POLICY brief

Washington Research Council

PB 07-07 March 1, 2007

One Thing You Can Count on in Olympia is a Rainy Day

BRIEFLY

The senate recently forwarded to the house a proposed constitutional amendment to create a "rainy day fund.". If approved by the house and by voters in November, the state would set aside 1 percent of general state revenues each year to be saved for use in the event of a recession. The fund would alleviate some of the strain put on government resources during a recession and help avoid tax increases.

With recovery from the 2001–03 fiscal crisis complete, policy makers are reevaluating Washington State's system of reserve funds. Currently 45 states have some type of "rainy day fund." These funds are intended to help moderate the ups and downs in state spending over the course of the business cycle.

Initiative 601, approved by Washington's voters in 1993, established a statutory rainy day fund, the emergency reserve fund, which was to receive all general fund-state revenues in excess of the I-601 expenditure limit. Budget writers, however, have found it too easy to divert money from the emergency reserve fund (often by manipulating the I-601 limit) for it to function as an effective cushion.

Several pieces of legislation have been introduced this session that would embed a stronger rainy day fund in the state constitution. The senate recently passed ESSJR 8206 (a proposed constitutional amendment) and SB 5311 (the related implementing bill). If ESSJR 8206 is approved by the house and by voters in November, the state would set aside 1 percent of general state revenues each year to be saved for use in the event of a recession. An alternate amendment introduced in the house (HJR 4207) would set aside 3 percent of general state revenues for this purpose.

When It Rains, It Pours

A rainy day fund is a way to alleviate some of the strain put on government resources during a recession. Typically, in periods of high growth tax revenues increase and demand for government support services is less pressing. The opposite is true in a recession; tax revenues decrease and demand for government services increases.

Legislators tend towards budget bulimia, greatly increasing spending in good years when tax revenues are high and then drastically cutting spending in economic downturns. The rainy day fund would dampen this cycle, setting aside a portion of the revenues from good years to limit spending cuts in lean years.

Legislation

This session there have been several proposals to create a constitutional rainy day fund.

The governor's proposal for a Budget Stabilization Account recently passed in the senate. If passed in the house and approved by voters in November, ESSJR 8206 will require 1 percent of general state revenues be put into the account each biennium. If the fund ever grew beyond 10

Washington Research Council
108 S Washington St., Suite 406
Seattle WA 98104-3408
voice: 206-467-7088
fax: 206-467-6957
www.researchcouncil.org

percent of general state revenues, the excess could be used for school construction.

In bad years money could be withdrawn from the fund with a majority vote of both houses, where a bad year is defined as a year with employment growth below 1 percent. The funds would also be accessible with a simple majority vote in the legislature "if the governor declares a state of emergency resulting from a catastrophic event that necessitates government action to protect life or public safety." Without the one percent trigger or declaration of emergency the funds can be accessed only with a super majority vote (60 percent) in both houses.

The governor plans to deposit $262 million into the fund initially. This amount is equal to 1 percent of projected general state revenues for the 2007–09 biennium. Subsequently, 1 percent of general state revenues would be deposited automatically each year. Annual deposits are projected to be around $150 million (OFM).

HJR 4207, introduced in the house, would require 3 percent of general state revenues be deposited into the Budget Stabilization Account. Under this bill the funds could be accessed with a simple majority vote if employment growth is forecast below 1 percent but, unlike the governor's proposal, this bill would require a super majority to access the funds upon a declaration of emergency.

Under this proposal the state reserve account would be allowed to grow to 7 percent of general state revenues. Revenues in excess of this amount would be deposited into a debt retirement fund, which would then be used for debt service on state bonds.

Discussion

Not everyone is excited about the savings account. House appropriations committee chairwoman Helen Sommers has reservations about locking up the funds and limiting the legislatures budgeting authority. Other legislators believe the super majority rules make it too difficult to access the funds. And still others feel that allowing the funds to be accessed anytime the governor declares an emergency will lead to misuse.

None of these concerns is unfounded. However, on balance, as we have stated in the past, we believe that a rainy day fund is good fiscal policy and will help Washington weather future economic storms.

We also believe this fund should not be the sole repository of reserves for the state. Rather, the rainy day fund should be complimented by a healthy reserve held in the general fund itself. In particular, the BSA initially will hold a relatively small amount of money. Its creation in no way obviates the need for legislators to write a budget for 2007–09 that preserves a substantial reserve in the general fund.

References

Office of Financial Management (OFM). 2007. *Policy Brief* : *Rainy Day Fund*.

Texts of ESSJR 8206, SB 5311 and HJR 4207 can be found on the web at: http://apps.leg.wa.gov/billinfo/