, inves
NJ TRANSIT, provides property tax relief, and so much more," **said Governor Murphy.** "However, we must be honest about its shortfalls: thi
fairness, does not ask opioid manufacturers to help fund addiction services, and does not raise gun fees that have been untouched since 1
have allowed us to save for a rainy day and sustainably fund necessary investments for New Jersey's nine million residents. Make no mista
fiscal responsibility well beyond today's budget actions."

Careful examination of the Legislature's budget revealed their estimated surplus to be roughly half a billion dollars short due to the use of u
savings assumptions, underfunded programs and services, and supplemental spending legislation passed outside the budget.

"As a result of the Governor's fiscal stewardship, the final $38.712 billion spending plan maintains a total of $1.276 billion in surplus revenues comprised of $875 million in undesignated surplus revenue, and a $401 million deposit into the state's Surplus Revenue Fund (SRF) – the "lock box" commonly known as the Rainy Day Fund – the first such deposit in more than a decade."

Connecticut Rainy Day Fund Poised to Reach Record Level



"Connecticut will have a more than $2.3 billion in reserve when the audit of the just-completed 2018-19 fiscal year is done in late September. This easily shatters the previous records of the $1.37 billion the state held as late as June 2009. More importantly, the $2.3 billion represents 12 percent of annual operating expenses, topping the 8 percent mark also set in 2009."

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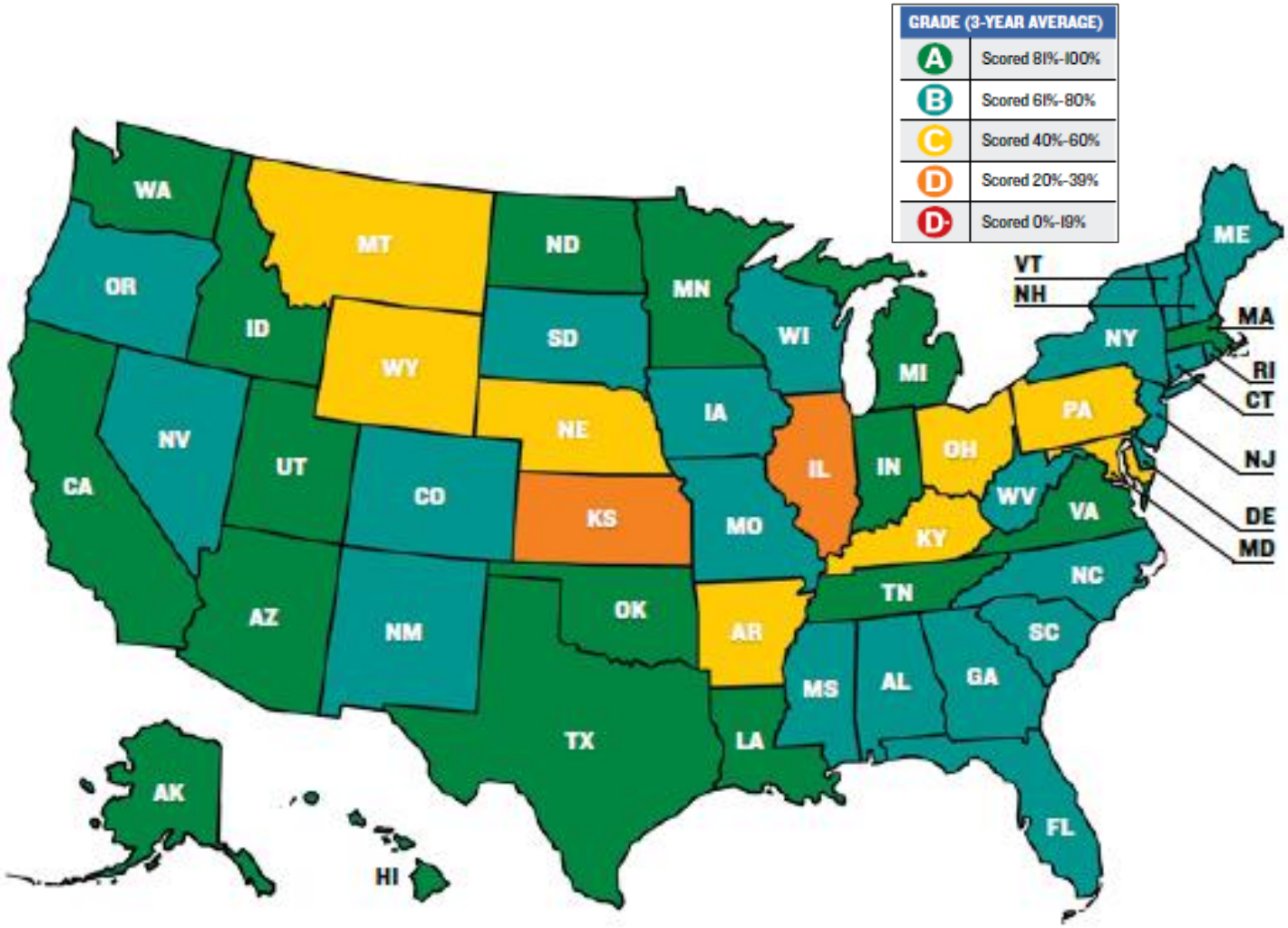
Reserve Funds Average Grades, FY 2016-18

Trend ↗ : 17 get an A, only 10 graded C or worse



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Rainy Day Funds 101: Enact Clear Withdrawal Policies

Only seven states lack or have limited policies for rainy day fund withdrawals: IL, KS, KY, MD, NE, OH, WY.

CALL TO ACTION

Establish Rules to Govern Withdrawals

ACTION Instead of giving a governor or legislature discretionary power to tap rainy day funds, establish formulas directing when and how reserves can be tapped.

BEST-PRACTICE EXAMPLE Indiana statutes permit transfers from the Counter-Cyclical Revenue and Economic Stabilization Fund to the general fund only when revenues have decreased by more than 2 percent from one fiscal year to the next.[1]

WHY THIS MATTERS Statutes defining appropriate uses of budget stabilization funds establish a framework for decisions about drawing down cash.

1. Ind. Code § 4-10-18-4, https://www.volckeralliance.org/indiana-rdf-example.

Rainy Day Funds 101: Establish Replenishment Rules

Just two states (AK, KS) lack replenishment statutes.

CALL TO ACTION

Set a Fund Replenishment Plan

ACTION Establish a reasonable and reliable schedule for replenishing rainy day funds after withdrawals.

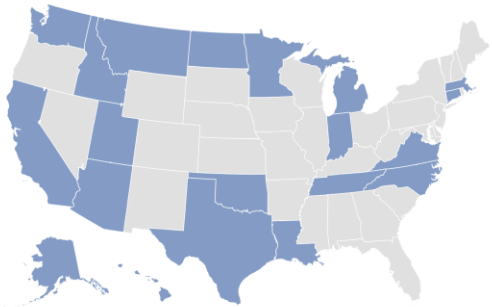
WHY THIS MATTERS
A predetermined replenishment schedule assures that money will be in the fund when it is next needed.

BEST-PRACTICE EXAMPLE In Florida, an expenditure from the state's Budget Stabilization Fund must be restored in five equal annual transfers from its General Revenue Fund, although the legislature may make exceptions. Payments begin in the third fiscal year after a withdrawal.[1]

1. Fla. Stat. § 215.32 (1)(c), https://www.volckeralliance.org/florida-rdf-example.

Rainy Day Funds 101: Formally Link Rainy Day Funds to Revenue Volatility

- 20 states now consider revenue volatility in determining adequacy of reserves.



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CALL TO ACTION

Use Revenue Volatility to Guide Reserve Policies

ACTION Consider the volatility of tax revenues when calculating the adequacy of reserves.

WHY THIS MATTERS
The more volatile a state's revenue streams, the more likely it is that unexpected downturns will occur. Typical drivers of such volatility may include capital gains and other income taxes, as well as severance levies. Formally considering this volatility when calculating the ideal amount of cash in a rainy day fund may help prevent tax increases or program cuts.

BEST-PRACTICE EXAMPLE
Minnesota's commissioner of management and budget develops and annually reviews a methodology for evaluating the adequacy of the budget reserve account. These reviews consider volatility of the state's general fund tax structure and economy.[1]

1. Minn. Stat. §16A.152, https://www.volckeralliance.org/minnesota-rdf-example.

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Case Study: Pennsylvania Budget FY 2016-18

Reserve Strengths:

✓ Existence of withdrawal and replenishment policies.

Reserve Weaknesses:

x Replenishment policies could be stronger;

x Inconsistent balances;

x Lack of rainy day fund link to revenue volatility.

PENNSYLVANIA Budget Report Card

BUDGET FORECASTING	2016	2017	2018
CATEGORY GRADE	B	B	B
Consensus Revenue Forecasts	✗	✗	✗
Multiyear Expenditure Forecasts	✓	✓	✓
Multiyear Revenue Forecasts	✓	✓	✓
Revenue Growth Projections	✓	✓	✓
	3-YEAR AVERAGE B		3-YEAR TREND —

BUDGET MANEUVERS	2016	2017	2018
CATEGORY GRADE	D	D	D
Deferring Recurring Expenditures	✗	✗	✗
Revenue and Cost Shifting	✗	✗	✗
Funding Recurring Expenditures with Debt	✓	✗	✗
Using Asset Sales and Up-Front Revenues	✗	✗	✗
	3-YEAR AVERAGE D		3-YEAR TREND ↘

LEGACY COSTS	2016	2017	2018
CATEGORY GRADE	D	D	D
Public Employee OPEB Funding	✗	✗	✗
Public Employee Pension Funding	✗	✓	✓
Public Employee Pension Funded Ratio*	53%	55%	55%
	3-YEAR AVERAGE D		3-YEAR TREND ↗

RESERVE FUNDS	2016	2017	2018
CATEGORY GRADE	B	C	C
Positive Reserve or General Fund Balance	✓	✗	✗
Reserve Funds Disbursement Policy	✓	✓	✓
Reserve Funds Replenishment Policy	✓	✓	✓
Reserves Tied to Revenue Volatility	✗	✗	✗
	3-YEAR AVERAGE C		3-YEAR TREND ↘

TRANSPARENCY	2016	2017	2018
CATEGORY GRADE	B	B	B
Consolidated Budget Website	✓	✓	✓
Provides Debt Tables	✓	✓	✓
Discloses Deferred Infrastructure Replacement Costs	✗	✗	✗
Discloses Tax Expenditures	✓	✓	✓
	3-YEAR AVERAGE B		3-YEAR TREND —

How Pennsylvania Governs its Rainy Day Fund

State Policies for Rainy Day Fund Withdrawals…

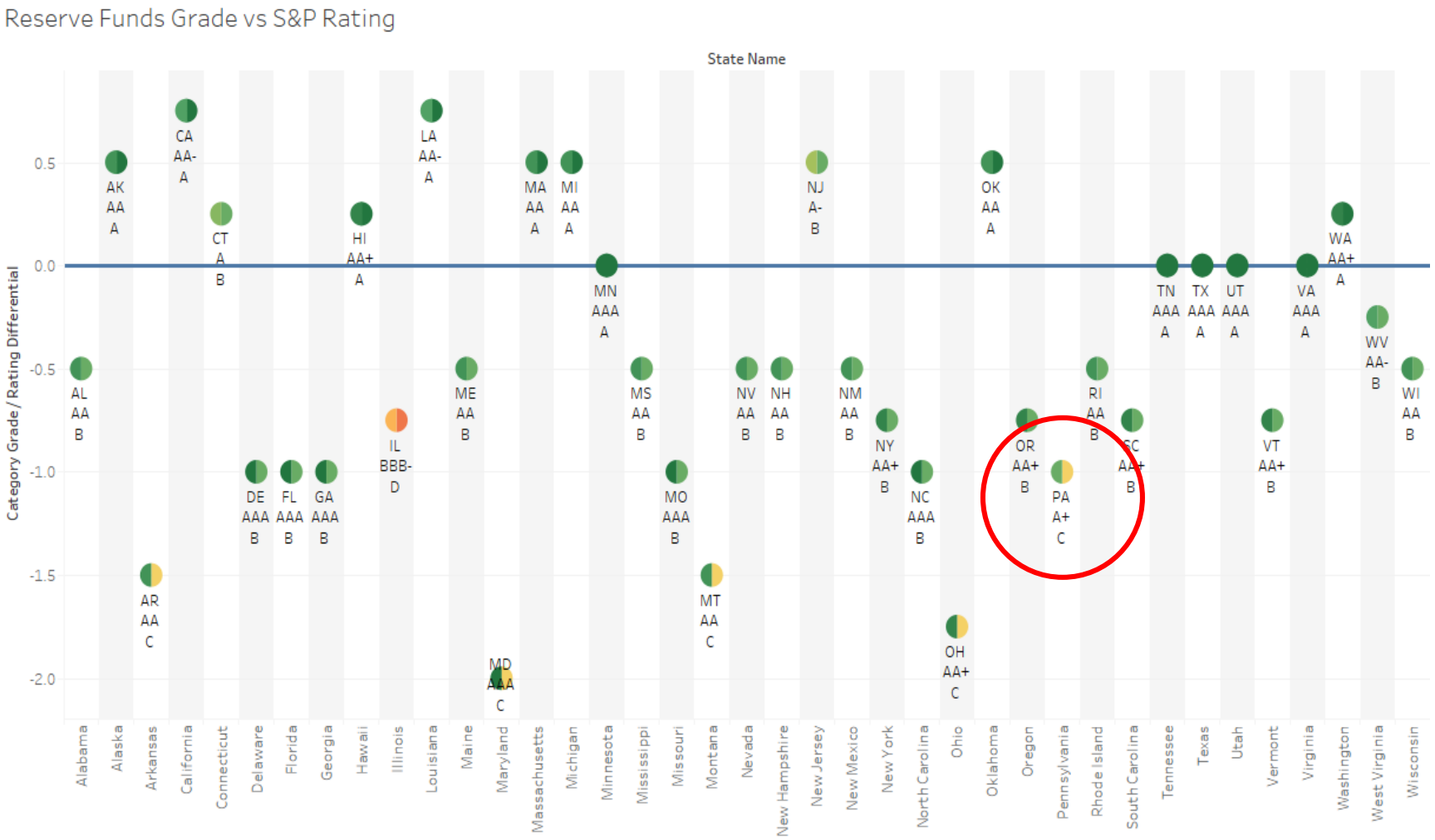
Revenue Shortfall	Revenue Growth Below Trend	Economic Downturn	Health/Safety Emergency	Misc. Other	Supermajority for Some Spending
✓		✓	✓		✓

…And Policies for Replenishments

Dedicated Funding Source	Irregular Funding Source	Surplus	Revenue Above Estimate	Funding Formula	Defined Replenishment Period
		✓			

Budget Grades and Credit Ratings

Would Fatter, More Consistent Reserves Help PA's Credit Grade?



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Questions?

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