

NEWS RELEASE



CENTER ON BUDGET AND POLICY PRIORITIES

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FISCAL CRISIS SHOWS NEED TO IMPROVE STATE RESERVE FUND POLICIES

The economic downturn has demonstrated the weaknesses in many states' policies regarding state reserve funds (or "rainy day funds"), according to a new study by the Center on Budget and Policy Priorities. The study, which provides state-by-state data on reserve fund balances and policies, describes how states can strengthen these funds to prepare themselves better for the next recession.

"States' reserves at the start of the current downturn were more than twice as big a share of total state expenditures as at the start of the recession of the early 1990s," stated Robert Zahradnik, the study's lead author. "But even that higher amount wasn't enough, and only a few states have significant and accessible reserves left. This is a good time for states to improve their rainy day fund policies: it won't cost any money in the short term, and the very real pain states are currently experiencing has created a powerful incentive for reform."

Current Rules Make Amassing, Spending Funds Too Difficult

One common problem is overly-restrictive limits on the size of rainy day funds. In 19 states, the fund may not exceed 5 percent of state spending, an inadequate amount given that state budget shortfalls have averaged close to 10 percent of state spending in fiscal years 2002, 2003, and 2004. In addition, most states make deposits in reserve funds only after the fiscal year has ended, so these deposits often are squeezed out by various tax and spending initiatives that are seen as higher priorities. Other problems are caused by state rules that make it difficult to obtain the funds during a downturn or require the state to replenish its reserves too soon after drawing on them.

The current state fiscal crisis "shows that reserve funds can help cushion the effects of a downturn," says Zahradnik. "States have used around \$23 billion in reserves in the past two years to help close their budget gaps, so their spending cuts and tax increases would have been \$23 billion worse without these reserves. But the fiscal crisis also shows that states need to do a better job in this area."

The Center report, *Heavy Weather: Are State Rainy Day Funds Working?*, is available at <http://www.cbpp.org/5-12-03sfp.htm>.

The Center on Budget and Policy Priorities is a nonprofit, nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs. It is supported primarily by foundation grants.

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