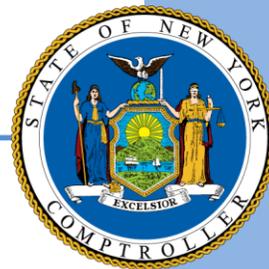


The Case for Building New York State's Rainy Day Reserves

OFFICE OF THE NEW YORK STATE COMPTROLLER

Thomas P. DiNapoli, State Comptroller



December 2019

Message from the Comptroller

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The national economy has now been growing for more than a decade – a lengthy expansion, by historical standards. While we have no way of knowing exactly when that will change, we can be sure that at some point a downturn will come. When that happens, the State must be prepared to safeguard essential services and avoid undesirable tax increases.

The simple truth, however, is that New York is not adequately prepared today. The State's two statutory rainy day reserve funds – the Tax Stabilization Reserve and the Rainy Day Reserve – together hold just over \$2 billion. That's little more than a third of their authorized levels, and below many other states' rainy day reserves as a proportion of spending. New York's reserves are 2.8 percent of General Fund spending; in states such as California, Texas and Michigan, that percentage is far higher.



The Division of the Budget deposited \$250 million to the Rainy Day Reserve at the end of the last fiscal year, and plans to add \$428 million in March 2020. While these are positive steps, we must do more. Otherwise, we face increased risks of truly harmful spending cuts, tax hikes, elevated borrowing or damaging budgetary gimmicks the next time we are confronted with a recession or catastrophic event.

The starting point for reform should be a commitment to build these reserves steadily and consistently, by requiring deposits each year unless the Legislature and the Executive determine that economic and fiscal conditions preclude such a step in a given year. Whether we are talking about a family budget or State government, putting funds aside for future needs is a basic principle of prudent financial management. Over time, such a disciplined approach can add up to billions of dollars – and enhanced fiscal security – for the State.

As a near-term goal, the rainy day reserves should be fully funded to their current statutory maximum levels within five years. Over the longer term, these reserves should be funded to 10 percent of General Fund revenues. That would provide the State truly meaningful protection against damaging impacts during serious fiscal challenges in the future.

The concept of New York's rainy day reserves goes back to the Great Depression. The need for such safeguards is especially great today given our experience with volatile revenues in recent years, the challenges of an increasingly globalized economy, heightened climate-related threats to infrastructure, and potential cuts to federal aid, which accounts for more than a third of the State budget. The time to prepare for serious problems is before they arrive.

Thomas P. DiNapoli
State Comptroller

Table of Contents

I. EXECUTIVE SUMMARY	1
II. NEW YORK STATE RAINY DAY RESERVES	3
<i>History of TSRF and RDRF Deposits and Withdrawals</i>	4
<i>Unrestricted General Fund Balance</i>	5
<i>Economic Factors and Other Context</i>	7
III. COMPARISONS: HISTORICAL AND OTHER STATES	8
IV. RECOMMENDATIONS FOR RAINY DAY RESERVES	12
<i>What Reforms Are Needed?</i>	13
V. APPENDIX	17

I. Executive Summary

Just a decade ago, a double whammy of revenue shortfalls brought on by the Great Recession and a growing structural budget gap combined to create an acute cash crunch for New York State. These events forced State policy makers to cut spending, raise taxes and take other undesirable budgetary actions. The State closed budget gaps and cash flow shortfalls with steps including more borrowing; the deferral of billions of dollars in school aid, Medicaid and tax refunds; and a variety of budgetary manipulations.

Recognizing the risks that economic downturns or catastrophic events may pose to essential services and to taxpayers, the State has created rainy day reserve funds that are intended to help mitigate such challenges. The need for strong budgetary reserves has grown in recent decades due to the cyclical nature of New York's Personal Income Tax receipts as well as periodic threats to federal aid, among other factors.

Unfortunately, the rainy day reserves remain inadequately funded, limiting their value in the event of a fiscal emergency. The combined levels of the Tax Stabilization Reserve Fund (TSRF) and the Rainy Day Reserve Fund (RDRF), just over \$2 billion, equate to little more than a third of their statutorily authorized levels. While the median rainy day holdings among all states with such reserves is estimated at 7.5 percent of General Fund spending, New York's reserve funds total only 2.8 percent.

Although State Finance Law provides rules for additions to and loans from the two reserve funds, deposits in recent years have been limited. Over three recent years when State revenues were growing and the State was receiving extraordinary one-time monetary settlements (State Fiscal Years 2015-16 through 2017-18), no deposits were made to either fund.

Building budgetary reserves may be perceived as a low priority during the annual budget decision making process, given limited resources and competing needs. Yet adequate rainy day reserves should be considered essential, precisely because they can help avert unwanted service reductions and tax increases when unexpected fiscal challenges arise.

Relatively modest deposits during periods of economic growth – even a fraction of 1 percent of General Fund revenues – can add up to billions of dollars over time. The State should augment those continuous additions to reserves with periodic larger deposits made when extraordinary monetary settlements, unexpectedly high tax revenues or other circumstances allow.

State policy makers should also avoid the costs New York has incurred in the past when fiscal crises resulted in borrowing to close budget gaps, thus imposing substantial debt service costs over many years. Each investment in higher reserve levels can be considered a down payment on preventing such borrowing, the associated debt service costs and the potential resulting harm to the State's credit rating.

This report summarizes the history of the TSRF and the RDRF, provides additional comparisons with other states, and recommends reforms to ensure more robust reserves will be available the next time economic or other conditions merit their use. Such steps include:

- Fully funding the rainy day reserves to statutorily authorized levels, approximately 7 percent of General Fund spending (more than \$5.3 billion as of the end of last fiscal year), within five years.
- Boosting reserves further, to 10 percent of General Fund revenues, over the following five years.
- To achieve these goals, the Division of the Budget should be required to develop a multi-year plan that would raise New York's rainy day reserves to a level that would significantly mitigate the State's next severe fiscal challenge. Such plan would include the following steps:
 - Requiring monthly deposits to rainy day reserves of 0.35 percent of General Fund revenues unless policy makers explicitly determine such deposits are not practicable. This step would allow for such reserves to be built up gradually and consistently.
 - Making additional annual deposits when possible, up to an additional 1 percent of General Fund revenues. Such additional deposits could include resources now designated as informal reserves, such as certain resources from monetary settlements.
- Assessing the adequacy of rainy day reserves at least annually. In addition, the State should establish clear policies for expected use of these resources.

Rainy day reserve funds are needed to mitigate economic or other circumstances that could force cuts to essential services and harmful tax increases. The State has made some progress in building these reserves in recent years, but the rainy day funds remain inadequate. A disciplined plan to achieve robust reserves, as outlined in this report, can reduce the risk of unwanted, potentially costly budgetary actions in response to future fiscal challenges.

II. New York State Rainy Day Reserves

The creation of New York State’s formal budget reserves to mitigate revenue declines during economic downturns can be traced to 1938. At a time when the impact of the Great Depression was still being felt in New York, an amendment to the State Constitution to allow such reserves was proposed in the Legislature. Five years later, voters approved what is now Section 17 of the Constitution’s Article VII, authorizing “a fund or funds to aid in the stabilization of the tax revenues of the state available for expenditure or distribution.”

Making the case for approval of that constitutional amendment, the chair of the Assembly Ways and Means Committee, Abbot Low Moffat, said: “Although clearly it would be sound public policy for the State to set aside part of its revenues in good times as a reserve against a decrease of revenues in times of depression, there is no way under the present constitution that this can be done without the danger that some subsequent Legislature will raid the reserves for political purposes.”¹ Governor Thomas E. Dewey proposed, and the Legislature approved, implementing legislation in 1946 to establish tax stabilization reserves. In his Executive Budget message that year, Dewey wrote: “One of the serious consequences of the depression 30’s was the weakening of our State and municipal governments because they lacked a reserve of financial strength.”² Dewey added that “progressive State government” should not be thwarted by inadequate fiscal planning. Over time, State leaders have acknowledged the importance of ensuring a balanced budget while also being financially prepared to meet economic downturns, natural disasters and other catastrophic events.³

New York State has established two statutory rainy day funds, the Tax Stabilization Reserve Fund (TSRF) and the Rainy Day Reserve Fund (RDRF), also referred to as formal rainy day reserves in this report. While the two funds are governed by distinct legal provisions, both were established primarily to manage budget gaps when revenues fall short due to an economic downturn or other circumstances.

New York also has unrestricted General Fund balances that the Division of the Budget can use to provide flexibility in managing the State budget. While this report provides certain information and analysis with regard to such balances, it focuses primarily on the TSRF and the RDRF, and the steps the State should take to maximize the usefulness of those funds.

The authorization for the TSRF derives from the New York State Constitution as referenced above and the State Finance Law. The TSRF was established as part of the Accounting, Financial Reporting and Budget Accountability Reform Act of 1981 (Act) replacing the State Purposes and Local Assistance Reserve Funds, which were created in 1946. The assets from those funds were required to be transferred to the TSRF.⁴ The statutory purpose of the TSRF

¹ “Legislature Gets Tax Reserve Plan,” *The New York Times*, p. 7, February 27, 1943.

² “Message to the Legislature Transmitting the Executive Budget and Recommended Appropriations for 1946-47,” January 31, 1946, *Public Papers of Governor Dewey*, p. 50.

³ See, for example, New York State Division of the Budget, Executive Budget Briefing Book for SFY 2007-08.

⁴ The Tax Stabilization Reserve Fund was established by Section 27 of Chapter 405 of the Laws of 1981, as further amended by Section 27 of Chapter 957 of the Laws of 1981. The assets and liabilities of the Local Assistance Reserve Fund and State Purposes Reserve Fund were transferred to the TSRF pursuant to section 38 of Chapter 405 of the Laws of 1981. The provisions establishing the new Fund did not become effective until 1984 because Section 17 of Article VII in the Constitution

is to provide for the stabilization of State revenues from taxes, fees and other sources that are required to be deposited into the General Fund. The RDRF was established in 2007 as part of legislation that included a number of other provisions intended to improve the budget process.⁵

The RDRF provisions are less restrictive than those of the TSRF. For example, deposits to the RDRF are statutorily left to the discretion of the Budget Director, while State Finance Law requires deposits to the TSRF under certain circumstances. (However, in practice, DOB may take other actions that obviate the need for a deposit to the TSRF. For example, in certain prior fiscal years funds that might otherwise have been deposited to the TSRF have been used to prepay debt service and other expenses, increase the amount of tax refunds paid out at the close of the fiscal year, or deposit surplus funds to other General Fund accounts, primarily the refund reserve account.) There is no limit on the amount that can be withdrawn from the RDRF and those moneys can be used to meet financial plan needs at any time during the year if the required conditions are met. Withdrawals from the TSRF can only be used at year-end to address shortfalls. See the Appendix for more detail of key statutory provisions of the TSRF and RDRF.

History of TSRF and RDRF Deposits and Withdrawals

The vast majority (nearly \$1.1 billion) of the TSRF's current balance of \$1.26 billion was deposited after the 1984 effective date of the current TSRF provisions. There have been no loans from the TSRF to cover fiscal year end operating deficits in over 25 years. Under the current statutory provisions, TSRF moneys have only been drawn upon for this purpose three times leading up to and during portions of the recession that occurred in New York from 1989 to 1992 (\$132.5 million in SFY 1987-88, \$68.9 million in SFY 1988-89 and \$44.2 million in SFY 1991-92). The TSRF was fully depleted in SFY 1988-89 and its balance remained at \$0 throughout that recession.⁶

Beginning in SFY 1992-93, repayments, transfers of surplus funds, or both drove steady growth in the TSRF until it reached a balance of just over \$1 billion by the end of SFY 2006-07. In SFYs 1999-00 through 2001-02, the State transferred a total of \$227 million in surplus funds to the TSRF during a recessionary period, as illustrated in Figure 1. The last deposit, \$126.4 million, was made on March 31, 2015, at which point the fund had reached its maximum balance. Since there have been no deposits to this Fund since that time and General Fund spending has continued to grow, the fund balance is no longer at the maximum amount authorized. As of the end of SFY 2018-19, the TSRF balance was 1.7 percent of General Fund disbursements, \$198 million short of the maximum authorized at that time. While there are currently no outstanding loans from the TSRF, the balance remains available for intra-year cash flow purposes.⁷

states that "no law changing the method of determining a norm or prescribing the amount to be paid into such fund or to be paid from such a fund into the general fund may become effective until three years from the date of its enactment." The provisions governing the TSRF are codified at Section 92 of the State Finance Law (SFL).

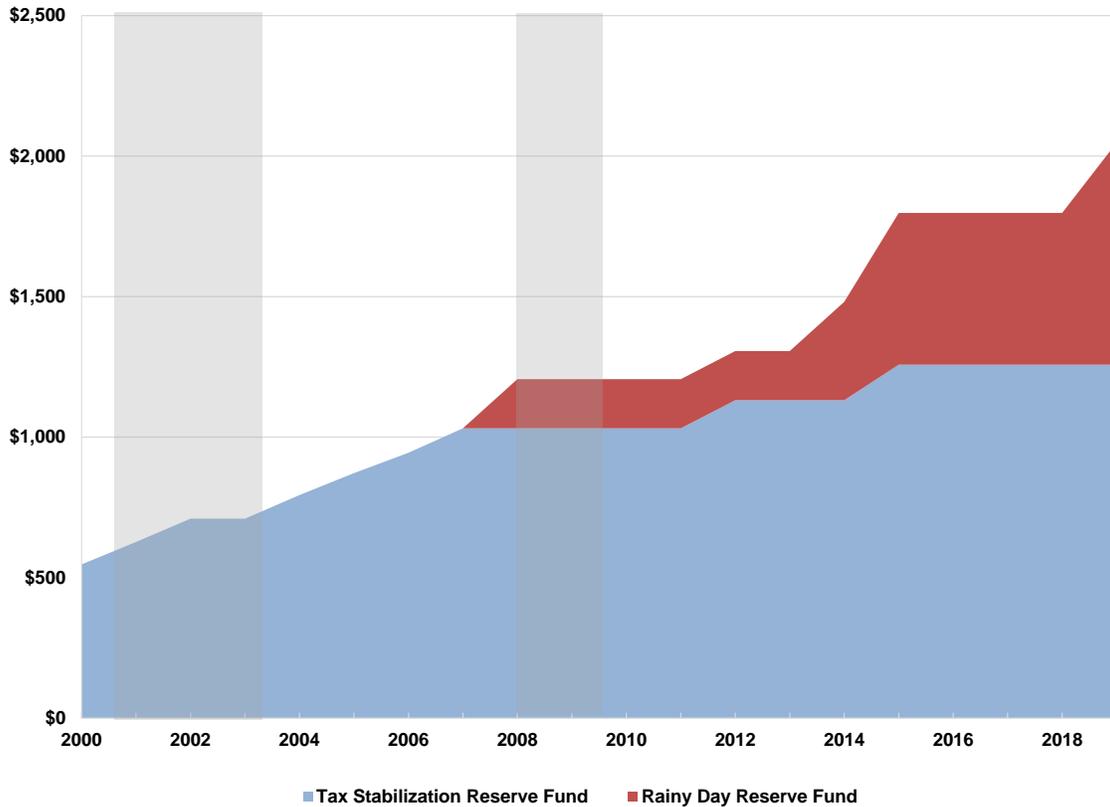
⁵ Section 14 of Chapter 1 of the Laws of 2007 established the Rainy Day Reserve Fund as Section 92-cc of the State Finance Law.

⁶ In SFY 1991-92, the TSRF balance remained at \$0 due to a \$44.2 million repayment and a \$44.2 million loan occurring in that year.

⁷ For additional historical detail regarding the TSRF see the *Comptroller's Annual Report to the Legislature on State Funds Cash Basis of Accounting*, Schedule 27 at: https://www.osc.state.ny.us/finance/cbr_annual.htm.

Figure 1

**Tax Stabilization Reserve Fund and Rainy Day Reserve Fund Balances
SFY 1999-00 through SFY 2018-19**
(in millions of dollars)



Source: NYS Office of the State Comptroller, NYS Department of Labor
 Note: Shaded areas represent recessions in New York State.

Although the Great Recession began shortly after the establishment of the RDRF, no loans were made from the Fund in response to the downturn in economic activity and revenues. At the time, the fund balance was \$175 million (the amount of the initial deposit that was made in March 2008). As of March 31, 2019, the RDRF balance was \$790 million, or \$3.1 billion below its statutorily authorized maximum.⁸ That balance included \$250 million deposited by DOB at the end of SFY 2018-19; the maximum deposit allowable under State Finance Law would have been \$546 million. This year’s Financial Plan indicates that an additional \$428 million is expected to be deposited in March 2020, bringing the balance to \$1.2 billion. Since its creation, the State has not drawn upon the RDRF for an economic downturn or catastrophic event. As with the TSRF, these moneys are commonly used for intra-year cash flow management.

Unrestricted General Fund Balance

In addition to its formal rainy day reserves, the State has an unrestricted General Fund balance, all of which is available for any purpose, including the purposes of the rainy day reserves. These moneys, however, are not subject to the same restrictions and limitations as the

⁸ Based on SFY 2019-20 projected General Fund spending as indicated in the SFY 2019-20 Enacted Budget Financial Plan.

statutory rainy day funds. Subject to appropriation and transfer authority, such resources can be used at any time, regardless of prevailing economic conditions, and for any purpose, including budget relief. In fact, over the past five years, more than \$3.8 billion of these unrestricted funds (including certain monetary settlement resources) were used for budget relief, even as the State and the nation were in the midst of a prolonged period of economic expansion.

Over the past two decades examined in this report, the unrestricted General Fund balance has often exceeded the combined balances in the statutory rainy day reserves by significant amounts. For example, over the past five years, the State's unrestricted General Fund balance has burgeoned due to the receipt of billions of dollars in largely unrestricted monetary settlements from financial and other institutions. As of March 31, 2019, the unrestricted balance totaled \$5.1 billion, nearly 2.5 times the amount of the formal reserves.

These unrestricted balances provide additional flexibility for budget management and may be available for use during unexpected fiscal challenges. However, they are devoid of formal requirements related to how much the State should hold in reserve, when and for what purposes such funds may be used, and if or when such funds should be repaid. In short, there is no assurance that these moneys will be available when rainy day reserves are needed.

DOB has indicated that a portion of the current unrestricted General Fund balance would be reserved for certain uses. For instance, in the FY 2020 Mid-Year Update to the Financial Plan, DOB has informally designated \$500 million for debt management, as various amounts have been for more than a decade. In addition, another \$890 million from monetary settlements received in SFY 2019-20 has been set aside for economic uncertainties. The State has collected \$12.8 billion in extraordinary monetary settlements since 2014; \$488 million of such receipts has been or is anticipated to be deposited to the statutory rainy day reserves.

In addition to the unrestricted General Fund balance, DOB has other tools that it uses for budget management. As in recent years, the Financial Plan includes a line called "Reserve for Transaction Risks" in its accounting of transfers from other funds. This is not a formal reserve, but provides the Executive with flexibility in managing the General Fund. If spending or receipts vary from anticipated levels, this figure can be adjusted to increase projected General Fund receipts. The Financial Plan designates \$400 million for this purpose in the current year and \$350 million in each of the out-years of the Plan.

The unrestricted General Fund balance is also used throughout the year for cash flow management. In addition, the General Fund is authorized to borrow from certain other funds within the State's Short Term Investment Pool (STIP) but outside the General Fund for up to four months or until the end of the fiscal year, whichever occurs first. The State last used this authorization in April 2011, when the General Fund needed to borrow funds from STIP for a period of five days.⁹

⁹ New York State Division of the Budget, *New York State Annual Information Statement*, June 12, 2019, p. 27.

Economic Factors and Other Context

New York relies heavily on revenues that are highly sensitive to changing economic conditions, particularly the Personal Income Tax (PIT). The Great Recession and previous downturns have resulted in the need for deficit reduction actions, including difficult spending cuts, staff reductions and significant tax increases, at times when such steps may have been especially damaging. In the past, the State has also relied on other less prudent budget management actions, including sweeps of funds originally dedicated to other purposes, changes in timing of payments, increased borrowing including deficit financing, and other fiscal gimmicks.

Using restricted reserves typically should not be the only budgetary response to serious fiscal challenges. Relying exclusively on rainy day reserves could exacerbate the State's structural imbalance and delay the difficult choices that need to be made to bring recurring spending in line with recurring revenue. However, rainy day reserves can be used as a bridge or temporary resource to support essential services, while providing the State an opportunity to develop more complete responses to an economic downturn or catastrophic event.

Robust reserves can guard against bond rating downgrades and potentially contribute to decisions to upgrade. For example, Moody's Investors Service has indicated that factors that could lead to an upgrade in the State's bond rating include "accumulation of significantly larger reserves that would offset risks related to personal income tax collection volatility and protect against unfavorable macroeconomic events."¹⁰ Moody's further indicates that factors that could lead to a downgrade include "significant decline in reserves and cash balance or return to large payment deferrals to manage cash flow" and "significant increase in non-recurring budget solutions or return to deficit financing practices."¹¹

At times in each of the past three fiscal years, PIT receipts have varied significantly from projections, both upward and downward, due in part to taxpayer response to the expectation and enactment of federal tax changes. Current federal trade policies, especially tariffs on foreign goods, may contribute to financial market volatility and uncertainty regarding the overall direction of the national economy. The State receives substantial amounts of federal aid for health care and other purposes (estimated to be approximately one-third of All Funds revenue in the current year's Enacted Budget), and continues to face certain risks regarding federal funding in the coming years.

Recent years' Enacted Budgets have expanded Executive authority to address certain potential revenue shortfalls with spending reductions. However, stronger reserves could better position the State to respond in the event of a revenue shortfall driven by an economic downturn or other factors, enabling policy makers to limit programmatic reductions and/or tax increases.

¹⁰ Moody's Investors Service, *Rating Action: Moody's assigns Aa1 to New York State General Obligation Bonds, Series 2019A Tax-Exempt Bonds; outlook stable*, March 11, 2019.

¹¹ *Ibid.*

III. Comparisons: Historical and Other States

New York's statutory rainy day funds would have totaled more than \$5.3 billion at the end of SFY 2018-19 if they were funded at the maximum amount authorized.¹² However, with a combined balance of just over \$2 billion, these reserves total only 38.3 percent of fully funded levels. If the \$428 million deposit to the RDRF is made at the end of the current fiscal year as planned, this would increase the total to nearly \$2.5 billion or 41.2 percent of the authorized amount of \$5.9 billion for SFY 2019-20.¹³

When reviewing the adequacy of rainy day reserves, it is helpful to assess reserve balances in the context of comparisons between states and over time.

At the end of SFY 2018-19, New York's rainy day reserves were equivalent to just over 2.8 percent of General Fund spending, as shown in Figure 2.

This level was just below the historic high point over the last two decades of nearly 2.9 percent that was reached at the end of SFY 2014-15. The low point over the 20-year period was 1.5 percent in SFY 1999-00. While the TSRF balance has generally been close to or at its maximum level during this period, the combined balance of the rainy day reserves has not approached authorized levels since creation of the RDRF.

The picture becomes more variable when the rainy day reserves are combined with the unrestricted General Fund balance, with results ranging from a high of 13.5 percent in SFY 2017-18 to a low of 2.2 percent in SFY 2010-11 following the end of the Great Recession.

New York's rainy day reserves last year equated to 10.3 days of General Fund spending, a near high point for this metric over the past two decades.¹⁴ The lowest level of coverage occurred in SFY 1999-00, with 5.4 days. At the end of SFY 2018-19, rainy day reserves totaled \$105 per capita.

¹² Based on SFY 2018-19 actual General Fund spending and SFY 2019-20 projected spending in the SFY 2019-20 Enacted Budget Financial Plan.

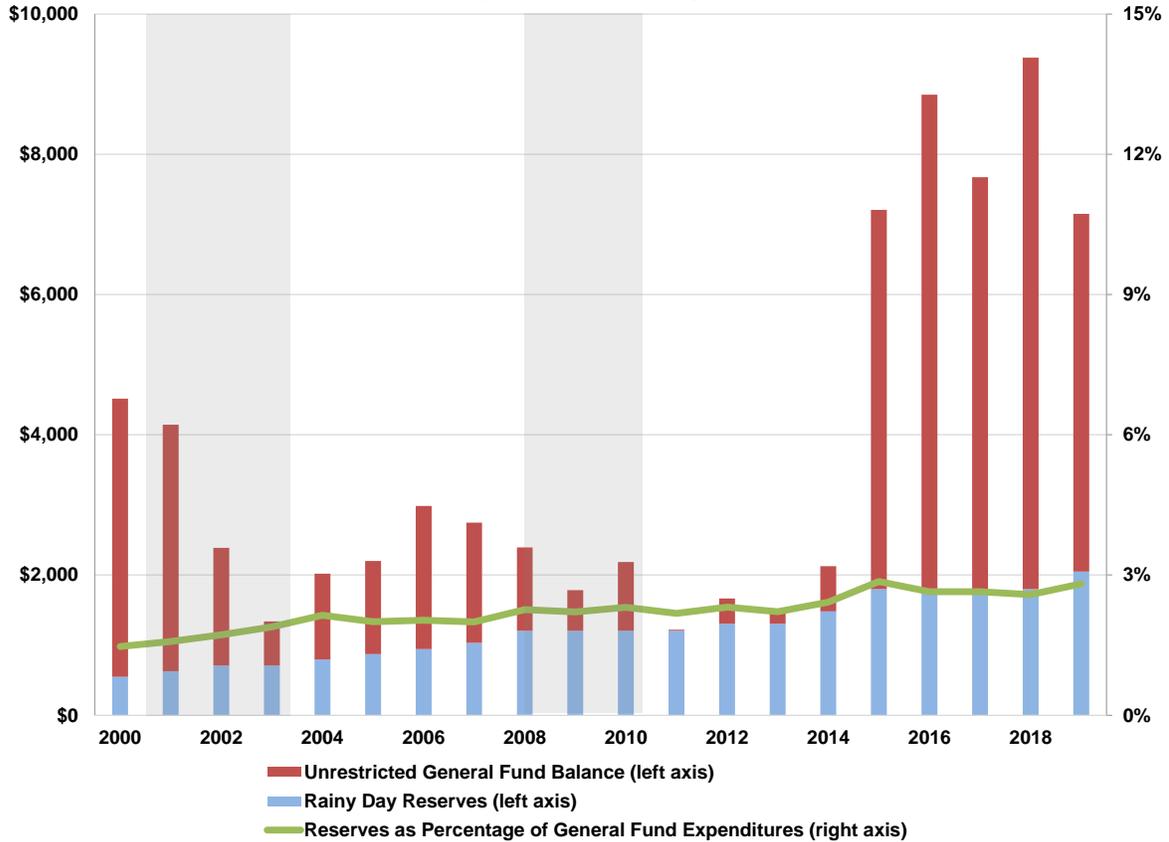
¹³ Based on SFY 2019-20 estimated General Fund spending and SFY 2020-21 projected spending in DOB's FY 2020 Mid-Year Update.

¹⁴ The number of days of coverage for General Fund spending was calculated using an average daily General Fund spending for each year.

Figure 2

New York’s Rainy Day Reserves and Unrestricted General Fund Balance Total, and Rainy Day Reserves as a Percentage of General Fund Spending SFY 1999-00 through SFY 2018-19

(in millions of dollars)



Source: NYS Office of the State Comptroller, NYS Department of Labor

Note: Rainy day reserves and unrestricted General Fund Balance are as of each March 31. Shaded areas represent New York recessions.

Figure 3 compares New York’s rainy day reserve balances with the estimated median among all states with such reserves and with estimates for the ten largest states by population with a rainy day fund (the comparison states).¹⁵

New York falls well under the national and comparison state medians with respect to the number of days of General Fund spending covered by rainy day balance and rainy day balance as a percentage of General Fund spending metrics. For example, New York’s \$2 billion balance equated to about 10 days of its General Fund spending in FY 2019, less than half the national median, well below the comparison states median and almost all the comparison states.

¹⁵ Figure 3 shows actual year-end fund balances and General Fund spending for SFY 2019 for New York State as reported by the Division of the Budget and estimated year-end fund balances and General Fund spending for other states and for the peer median. OSC calculated the national medians for FY 2019 using actual figures for New York State and estimated figures as reported by states to the National Association of State Budget Officers (NASBO) and published in *The Fiscal Survey of States*, Spring 2019. Historical information for New York and other states prior to FY 2019 presented in this report is from The Pew Charitable Trusts (Pew), *Fiscal 50: State Trends and Analysis, Reserves and Balances*. Pew indicates that such data was drawn from certain NASBO reports.

If New York’s rainy day funds were fully funded, totaling approximately \$5.3 billion at the end of SFY 2018-19, New York would score higher than or close to the national median and the comparison states’ estimated medians, with \$274 per capita, 27 days coverage of General Fund spending and rainy day reserves equivalent to approximately 7.0 percent of General Fund spending.

Figure 3

Rainy Day Fund Comparisons, FY 2019
Largest States with Rainy Day Reserve Funds
 (Reserve balances in millions of dollars; per capita figures in dollars)

	Rainy Day Reserve Balance	Rainy Day Reserve per Capita	Days' Worth of General Fund Expenditures in Rainy Day Funds	Rainy Day Funds as a Percent of General Fund Expenditures
California	17,816	450	47	12.4%
Florida	1,483	70	16	4.4%
Georgia	-	-	-	0.0%
Illinois	-	-	-	0.0%
Michigan	1,152	115	42	10.9%
New Jersey	-	-	-	0.0%
North Carolina	1,254	121	19	5.2%
Ohio	2,692	230	29	8.0%
Pennsylvania	23	2	-	0.1%
Texas	11,800	411	84	22.8%
New York	2,048	105	10	2.8%
National Median	738	199	25	7.5%
Comparison States Median	1,203	92	18	4.8%

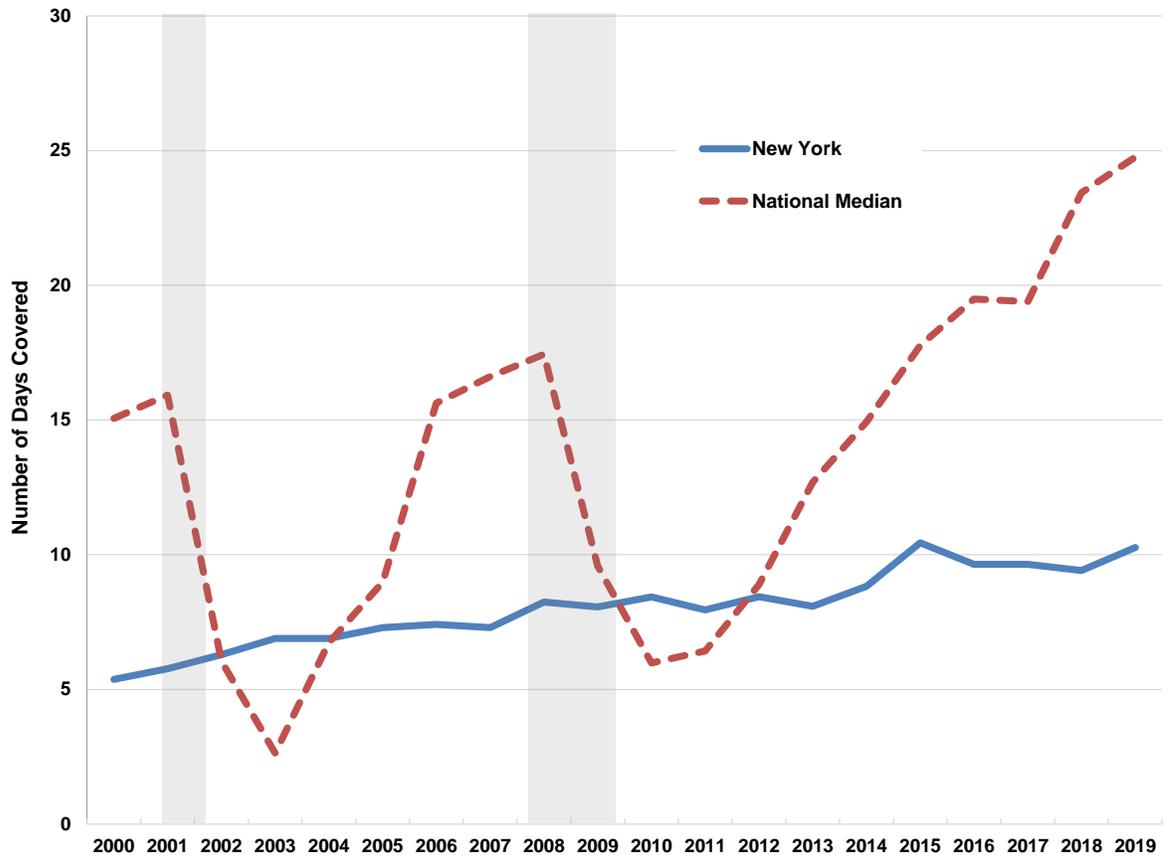
Source: National Association of State Budget Officers, The Pew Charitable Trusts, Office of the State Comptroller
 Note: New Jersey deposited \$250 million into its Surplus Revenue Fund after the Spring 2019 Fiscal Survey of the States was published by the National Association of State Budget Officers. In the column entitled "Days' Worth of General Fund Expenditures in Rainy Day Funds," the amount for Pennsylvania is 0.26, which rounds to 0.

The level of New York State’s combined rainy day reserves has exhibited a much different trend than that for all states over the past two decades, as Figure 4 shows in terms of the number of days of General Fund spending coverable by reserves.

The national median shows that typical states experienced steep declines in reserves as they drew upon those funds during periods of recession, followed by restoration of reserves in post-recessionary periods. In contrast, New York has consistently kept its reserves at relatively low levels and has not used them to mitigate difficult fiscal periods.

Figure 4

**Days of General Fund Spending Covered By Rainy Day Reserves
New York State Compared to the National Median
FY 2000 through FY 2019**



Source: National Association of State Budget Officers, The Pew Charitable Trusts, Office of the State Comptroller
Note: The shaded areas reflect periods of national recession.

IV. Recommendations for Rainy Day Reserves

Unlike the federal government, New York and most other states have some form of a balanced-budget requirement. Economic downturns or other extraordinary events can make balancing revenues and spending without harmful spending cuts or tax increases especially difficult. Forty-eight states, including New York, have created rainy day funds to help address that challenge.¹⁶

As shown earlier in this report, the states' rainy day fund balances vary widely both in dollar terms and in relation to spending, with California and Texas leading the way among the more populated states. California requires transfers of 1.5 percent of estimated general fund revenues for the current fiscal year to its Budget Stabilization Account each year, along with any personal capital gains tax revenue exceeding 8 percent of general fund revenues. In Texas, deposits to the Economic Stabilization Fund are required based on several factors, including unencumbered general revenue fund balance at the end of each fiscal biennium and the level of oil and gas production tax collections.

Fund structures differ from state to state, but their provisions commonly address rules for deposits, circumstances under which withdrawals can be made, repayment of such withdrawals, and the maximum size of the fund.

When determining the level of rainy day reserve balances necessary to mitigate budgetary risks and ensure stable tax rates, analysis of a variety of risks and other factors should be considered, including:

- The volatility of revenues and/or expenditures;
- Exposure to significant one-time outlays due to disasters, cuts in aid from external sources or other factors;
- Potential impacts on bond ratings and corresponding borrowing costs; and
- Whether some portions of the fund balance are already committed for specific purposes (e.g., cash flow).

While New York's statutory reserves provide vehicles for meeting the goals outlined above, the State has failed to make adequate use of these funds to fulfill their intended purposes:

- There is no effective requirement for building reserves during times of economic growth or otherwise. Most recently, for three consecutive years when the economy was expanding and State revenues were growing – SFYs 2015-16 through 2017-18 – no deposits were made to either fund. As outlined earlier in this report, while rainy day reserves have grown over the past decade, they amount to less than half of the combined authorized level, approximately 7 percent of General Fund spending.

¹⁶ Information in this section relating to other states is from National Conference of State Legislatures, "Rainy Day Fund Structures," November 2018, available at: http://www.ncsl.org/Portals/1/Documents/fiscal/RDF_2018_Report.pdf.

- Even if fully funded, New York’s rainy day reserves would be lower, as a percentage of the General Fund, than those in many other states that have set aside funds to provide more robust protection for future years’ budgets through this mechanism.
- In recent years, the Executive has established a practice of identifying certain unrestricted General Fund resources as available, or potentially available, in case of economic downturn or other critical need. For example, \$890 million in the General Fund is currently designated by DOB as an informal reserve for “economic uncertainties.” Such practice ignores the benefits of using formal budgetary reserves, which include increased certainty, stability and transparency as to whether funds will be available when most needed.
- The State’s last draw from the TSRF was in 1992, despite having experienced two recessions since then, the first of which included the painful budgetary impacts from the September 11, 2001 terrorist attacks. Funds in the RDRF have never been used. At times, the State has issued long-term debt to provide short-term operating budget relief, inappropriately shifting the burden of its current costs years and even decades into the future.
- Enhanced reserve levels would provide a form of self-liquidity for the State in times of reduced revenues. Such reserves would assist in avoiding a return to the State’s annual reliance on short-term borrowing for cash flow, and reinforce fiscal reforms made in this area in the 1990s. Robust reserves would also better enable the State to avoid the use of costly deficit financing in the event of economic downturns or catastrophic events.

What Reforms Are Needed?

After DOB added \$250 million to the RDRF at the end of SFY 2018-19, carrying out the projected \$428 million deposit this fiscal year should be a priority. This need is perhaps even more pronounced now, given revenue volatility in recent years and threats of potentially significant cuts in federal aid.

During each of the past two recessions the State’s base tax receipts declined, by more than 15 percent in SFYs 2008-09 and 2009-10 combined, and by approximately 12 percent in SFYs 2001-02 and 2002-03 combined.¹⁷

Tapping formal reserves may allow policymakers to cushion the effects of steep revenue declines or increased spending needs stemming from the effects of an economic recession or catastrophic event. However, use of reserves should not be considered the solution to addressing serious fiscal challenges resulting from issues of structural budgetary balance driven by non-economic factors. Such an approach could exacerbate the structural imbalance and delay difficult choices that need to be made to bring recurring spending in line with recurring revenue. Still, achieving significantly stronger reserves would give policy makers broad new flexibility by providing an interim tool to preserve essential services and limit unwanted tax increases in response to recessions or catastrophic events.

¹⁷ New York State Division of the Budget, *FY 2020 Economic and Revenue Outlook*, p. 6 at: <https://www.budget.ny.gov/pubs/archive/fy20/exec/ero/fy20ero.pdf>.

Providing the robust reserves New York State needs will require further, major steps. DOB should be charged with developing a plan, including statutory revisions where necessary: (1) to fully fund the TSRF and RDRF to currently authorized levels within five years; and (2) to further bolster these reserves to 10 percent of General Fund revenues over the following five years. When fully implemented, such a level of reserves would allow for a meaningful difference in the State's response to future economic downturns or catastrophic events.

Key elements of the plan to be developed by DOB should include:

Consistently adding to reserves. Just as the practice of routinely putting money away helps families and individuals build savings, consistent reserve deposits provide a reliable path to stronger State budgetary reserves. Regular deposits to reserves should be statutorily required, with exceptions for periods when the Legislature and the Executive jointly make a formal determination that economic and fiscal conditions preclude a deposit. Required deposits of at least 0.35 percent of General Fund revenues (with the exception mentioned above) would allow the State to achieve steady progress toward fully funding its rainy day reserves at the currently authorized and recommended elevated levels while appropriately recognizing broader budgetary needs. To assist in making such deposits routine rather than special events, they should be made monthly, based on ongoing General Fund receipts.

For illustrative purposes, a deposit of 0.35 percent of such receipts in SFY 2018-19 would have totaled \$245 million, compared to the \$250 million deposit actually made at the end of the fiscal year.

From SFY 1999-00 through SFY 2018-19, rainy day reserves rose by an average of \$79 million per year, or 0.15 percent of the annual average of General Fund revenues during this period. If a policy requiring annual deposits of 0.35 percent of annual General Fund receipts had been authorized and implemented during that period, the State's current rainy day reserves would be \$2.3 billion higher as of the end of SFY 2018-19, as illustrated in Figure 5. Further, using this scenario, rainy day reserves as a percentage of General Fund spending would have been 5.9 percent, rather than the actual 2.8 percent as of that date.

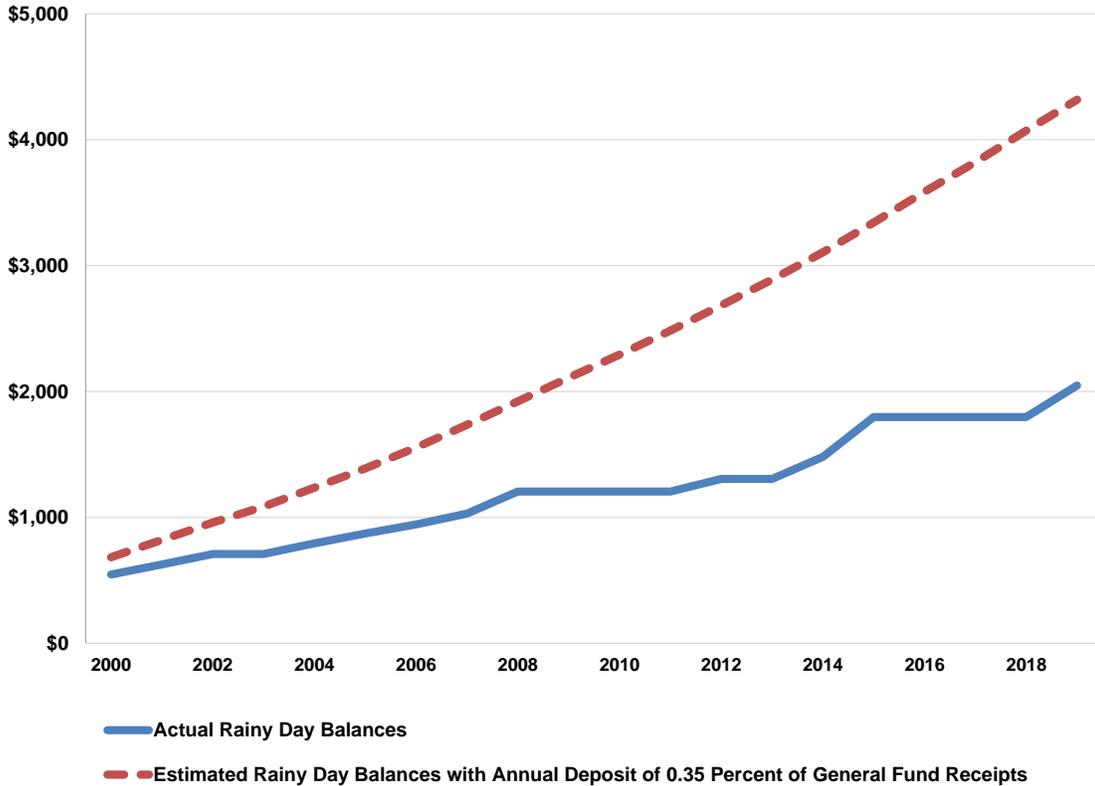
Key steps forward in building New York's rainy day reserves

- Fully fund reserves to current statutory limits within five years.
- Statutorily authorize reserves up to 10 percent of General Fund revenues; fully fund that level within the following five years.
- Require ongoing deposits of at least 0.35 percent of General Fund revenues, with limited exceptions. Additional deposits would be allowed, to reach the goals outlined above.

Figure 5

**How Annual Deposits Could Add Up Over Time:
Actual Rainy Day Reserve Balances and
Estimated Balances With Annual Deposits of 0.35% of General Fund Receipts
SFY 1999-00 through SFY 2018-19**

(in millions of dollars)



Taking advantage of new opportunities to build reserves. The State has used some of the extraordinary monetary settlement revenues received in recent years to strengthen its statutory rainy day reserves. To help meet the interim goal of fully funding the rainy day reserves at their authorized amounts within five years, the “economic uncertainties” set-aside of \$890 million should be deposited to the RDRF this year. Going forward, additional deposits up to a limit of 1 percent of General Fund revenues should be made to the extent practicable. Such deposits should be given strong consideration if and when additional settlements are received. Another new opportunity arises as the State’s debt service payments to the New York Local Government Assistance Corp. (LGAC) decline as outstanding LGAC debt is fully paid off over the coming years, with final payments currently scheduled in 2025. LGAC was created in 1990 to eliminate the State’s annual reliance on short-term borrowing for cash flow purposes. Resources of a comparable level to those that have been dedicated to pay those debt service costs – \$301 million in the current fiscal year – could be used at least in part as an investment in a stronger fiscal future by allowing more robust annual deposits to reserves.

Routinely assessing adequacy of reserves. While Financial Plan documents provide figures on reserve levels, the Division of the Budget does not include an assessment of the adequacy of its rainy day reserves for managing risks related to economic downturns, revenue volatility

and catastrophic events. Such assessment should be required as part of the Financial Plan and updates to it. In addition to its rainy day reserves, prudence requires that the State maintain a certain level of resources within the General Fund as an available reserve for cash flow purposes, given variations in timing of certain revenues and spending during the fiscal year. The Financial Plan typically does include commentary as to the adequacy of cash holdings during the current fiscal year; a required assessment of rainy day reserves would significantly enhance this perspective.

Making budgetary reserves transparent. Since the State began receiving billions of dollars in extraordinary monetary settlements in 2014, some of these resources have been retained in the General Fund and treated informally as reserves. While informal reserves may augment resources in the TSRF and RDRF, the State's clear emphasis should be on bolstering its formal reserves to the fullest practical extent.

Establishing clear policies for expected use of rainy day reserves. While budget reserves should only be used when truly needed, revenue declines driven by recession or other circumstances may make drawdown from reserves completely appropriate. The State used TSRF resources 11 times from 1949 through 1992, but has not drawn upon either rainy day reserve since. As a result, the budgetary benefits of these reserves have been limited, with cash flow management a primary purpose. Instead of using reserves as intended, the State too often has resorted to undesirable budgetary actions such as delays in payments, tax increases, borrowing, or raiding funds dedicated to other purposes. State policy makers should consider establishing clearer expectations as to when formal reserves should be drawn upon in response to significant budgetary challenges, including statutory reforms as needed.

Revenue declines during previous economic downturns have forced New York leaders to enact painful spending cuts, tax increases, increases in borrowing and other undesirable actions. The State's rainy day reserves were established to avoid such steps in the future. Disciplined action to build these reserves is essential if the State is to successfully address fiscal challenges in coming years without having to resort to severe spending reductions, unwanted tax increases and other damaging steps.

V. Appendix

New York's Rainy Day Reserves: Overview of Statutory Provisions

Tax Stabilization Reserve Fund

Key statutory provisions of the TSRF include those described below.

Deposits: At the close of each State fiscal year when there is a General Fund cash surplus, such surplus, up to and including 0.2 percent of the “norm” (which is defined as the aggregate spending from the General Fund during the year in which the surplus occurred), is required to be deposited into the TSRF.¹⁸ The most recent deposit, \$126.4 million, was in 2015. In practice, the Division of the Budget determines whether such deposits are required to be made pursuant to these provisions.

Maximum balance: The balance of the TSRF is limited to 2 percent of the norm. As of the end of last year, this would have allowed up to \$1.5 billion to have been held in the fund, \$198 million above the actual balance. In any year in which a required deposit would increase the balance above the limit, the excess amount is required to remain in the General Fund and be used for the reduction of State taxes.

Withdrawals: Moneys can be transferred or loaned to the General Fund as follows:

- ***Year-end transfers to the General Fund:*** At the end of any fiscal year in which receipts from taxes, fees and other sources required to be deposited to the General Fund are lower than the “norm” for such year (based on a calculation involving current year General Fund spending), a transfer (deposit) to the General Fund is required. The amount of such transfer must equal the difference between such receipts and the norm, to the extent that there are sufficient moneys in the TSRF.
- ***Intra-year temporary loans to the General Fund:*** Moneys in the TSRF may be temporarily loaned to the General Fund during any year in anticipation of the receipt of taxes, fees and other sources required to be deposited to the General Fund during such year. No interest cost is imposed on intra-year temporary loans to the General Fund.

Repayments:

- Year-end transfers from the TSRF to the General Fund are required to be paid back in at least three equal annual installments over a period of six years or less following the transfer. Such repayments are required to be included in annual budget bills.
- Intra-year loans must be repaid by the close of the fiscal year in which the loan was made. If an intra-year loan is not repaid by the close of the fiscal year in the year it was loaned, the amount is deemed to be an inter-year transfer.

¹⁸ According to Section 92(2) of the State Finance Law, “the aggregate amount disbursed from the general fund during the fiscal year shall constitute the norm for such fiscal year of the amount of revenues from such taxes, fees and other sources.”

Rainy Day Reserve Fund

The RDRF includes the following key statutory provisions:

Deposits: Deposits may be made at the option of the State Budget Director and are limited to 0.75 percent of projected General Fund disbursements in the then-current fiscal year, up to the maximum permitted fund balance.

Maximum balance: The balance is limited to 5 percent of projected General Fund disbursements in the State fiscal year (SFY) immediately following the then-current year. This maximum was increased in 2015 from its initial limit of 3 percent.

Withdrawals: No withdrawals have been made from the RDRF since its inception. Moneys may be withdrawn from the RDRF under the following conditions:

- **Economic downturns:** If a composite index of business cycle indicators published by the State Commissioner of Labor declines for five consecutive months, the Commissioner is required to notify the Governor, the Temporary President of the Senate, the Speaker of the Assembly and the Minority Leaders of the Senate and the Assembly. Upon such notification, the Budget Director may authorize a transfer from the RDRF to the General Fund as the Director deems necessary to meet the requirements of the Financial Plan.¹⁹ This authority to transfer funds lapses when the index increases for five consecutive months or 12 months from the original notice of five consecutive declines provided by the Commissioner (with each consecutive monthly decline in the index, this 12-month lapse date extends by one additional month), whichever is earlier.
- **Catastrophic events:** In case of a need to repel invasion, suppress insurrection, defend the State in war or respond to any other emergency resulting from a disaster, including an act of terrorism, the Budget Director may authorize a transfer from the RDRF.
- **Notification of transfers:** Prior to authorizing any transfer from the RDRF for reasons of economic downturns or catastrophic events, the Budget Director is required to notify the Speaker of the Assembly, the Temporary President of the Senate and the Minority Leaders of the Senate and the Assembly of the reasons for the transfer and the amount.
- **Intra-year temporary loans to the General Fund:** In 2009, authorization was added to allow moneys in the RDRF to be loaned to the General Fund during any year in anticipation of certain tax and other revenues. This authorization effectively allows the RDRF to be used for cash-flow management purposes in addition to its original purpose of mitigating “rainy day” risks.

Repayments:

- In the case of an economic downturn, moneys transferred to the General Fund must be repaid to the RDRF within three years after the authority to transfer funds lapses (as described above).
- When RDRF resources are used in response to a catastrophic event, repayment is subject to provisions proposed by the Executive and implemented by appropriation or transfer of funds.
- Intra-year loans must be repaid by the close of the fiscal year in which they occurred.

¹⁹ The statute was amended in 2016 (Chapter 54, Laws of 2016, Part UU Section 26) to change how the composite index of business cycle indicators is measured.

Contact

Office of the New York State Comptroller
110 State Street, 15th Floor
Albany, New York 12236

(518) 474-4015

www.osc.state.ny.us

Prepared by the Office of Budget and Policy Analysis



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