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# States Should Improve the Design of Their Rainy Day Funds

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States must balance their budgets even when they face recessions and other unexpected shocks to their revenues. Rainy day funds and other reserves are some of the most important tools they have to preserve the services that people need always and especially during economic downturns. But today many states do not save enough. A separate challenge is that many states with reserves don't use them assertively, even when they are most needed, in part because of antiquated and backward rules that states should change.

Rainy day funds buy time for states at the start of a downturn, allowing them to maintain programs and retain workers without major tax increases or spending cuts. States can use this time to determine how severe the downturn is and what federal assistance will likely come, and to develop well-thought-out plans to address the downturn and put families and communities first.

The three recessions the nation has faced since 2000 highlight the importance of adequate and well-designed rainy day funds and expose the current funds' flaws. For example, some states had inadequate reserves to weather the Great Recession and the current pandemic because they lack formal rules to make deposits in good times or because they restrict the size of their reserves at inadequate levels. Even some states with adequate reserves found it hard to use them because of withdrawal limits and rules requiring them to replenish funds before they are ready, for example before economic conditions have improved. And many states were hesitant to tap reserves because of an overly cautious and incorrect view of how using reserves might affect their credit rating, despite clear indications that bond rating agencies see rainy day reserves as important tools to cope with economic downturns.

Right now, states should focus on helping people and building to a better future. They should not start rebuilding reserves until they have adequately addressed the hardships people are facing. They should not deposit federal aid in their rainy day funds.[2] They may not need to *spend* their reserves now, given unprecedented levels of federal aid. But what they can do now is improve the design of their rainy day funds, so they are positioned to have adequate and useable ones when the next downturn arrives.

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[1] Abigail Magnus and Michael Johnson, Jr. provided research assistance for this report.

[2] The American Rescue Plan prohibits states from depositing the aid it provides in rainy day funds.

The pandemic-induced recession is different from past recessions in ways that underscore the need to improve rainy day funds. Its onset was more sudden and deeper and its impact was even more uneven than recent downturns. Low-income families and communities of color have faced devastating job loss and food insecurity, and their health remains at great risk. Meanwhile the incomes of the wealthiest have generally been spared and high-income families have maintained better access to health care, housing, and education. The health crisis, need for social distancing, and dramatic increase in poverty have also put extraordinary pressure on state budgets beyond what a typical recession brings.

As in past downturns, at this one's start states with well-stocked reserves could use them to maintain economic security programs and address some unplanned costs even as revenues plummeted. But the long-standing and deep divides that the pandemic revealed and worsened made clear that the nation requires more than just a return to the pre-pandemic status quo.

The federal aid states will receive from the American Rescue Plan — which is much more generous than that provided in recent recessions — is an opportunity for states to address these deep divides. The aid is intended to be spent, not socked away in reserves. If states use rebounding revenues and federal aid for new investments in education, child care, infrastructure, and other areas, they must sustain these investments if they are to bring the transformative change needed to reduce inequities now and in the future.

That will first require states to build revenue systems capable of sustaining the investments once the federal aid has expired. But states must also go further than simply restocking their reserves to (often inadequate) pre-pandemic levels. They must improve their rainy day funds' design so that, at the first sign of the next recession, their reserves are both large enough to protect against layoffs and service cuts and accessible enough to ensure that new investments are not at risk.

States with inadequate or restrictive rainy day funds should:

- increase the target size of their funds and perform periodic stress tests to determine their adequacy;
- remove rainy day fund rules that make it difficult for them to make deposits in good times;
- remove too-rapid replenishment rules that hinder use of reserves as intended; and
- scale back limits on funds' use.

## Why States Should Build Adequate Rainy Day Funds and Use Them During Downturns

States, unlike the federal government, must balance their budgets each year. Thus, all states need robust rainy day funds and they should tap them when revenues decline unexpectedly. That's because:

- **It helps states avoid cutting economic security programs on which people rely during economic crises.** Health care, food assistance, and cash assistance help people keep their homes, stay healthy, and put food on the table, especially when job opportunities decline and people risk losing their employer-sponsored health coverage.[3] Using rainy day funds can ensure that these supports are available to all eligible families when they need them the most. Otherwise, states may cut these services, likely worsening the crisis as people get evicted from their homes or can't afford healthy food.

- **It buys states time to enact policies that put families and communities first.** The first measures that states often take in recessions — especially drastic budget cuts — can deepen and prolong recessions while worsening barriers to prosperity for people with low incomes and people of color, who, due largely to long-standing inequities, have faced disproportionate harm from the pandemic's health and economic effects.[4] For example, following the Great Recession, states relied too heavily on cuts that resulted in unemployment systems that are ill equipped for today's economy[5] and that led to permanent teacher shortages.[6] States also imposed higher fines and fees, which ask the most from people with the least ability to pay, particularly low-income communities of color.[7]

  Tapping rainy day funds can let states take a more measured budget-balancing approach that preserves spending needed during a recession and limits the need for immediate tax increases. This lays the groundwork for a more equitable recovery. Historical racism and ongoing forms of discrimination and bias leave people of color, on average, with much less income and wealth than they would have otherwise. Economic security programs are key to helping them overcome these barriers. Past and present state policies are part of what created and sustain these inequities, so states have an obligation to make progress in reversing them, especially during recessions.[8]

- **It keeps money flowing through state economies.** Taking money out of state savings and putting it to work during an economic downturn makes good sense. It keeps money circulating through the state's economy and minimizes layoffs and furloughs for first responders, teachers, health care workers, and others who are especially needed during the pandemic and other crises. Rainy day fund spending also helps fuel state economies when people can't buy as much because so many are out of work.

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[3] Sharon Parrott *et al.*, "Building an Equitable Recovery Requires Investing in Children, Supporting Workers, and Expanding Health Coverage," CBPP, March 24, 2021, https://www.cbpp.org/research/poverty-and-inequality/building-an-equitable-recovery-requires-investing-in-children.

[4] Erica Williams and Cortney Sanders, "3 Principles for an Antiracist, Equitable State Response to COVID-19 – and a Stronger Recovery," CBPP, updated April 29, 2021, https://www.cbpp.org/research/state-budget-and-tax/3-principles-for-an-antiracist-equitable-state-response-to-covid-19.

[5] Heather Long and Abha Bhatterai, "As layoffs skyrocket, the holes in America's safety net are becoming apparent," *Washington Post*, March 19, 2020, https://www.washingtonpost.com/business/2020/03/19/unemployment-insurance-today-coronavirus/.

[6] Leib Sutcher, Linda Darling-Hammond, and Desiree Carver-Thomas, "A Coming Crisis in Teaching? Teacher Supply, Demand, and Shortages in the U.S.," Learning Policy Institute, September 15, 2016, https://learningpolicyinstitute.org/product/coming-crisis-teaching.

[7] Matthew Menendez *et al.,* "The Steep Costs of Criminal Justice Fees and Fines," Brennan Center for Justice, November 21, 2019.

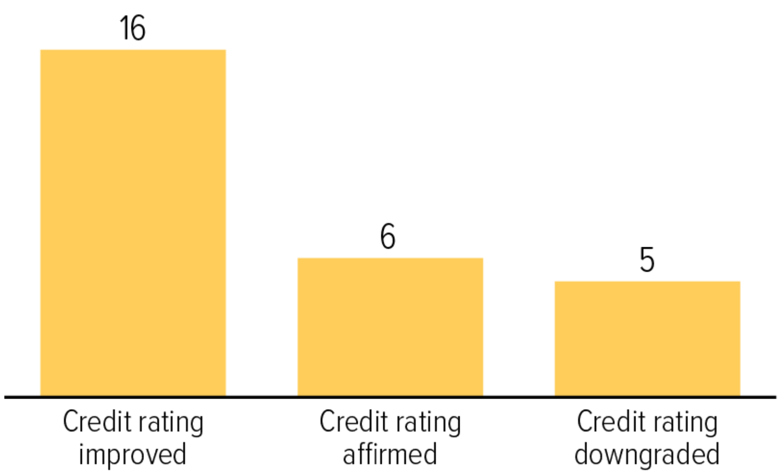
[8] Erica Williams, "States Should Adopt Policies to Help Dismantle Racial Barriers to Broader Prosperity," CBPP, September 13, 2018, https://www.cbpp.org/blog/states-should-adopt-policies-to-help-dismantle-racial-barriers-to-broader-prosperity.

- **Credit rating agencies see rainy day funds as important financial stabilization tools and support states using their reserves during downturns.** Credit rating agencies encourage states to maintain rainy day funds. They also generally expect states to draw on the funds during a recession or after a natural disaster. And they likely won't downgrade states' credit, if states use the reserves in line with their intended purposes and rebuild those reserves in a reasonable time frame after the recession ends, as most have done since the Great Recession.[9] For example, 40 states tapped their funds from 2008 to 2010 but of those whose credit ratings Moody's Analytics reviewed, only five suffered a downgrade. (See Figure 1.)

FIGURE 1

**Most States Using Rainy Day Funds in Great Recession Kept or Boosted Their Credit Rating**

States reviewed by Moody's and that used rainy day funds, 2008-2010




Source: Moody's Analytics

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## States' Failure to Build and Tap Reserves Has Been Costly

The economy's ups and downs since 2000 have highlighted the importance of rainy day funds. Designated rainy day funds and unrestricted general fund balances serve as a state's first line of defense against the budget pressures caused by declining revenues and the rising need for public services during a downturn. For example, states used both of these to avert over $20 billion in cuts to services and/or tax increases in each of the two recessions of the 2000s. But states would have weathered the storms better with bigger and more effective rainy day funds. (This report focuses on improvements to rainy day funds because, in any period other than one of extremely rapid economic growth, it is difficult for a state to build up its balances without setting money aside in a rainy day fund.) States entered the Great Recession of 2007-09 with then-record reserves[10] of close to 11

[9] Pew Charitable Trusts, "Rainy Day Funds and State Credit Ratings," May 2017, https://www.pewtrusts.org/-/media/assets/2017/05/statesfiscalhealth_creditratingsreport.pdf.

[10] Reserves here refer to both the balance in rainy day funds and unrestricted general fund ending balances.

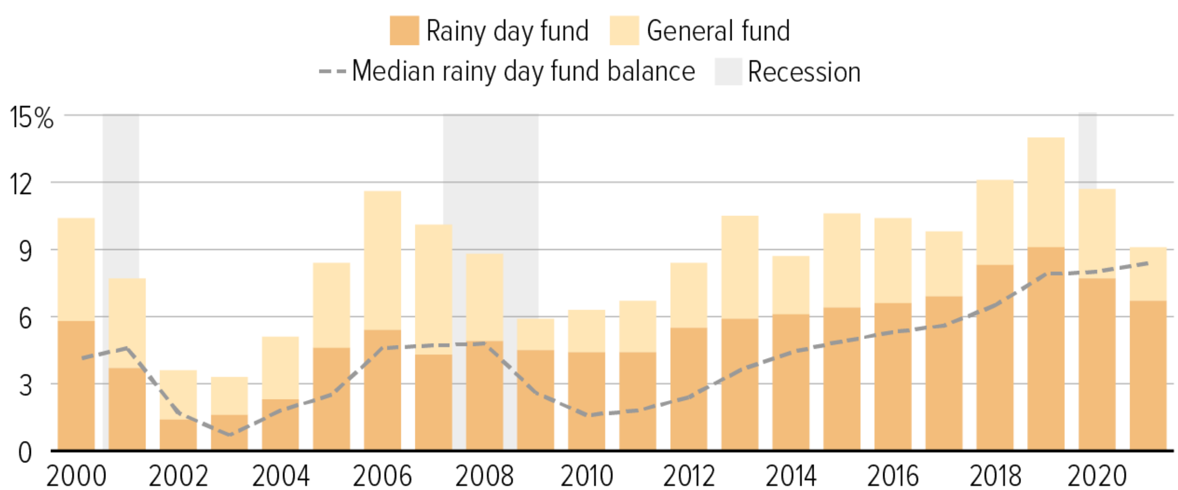
percent of state spending. Yet these reserves filled only a modest share of states' record-setting budget gaps in what was the deepest recession in 70 years. Only 9 percent of these gaps were closed with reserves.[11]

After draining general fund reserves to a low of 2.4 percent of spending in state fiscal year 2010, states refilled them. While some states lagged, as a whole they restored their reserves to pre-Great Recession levels before the pandemic hit. Reserves reached 14 percent of spending by the end of fiscal year 2019. (See Figure 2.) Most states (38) had general fund balances of 10 percent or more of their budgets. (See Table 1 and Appendix Table 1.)

FIGURE 2

**States Build Reserves During Good Times for Use During Bad Times**

States' average rainy day fund and general fund balances as a share of yearly spending




Source: CBPP calculations of National Association of State Budget Officers data

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Then in the spring of 2020 state revenues plunged because of lockdowns and job losses. Economists and state revenue forecasters were projecting deep revenue declines that could last up to a year but these projections were very uncertain because of the pandemic's unprecedented nature.

In the face of these uncertain declines, 18 states used their reserves to avoid spending cuts or tax increases and in total used only about one-quarter of their reserves. By the fall of 2020, these states had transferred funds out of their rainy day funds or other reserves to replace lost revenue in either or both of fiscal years 2020 and 2021.[12] Total state balances were projected to decline by $33.3 billion (27 percent) in 2021 compared to 2019. This means that most states did not use their reserves

[11] Elizabeth McNichol, "Out of Balance: Cuts in Spending have Been States' Primary Response to Budget Gaps, Harming the Nation's Economy," CBPP, April 18, 2012, https://www.cbpp.org/research/out-of-balance.

[12] National Association of State Budget Officers, "The Fiscal Survey of the States: Fall 2020," December 2020, https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Fall_2020_Fiscal_Survey_of_States_S.pdf.

at all and those that did tapped only a fraction of their rainy day funds, despite the steepest and fastest economic downturn in memory.

The failure of many states to quickly tap available reserves resulted in avoidable spending cuts. Some states and localities started slashing spending almost immediately in April and May 2020 once the severity of the crisis became clear. For example, governors in Colorado, Missouri, and Ohio used their executive authority to enact emergency cuts for the final months of fiscal 2020.[13]

Many states waited to impose lasting, larger-scale cuts, hoping for additional federal aid and seeking a better sense of where the economy was headed.[14] But by June, states had furloughed or laid off over 5 percent of their workforce. As of March 2021, states and localities employed 1.2 million fewer workers than they did in February 2020 (the month before the pandemic took hold in the United States), a substantially larger drop than in the aftermath of the Great Recession.[15] Black workers were likely employed disproportionately in the jobs being cut. For example, nearly half of Black women are employed in education, health services, or public administration — the main industries of state and local government.[16]

TABLE 1

**State General Fund Balances, by Size, Year, and Number of States**

| Size (as share of general fund) | 2006 | 2019 | 2020 |
| --- | --- | --- | --- |
| **20%+** | 8 | 12 | 11 |
| **15% - 20%** | 9 | 10 | 6 |
| **10% - 15%** | 15 | 16 | 18 |
| **5% - 10%** | 9 | 7 | 10 |
| **0% - 5%** | 9 | 5 | 5 |
| **20%+** | 8 | 12 | 11 |

Source: NASBO Fiscal Survey of the States

By the start of the 2021 budget year (July 1, 2020 in most states), more were revisiting their spending plans in order to make cuts, despite many still having reserves to draw on:

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[13] Elise Schmelzer and Sam Tabachnik, "Gov. Jared Polis limits evictions, cuts immediate state spending by $228.7 million," *Denver Post*, May 7, 2020, https://www.denverpost.com/2020/05/01/polis-coronavirus-covid-state-spending/; Jack Suntrup, "Parson announces more Missouri budget cuts: K-12 education takes a $133 million hit," *St. Louis Post-Dispatch*, June 1, 2020, https://www.stltoday.com/news/local/govt-and-politics/parson-announces-more-missouri-budget-cuts-k-12-education-takes-a-133-million-hit/article_c4dd46f2-d201-5abc-8e14-c6795e62d496.html; Randy Ludlow, "Coronavirus in Ohio: $775 million in budget cuts due to pandemic include $300 million reduction to schools," *Columbus Dispatch*, May 5, 2020, https://www.dispatch.com/news/20200505/coronavirus-in-ohio-775-million-in-budget-cuts-due-to-pandemic-include-300-million-reduction-to-schools.

[14] Tami Luhby, "Struggling states put off tough cuts in hopes of a congressional rescue," CNN, June 30, 2020, https://www.cnn.com/2020/06/30/politics/state-budget-cuts-congress-lifeline/index.html

[15] Wesley Tharpe, "States, Localities Need More Federal Aid to Avert Deepening Budget Crisis," CBPP, July 21, 2020, https://www.cbpp.org/blog/states-localities-need-more-federal-aid-to-avert-deepening-budget-crisis.

[16] David Cooper and Julia Wolfe, "Cuts to the State and Local Public Sector Will Disproportionately Harm Women and Black Workers," Economic Policy Institute, July 9, 2020. https://www.epi.org/blog/cuts-to-the-state-and-local-public-sector-will-disproportionately-harm-women-and-black-workers/.

- In **Florida** Governor Ron DeSantis vetoed $1 billion in spending that lawmakers approved before the crisis.[17] The vetoes affected (among other things) money for community colleges and behavioral health services, including for opioid and other substance use treatment, crisis intervention, and services for people experiencing homelessness.
- In **Georgia**, policymakers initially approved a 10 percent spending cut for 2021. While many of these cuts were reversed when revenues improved and federal aid arrived, their impact lingered. The enacted fiscal 2022 budget cuts spending by nearly $850 million (approximately 4 percent) compared to 2020 levels, and underfunds pre-K through 12th grade education and reduces funding for health and human services.[18]
- In July 2020 **Nevada** policymakers responded to a projected $1.2 billion shortfall by approving more than $500 million in cuts and using one-time funds by, for example, enacting a tax amnesty program and shifting funds originally intended for other purposes.[19] The cuts fell most heavily on education and health programs, such as less money for literacy programs and lower Medicaid reimbursements for doctors. Governor Steve Sisolak's most recent two-year spending proposal, released in January and still under consideration by lawmakers, would reverse some but not all of the cuts enacted last summer and includes an additional reduction to K-12.[20]
- In **Ohio** Governor Mike DeWine cut $776 million from the 2020-21 state budget, including cuts to Medicaid, K-12 schools, higher education, and county public defenders.[21] The scope of the cuts later fell to $390 million spread across state agencies, after improved revenue outlooks allowed the governor to partially reverse the prior cuts to K-12 and higher education.[22]

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[17] Troy Kinsey, "DeSantis Signs $92.2B State Budget, Vetoes Record $1B in Spending," Spectrum News, July 6, 2020, https://www.baynews9.com/fl/tampa/news/2020/06/29/gov--desantis-signs--92-2b-state-budget--vetoes-record--1b-in-spending.

[18] James Salzer, "Kemp signs $26 billion budget as Georgia faces an uncertain fiscal future," *Atlanta Journal-Constitution*, June 30, 2020, https://www.ajc.com/news/state--regional-govt--politics/kemp-signs-billion-budget-state-faces-uncertain-fiscal-future/d9UngiJ5G7r2MV51VObNxJ/; Danny Kanso, "Sine Die: Overview of Georgia's 2022 Fiscal Year Budget," Georgia Budget and Policy Institute, April 9, 2021. https://gbpi.org/sine-die-overview-of-georgias-2022-fiscal-year-budget/.

[19] Andrew Davey, "Inside Our Budget Blues: A Nevada Legislature Special Report," *Nevada Today*, July 14, 2020, https://nevada-today.com/inside-our-budget-blues-a-nevada-legislature-special-report; Sam Metz, "Nevada passes cuts to health care, education amid pandemic," AP News, July 19, 2020, https://apnews.com/article/d5fc6be1935c7d7b60a363ada5008a01.

[20] Associated Press, "Nevada lawmakers OK budgets, prep for end-of-session sprint," May 1, 2021, https://lasvegassun.com/news/2021/may/01/nevada-lawmakers-ok-budgets-prep-for-end-of-sessio/; Riley Snyder *et al.*, "Sisolak Proposes $8.68 billion budget restoring cuts to Medicaid, other state programs," *Nevada Independent*, January 18 2021, https://thenevadaindependent.com/article/sisolak-proposes-8-68-billion-budget-restoring-cuts-to-medicaid-other-state-programs; Ed Komenda and Sam Metz, "Nevada proposes $130 million in education cuts, hopes for federal relief," *Reno Gazette Journal*, January 18, 2021, https://www.rgj.com/story/news/2021/01/19/covid-nevada-budget-proposal-130-million-education-cuts-pandemic/4178935001/.

[21] Wendy Patton, "Pandemic budget cuts could mean more in store in 2021," Policy Matters Ohio, August 26, 2020, https://www.policymattersohio.org/press-room/2020/08/26/pandemic-budget-cuts-could-mean-more-in-store-in-2021.

[22] Randy Ludlow, "DeWine restores $260 million in pandemic-related cuts to Ohio K-12 schools, universities," *Columbia Dispatch*, January 22, 2021, https://www.dispatch.com/story/news/coronavirus/2021/01/22/ohio-gov-mike-dewine-

- In **Oregon**, lawmakers cut some $400 million across state agencies in the 2019-2021 biennial budget. In addition, according to Governor Kate Brown's 2021-2023 budget document, "The pandemic has led to a state budget shortfall that will require not only scrapping plans for long-needed investments, but also making small but difficult cuts in services and programs that affect Oregonians' lives daily."[23] Debate on the state's budget is ongoing, and some lawmakers hope to use federal relief funds from the American Rescue Plan to prevent harmful cuts and invest in new services and needs.

The states' failure to use their reserves more fully to maintain 2020 and 2021 budgets could have a lasting impact on economic security and other programs and the families and communities that rely on them. Before the pandemic, state budgets were expected to increase enough in 2021 to accommodate growth in state populations and costs. Many also included investments in areas like infrastructure or education to promote equitable growth. But after pandemic-related cuts, fiscal year 2021 budgets are lower on average than governors proposed before the pandemic, and state workforces remain below pre-pandemic levels.

This creates a "ratcheting" down of state investments as future budgets will build from that base. For example, a recent analysis of 23 states with annual budgets found that "Most states are still a long way from digging out of their COVID-19 budget holes."[24] Governors in half of those states cut or froze spending in their proposed 2022 budgets compared to what they proposed for 2021. In eight of these, 2022 budgets are the same or less than enacted 2021 budgets which often reflect the impact of the pandemic.[25] By the time the American Rescue Plan provided additional federal aid and revenues recovered in many states, these cuts were built into many state budgets.

Changes to the design of state rainy day funds that result in states having adequate reserves — and using them — can prevent this in the future.

## Improving the Design of Rainy Day Funds Would Help

To avoid similar missteps as in recent downturns and prepare for the next one, states should improve the design of their rainy day funds now to remove barriers to adequate funding. Some states' rainy day fund rules were established many years ago when the rule of thumb was that governments should maintain a 5 percent budget reserve. Analysis of the impact of the ups and downs of the economy on states' revenues and budgets since the turn of the century showed that this standard was inadequate and established the need to enact rules for deposits in good times.[26]

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restore-budget-cuts-k-12-schools-universities-coronavirus-pandemic/6678781002/; Jo Ingles, "DeWine Orders $390 Million Ohio Budget Cut, But Adds Money For Education," Statehouse News Bureau, January 22, 2021, https://www.statenews.org/post/dewine-orders-390-million-ohio-budget-cut-adds-money-education.

[23] Dirk VanderHart, "Gov. Brown's budget proposes prison closures and cuts to healthcare providers," Oregon Public Broadcasting, December 1, 2020, https://www.opb.org/article/2020/12/01/oregon-governor-kate-brown-budget-proposal/

[24] Richard C. Auxier, "To Understand How COVID-19 Affected States, Compare Governors' New Budgets to Their Pre-Pandemic Plans," Tax Policy Center, March 8, 2021, https://www.taxpolicycenter.org/taxvox/understand-how-covid-19-affected-states-compare-governors-new-budgets-their-pre-pandemic.

[25] *Ibid.*

[26] Tax Policy Center, "What are state rainy day funds, and how do they work?" March 2020, https://www.taxpolicycenter.org/briefing-book/what-are-state-rainy-day-funds-and-how-do-they-work.

But many states have failed to update rainy day fund rules yet. Here are some steps that states can take to address their antiquated and backward rules. [27] (We also outline states' approaches in Appendix Table 2.)

- **States should increase the target size of their funds and perform stress tests to determine their adequacy.** One reason rainy day funds weren't more effective in the most recent downturn is that 27 states,[28] the District of Columbia, and Puerto Rico cap them at inadequate levels, such as 10 percent of the budget or less.[29] This is not an adequate level for even a medium-sized recession. States with overly restrictive caps could either remove the cap or raise it to a more adequate level, such as 15 percent of the budget. More than 15 percent is needed on average to weather a moderate recession without substantially cutting spending or increasing taxes.[30]

  Since the Great Recession, a number of states have raised their caps. Connecticut, Georgia, Michigan, Oklahoma, and Virginia raised theirs to 15 percent; Arizona increased its cap from 7 to 10 percent and South Carolina raised it from 3 to 5 percent — still far too low, but a step in the right direction.

  The appropriate size of a state's rainy day fund depends in part on the potential volatility of the state's revenues and economy. As the Pew Charitable Trusts has pointed out, states that depend heavily on more volatile revenue sources such as oil and gas taxes should consider higher caps in order to maintain a larger budget cushion.[31] States can perform regular analyses called stress tests that estimate their fund's adequacy based on revenue volatility.[32] Currently only six states — Minnesota, Montana, Nebraska, New Mexico, North Carolina, and Utah — do regular stress testing and make the results public.

- **States should remove rainy day fund rules that make it difficult for them to make deposits in good times.** Few states prioritize replenishing their funds; most deposit only whatever surpluses are left over at the end of the year. All but six states have laws requiring rainy day fund deposits; however, in practice, many of these laws could be stronger. For example, New Jersey made no deposits into its rainy day fund for 11 years after the Great Recession. Nebraska continues to put money into its rainy day fund but a statute that would require additional deposits in years when revenue growth is significantly higher than average has been suspended until 2024. States could develop a process to integrate rainy day fund

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[27] Elizabeth McNichol and Kwame Boadi, "Why and How States Should Strengthen Their Rainy Day Funds," CBPP, February 3, 2011, http://www.cbpp.org/cms/?fa=view&id=3387.

[28] Arizona, California, Delaware, Florida, Hawai'i, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maryland, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New York, Ohio, Oregon, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin.

[29] By cap, we mean that the laws that require transfers into the rainy day fund no longer apply once the fund has reached a specified percentage of the general fund.

[30] Elizabeth McNichol and Kwame Boadi, "Why and How States Should Strengthen Their Rainy Day Funds," CBPP, February 3, 2011, https://www.cbpp.org/research/why-and-how-states-should-strengthen-their-rainy-day-funds?fa=view&id=3387.

[31] Pew Charitable Trusts, "Managing Uncertainty: How State Budgeting Can Smooth Revenue Volatility," February 4, 2014, https://www.pewtrusts.org/en/research-and-analysis/reports/2014/02/04/managing-uncertainty

[32] Josh Goodman, "Budget Stress Testing Helps States Prepare for Fiscal Distress," Pew Charitable Trusts, April 9, 2020, https://www.pewtrusts.org/en/research-and-analysis/articles/2020/04/09/budget-stress-testing-helps-states-prepare-for-fiscal-distress.

transfers into the budget as part of an overall reserve policy that prioritizes saving. For example, states that rely primarily on year-end surpluses to fill their reserves could set targets for overall annual increases in their reserves and require contributions in the budget if surpluses don't result in meeting those targets.

After the Great Recession, Hawai'i, Massachusetts, and Washington State made changes to improve prospects for replenishing the funds in the future. Hawai'i, which had operated under a rule requiring the state to refund to taxpayers any general fund ending balance exceeding 5 percent of the budget, modified the rule to give lawmakers a choice between providing a tax refund and depositing the funds in the rainy day fund. Massachusetts established a requirement that any capital gains revenue collections over $1 billion annually go into the state's reserves. Washington State voters approved a constitutional amendment that requires that any "extraordinary" revenue growth (that is, growth in general state revenues that exceeds by one-third the average biennial percentage growth in general state revenues over the prior five fiscal biennia) be deposited in the rainy day fund.

- **States should remove too-rapid replenishment rules that hinder use of reserves as intended.** Sixteen states and the District of Columbia require rainy day funds to be replenished quickly after they are used, even if economic conditions have not improved much. Such rules have proven a disincentive to using the funds, since state policymakers are unlikely to use reserves if they don't expect to have the money to replenish them quickly. (Given how long and unpredictable economic recoveries can be, this is a reasonable concern.) For example, if the District of Columbia had used half of its available rainy day fund in 2009, it could have covered nearly half of its revenue shortfall for fiscal years 2009 and 2010, rather than rely on service cuts. Instead the rigid replenishment rule deterred lawmakers from accessing the fund in a time of crisis. States with these replenishment rules should eliminate them.
- **States should scale back limits on funds' use**. Thirteen states have made their rainy day funds less effective in addressing budget deficits by requiring a supermajority vote by legislators to release the fund or by arbitrarily limiting how much of the fund can be released at one time. In some states, such as Missouri and Delaware, this has inhibited the funds' use, leading to greater spending cuts and tax increases than necessary. Often, limits such as a supermajority requirement have a chilling effect by discouraging legislators from even introducing measures to access these funds because of the difficulty in rounding up the necessary votes.

Never using a rainy day fund is the same as not having one. States risk very little, and can gain much, by tapping those funds, which were designed for an emergency like the COVID-19 pandemic. Not doing so risks repeating the mistakes of recent recessions. [33]

## Appendix

APPENDIX TABLE 1

### State Fund Balances, Fiscal Year 2006 vs. 2019

| | Rainy Day Fund Balance | | | | Total General Fund Balance | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2019 | | 2006 | | 2019 | |
| State | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending |
| Alabama | $419 | 6.0% | $848 | 9.8% | $1,368 | 19.6% | $1,823 | 21.1% |
| Alaska | 2,267 | 69.8% | 2,288 | 46.8% | 2,267 | 69.8% | 2,288 | 46.8% |
| Arizona | 650 | 7.4% | 743 | 6.9% | 1,697 | 19.4% | 1,700 | 15.9% |
| Arkansas | 0 | 0.0% | 153 | 2.7% | 0 | 0.0% | 448 | 8.0% |
| California | 10,816 | 11.8% | 23,001 | 16.4% | 10,816 | 11.8% | 26,176 | 18.7% |
| Colorado | 0 | 0.0% | 1,262 | 9.8% | 909 | 14.1% | 1,262 | 9.8% |
| Connecticut | 1,113 | 7.6% | 2,506 | 13.0% | 1,560 | 10.7% | 2,506 | 13.0% |
| Delaware | 161 | 5.1% | 240 | 5.5% | 691 | 21.7% | 947 | 21.6% |
| Florida | 1,069 | 4.1% | 1,483 | 4.5% | 6,059 | 23.3% | 3,973 | 11.9% |
| Georgia | 793 | 4.5% | 2,808 | 11.1% | 2,017 | 11.3% | 3,047 | 12.0% |
| Hawai'i | 54 | 1.2% | 378 | 4.8% | 786 | 16.8% | 1,130 | 14.3% |
| Idaho | 109 | 4.9% | 373 | 10.1% | 411 | 18.5% | 475 | 12.8% |
| Illinois | 0 | 0.0% | 4 | 0.0% | 866 | 3.6% | 466 | 1.3% |
| Indiana | 328 | 2.7% | 1,436 | 8.8% | 739 | 6.2% | 2,270 | 13.9% |
| Iowa | 392 | 7.8% | 757 | 10.1% | 541 | 10.8% | 1,047 | 13.9% |
| Kansas | 0 | 0.0% | 0 | 0.0% | 734 | 14.3% | 1,105 | 15.7% |
| Kentucky | 119 | 1.4% | 129 | 1.1% | 800 | 9.5% | 259 | 2.2% |
| Louisiana | 681 | 8.8% | 405 | 4.1% | 1,508 | 19.5% | 940 | 9.4% |
| Maine | 80 | 2.8% | 309 | 8.4% | 94 | 3.3% | 448 | 12.2% |

APPENDIX TABLE 1

## State Fund Balances, Fiscal Year 2006 vs. 2019

| | Rainy Day Fund Balance | | | | Total General Fund Balance | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2019 | | 2006 | | 2019 | |
| State | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending |
| Maryland | 759 | 6.1% | 877 | 4.9% | 2,121 | 17.2% | 1,851 | 10.3% |
| Massachusetts | 2,155 | 8.4% | 3,424 | 10.4% | 3,208 | 12.5% | 3,959 | 12.0% |
| Michigan | 2 | 0.0% | 1,149 | 11.0% | 5 | 0.1% | 2,065 | 19.8% |
| Minnesota | 1,113 | 7.2% | 2,480 | 10.8% | 1,813 | 11.7% | 3,971 | 17.2% |
| Mississippi | 73 | 1.7% | 350 | 6.3% | 108 | 2.5% | 354 | 6.4% |
| Missouri | 247 | 3.5% | 651 | 6.8% | 942 | 13.2% | 1,305 | 13.7% |
| Montana | 0 | 0.0% | 60 | 2.5% | 422 | 26.9% | 421 | 17.5% |
| Nebraska | 274 | 9.4% | 334 | 7.7% | 840 | 28.8% | 1,070 | 24.5% |
| Nevada | 184 | 6.3% | 332 | 7.5% | 535 | 18.2% | 685 | 15.5% |
| New Hampshire | 69 | 5.2% | 115 | 7.6% | 95 | 7.1% | 308 | 20.5% |
| New Jersey | 560 | 2.0% | 421 | 1.1% | 1,779 | 6.3% | 1,712 | 4.5% |
| New Mexico | 798 | 14.7% | 1,834 | 24.4% | 798 | 14.7% | 1,834 | 24.4% |
| New York | 944 | 2.0% | 2,048 | 2.8% | 3,257 | 7.0% | 7,206 | 9.9% |
| North Carolina | 629 | 3.7% | 1,849 | 7.8% | 1,378 | 8.1% | 3,558 | 15.0% |
| North Dakota | 100 | 10.4% | 659 | 29.9% | 296 | 30.6% | 724 | 32.8% |
| Ohio | 1,011 | 4.1% | 2,692 | 8.1% | 1,643 | 6.6% | 4,230 | 12.7% |
| Oklahoma | 496 | 9.0% | 806 | 11.5% | 630 | 11.4% | 1,116 | 15.9% |
| Oregon* | 622 | 10.2% | 1,288 | 12.7% | 627 | 10.3% | 3,997 | 39.3% |
| Pennsylvania | 512 | 2.1% | 22 | 0.1% | 1,026 | 4.2% | 22 | 0.1% |
| Rhode Island | 95 | 3.1% | 204 | 5.2% | 133 | 4.3% | 234 | 6.0% |

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## State Fund Balances, Fiscal Year 2006 vs. 2019

| | Rainy Day Fund Balance | | | | Total General Fund Balance | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2019 | | 2006 | | 2019 | |
| State | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending | Amount (in millions) | Percent of spending |
| **South Carolina** | 154 | 2.7% | 871 | 10.7% | 988 | 17.5% | 1,709 | 21.0% |
| **South Dakota** | 137 | 13.0% | 170 | 10.4% | 137 | 13.0% | 189 | 11.5% |
| **Tennessee** | 325 | 3.6% | 875 | 6.1% | 1,069 | 11.8% | 2,517 | 17.6% |
| **Texas** | 7 | 0.0% | 10,099 | 19.3% | 7,070 | 10.5% | 14,820 | 28.4% |
| **Utah** | 255 | 5.6% | 697 | 9.2% | 255 | 5.6% | 989 | 13.1% |
| **Vermont** | 52 | 4.7% | 224 | 14.0% | 52 | 4.7% | 224 | 14.0% |
| **Virginia*** | 1,065 | 7.0% | 792 | 3.7% | 2,442 | 16.0% | 1,022 | 4.8% |
| **Washington** | 4 | 0.0% | 1,618 | 7.1% | 703 | 5.2% | 2,617 | 11.4% |
| **West Virginia** | 359 | 10.1% | 753 | 16.4% | 828 | 23.2% | 1,271 | 27.6% |
| **Wisconsin** | 0 | 0.0% | 649 | 3.6% | 49 | 0.4% | 1,736 | 9.7% |
| **Wyoming** | 446 | 35.9% | 1,577 | 96.9% | 456 | 36.7% | 1,577 | 96.9% |
| **Total** | 32,498 | 5.4% | 79,040 | 9.1% | 69,568 | 11.6% | 121,602 | 14.0% |

Note: “Total General Fund Balance” includes both the ending balance and balances in budget stabilization funds.

*Fiscal year 2008 figures are used for Oregon in lieu of 2006, because this is when its rainy day fund came into being. Virginia rainy day fund balance includes both the Revenue Stabilization Fund and Revenue Reserve Fund.

Source: National Association of State Budget Officers, "Fiscal Survey of the States,” various years.

APPENDIX TABLE 2

## States With (and Without) Effective Rainy Day Fund Features

| States with: | Cap as % of general fund | No cap or cap of 15% or more of general fund | Deposit required by law | No rule requiring replenishment by set time | Can approve use with simple majority | Regular stress tests |
|---|---|---|---|---|---|---|
| **Total** | | | | | | |
| **Alabama** | No cap | X | | | X | |
| **Alaska** | No cap | X | | | | |
| **Arizona** | 10% | | X | X | X | |
| **Arkansas** | No cap | X | | | | |
| **California** | 10% | | X | X | X | |
| **Colorado*** | No cap | X | | | | |
| **Connecticut** | 15% | X | | X | X | |
| **Delaware** | 5% | | X | X | | |
| **District of Columbia Emergency Reserve, Contingency Reserve and Fiscal Stabilization funds** | 2%/4%/2.34% | | X | | X | |
| **Florida** | 10% | | X | | X | |
| **Georgia** | 15% | X | X | X | X | |
| **Hawai'i** | 10% | | X | X | | |
| **Idaho** | 15% | X | X | X | X | |
| **Illinois** | 5% | | X | | X | |
| **Indiana** | 7% | | X | X | X | |
| **Iowa*** | 10% | | | | X | |
| **Kansas** | No cap | X | | X | X | |
| **Kentucky** | 5% | | X | X | X | |
| **Louisiana** | 4% | | X | X | | |
| **Maine** | 18% | X | X | X | X | |
| **Maryland** | 10% | | X | X | X | |
| **Massachusetts** | 15% | X | X | X | X | |
| **Michigan*** | 15% | X | X | X | X | |
| **Minnesota** | No cap | X | X | | X | X |
| **Mississippi** | 10% | | X | | X | |
| **Missouri** | 7.5% | | X | | | |

APPENDIX TABLE 2

## States With (and Without) Effective Rainy Day Fund Features

| States with: | Cap as % of general fund | No cap or cap of 15% or more of general fund | Deposit required by law | No rule requiring replenishment by set time | Can approve use with simple majority | Regular stress tests |
|---|---|---|---|---|---|---|
| Montana | 4.5% | | X | X | X | X |
| Nebraska | No cap | X | X | X | X | X |
| Nevada | 20% | X | X | X | X | |
| New Hampshire | 10% | | X | X | | |
| New Jersey | 5% | | X | X | X | |
| New Mexico | No cap | X | X | X | | X |
| New York | 5% | | | | X | |
| North Carolina* | No cap | | X | X | X | X |
| North Dakota | 15% | X | X | X | X | |
| Ohio | 8.5% | | X | X | X | |
| Oklahoma | 15% | X | X | X | | |
| Oregon | 7.5% | | X | X | | |
| Pennsylvania | 6% | | X | X | | |
| Rhode Island | 5% | | X | | X | |
| South Carolina | 2% | | X | | X | |
| South Dakota | 10% | | X | | X | |
| Tennessee | No cap | X | X | X | X | |
| Texas* | 10% | | X | X | | |
| Utah | 9% | | X | X | | X |
| Vermont | 5% | | X | | X | |
| Virginia* | 15% | X | X | X | X | |
| Washington* | 10% | | X | X | X | |
| West Virginia | 13% | | X | X | X | |
| Wisconsin | 5% | | X | | X | |
| Wyoming | No cap | X | X | X | X | |
| Puerto Rico* | 6% | | X | X | X | |

Notes: CO: Refers to General Fund Reserve, not official rainy day fund; IA: Combined caps of Cash Reserve Fund and Economic Emergency Fund; MI: Cap is percent of General Fund and School Aid Fund; NC: Supermajority required for transfers that exceed 7.5 percent of budget or for extraordinary purposes; TX: Amount in fund could exceed cap because of treatment of federal funds; VA: Cap applies to Rainy Day Fund combined with Revenue Reserve Fund; WA: Supermajority required if employment growth is greater than 1 percent; PR: Also has an Emergency Reserve Fund for response to events like natural disasters.

Source: National Conference of State Legislatures, "Rainy Day Fund Structures, November 2018," https://www.ncsl.org/research/fiscal-policy/rainy-day-funds.aspx, updated with CBPP survey