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It's Raining Hard: Tap the Fund

by Jack Hoffman

More than 20 years ago, Vermont had the foresight to establish a rainy day fund to help the state through hard economic times. Today, the Legislature could spare Vermonters additional painful budget cuts and give the state economy a boost if it stopped hoarding this money and used these reserve funds as intended.

Vermont has four separate reserve funds. The largest of these, the General Fund Stabilization Reserve, contains $60 million, the statutory maximum.

Legislative leaders and the Douglas administration have resisted using the reserves. They argue that they don't know how long the recession will last, and once the funds have been spent, they're gone.

TABLE 1

Vermont's Reserves Aren't Being Used

Reserve fund ending balances FY2007-FY2009, in millions

	FY2007	FY2008	FY2009
General Fund	$55.2	$57.8	$60.0
Transportation Fund	10.7	11.2	11.3
Human Services	17.0	17.2	16.3
Education Fund	28.2	29.4	31.1
	$111.1	**$115.6**	**$118.7**

Source: Department of Finance and Management

It is true the rainy day funds can be spent only once. But their purpose is to prevent harmful cuts to important services—or to provide those services without the need for additional taxes. If the reserves are used first and the following year sees another budget gap, people can decide then how much revenue to raise or what services to cut. What the Legislature and the governor have done is to make cuts first and hold onto the reserves—evidently hoping they will never have to be used. While that may provide comfort to Montpelier, it's no help to Vermonters.

Vermont's first rainy day fund was created in 1987, when the economy was booming and the state was running large budget surpluses. Initially, the fund was capped at 2 percent of the General Fund; the first year the Legislature appropriated $8.6 million in reserves.[1] Just a couple of years later the economy went south. At the close of fiscal 1991, the fund contained $8.2 million, which was used to lower the state's year-end deficit to just under $60 million.

The recession of the early 1990s was painful. But as the economy improved, the administration and the Legislature moved promptly to refill the reserves. They increased the cap to 5 percent from 2 percent and created reserves for both the General Fund and the Transportation Fund. Later, reserves were established for the Education Fund and certain human services programs.[2]

Most states now have rainy day funds. In the past two years, 40 states have tapped them to some extent; 27 have used at least half of their reserves.[3] At the end of fiscal 2006, the states held almost $70 billion in general fund reserves—that is, year-end surpluses and rainy day funds. By the end of fiscal 2009, the year-end balances had dropped to $32 billion. The fact that nearly half of the remaining reserves are held by just two states, Alaska and Texas, means that most states have made substantial withdrawals from their rainy day funds. In other words, most other states have recognized this economic downpour for what it is.

Vermont is among the states that seem not to know it is pouring outside. At the end of fiscal 2009 the state had almost $120 million in reserves—a balance bigger than before the start of the recession in the middle of fiscal 2008 (**Table 1**).

Using rainy day funds not only eases some budget pressure, it also provides a small boost to the economy. The American Recovery and Reinvestment Act passed by Congress last year was designed to stimulate the economy by generating hundreds of billions of dollars of economic activity that would not have occurred otherwise. The federal government increased food stamp benefits and unemployment compensation, which provided people money that they spent immediately on food, heat, gas, and other necessities. It gave general operating funds to state governments so they would not have to cut back as much on their spending. Additional federal funding went to education, highway construction and maintenance, energy projects, telecommunications, and other infrastructure improvements.

The $60 million in Vermont's General Fund Stabilization Reserve, even in relative terms, is a tiny fraction of the federal stimulus package, which some economists have argued was far too small. But $60 million is not nothing, and using a substantial portion of it would generate spending that otherwise would not have occurred in Vermont. Cutting the budget by $60 million or raising taxes by $60 million does put a drag on the economy—although targeted increases on upper incomes create less of a drag than budget cuts. By contrast, spending rainy day funds would create a small but positive economic effect.

The Center on Budget and Policies Priorities in Washington, D.C., made this point two years ago in a report urging states to use their reserve funds to respond to the recession. "Is It Raining Yet? Yes, and It's Time for Many States To Use Their Rainy Day Funds" listed four reasons for states to dip into their reserves sooner rather than later. Reason Number 1: "It's good for the state economy."[4]

Before Vermont created rainy day funds, it occasionally ran budget deficits when recessions hit. These deficits served essentially the same purpose: They allowed the state to avoid harmful budget cuts and big tax hikes. Taxes were raised in the recessions of the early 1980s and early 1990s, and the additional revenue went to paying off the deficits gradually. Running a short-term deficit is an option available only to Vermont; all other states have constitutional or statutory prohibitions against operating deficits. Rainy day funds should be used first. But a temporary deficit would cause less harm to individual Vermonters than some of the budget cuts that are likely to be proposed in the coming weeks.

And when the economy does turn around and Vermont starts refilling the stabilization reserves, the Legislature should increase the maximum allowed in the funds to at least 10 percent of annual expenditures. Imagine how much easier it would have been to close Vermont's budget gaps if the state had had $150 million or $200 million in reserves at the start of this recession.

The blow this recession has dealt state budgets is worse than any other in the last several decades. Perhaps Congress will take the steps necessary to avoid a similar calamity for another couple of generations. But this crisis teaches the states a lesson: They must be prepared for precipitous drops in revenue just when people are most in need of essential public services. Like other states, Vermont needs a healthy rainy day fund—and it needs to use it.

ENDNOTES

1. Deborah Sline, "Fund to Prevent Deficits Wins Legislative Approval," *Rutland Herald*, May 21, 1987, 1.
2. Vermont Statutes Annotated, 16 V.S.A. § 4026; 32 V.S.A. § 308.
3. National Association of State Budget Officers, *Fiscal Survey of the States*, Fall 2009, table 9, 26; table A-13, 72.
4. Elizabeth McNichol, "Is It Raining Yet? Yes, and It's Time for Many States To Use Their Rainy Day Funds," *Center on Budget and Policies Priorities,* Feb. 21, 2008, http://www.cbpp.org/cms/index.cfm?fa=view&id=1094 (accessed Jan. 11, 2010).

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PO Box 942, Montpelier, Vermont 05601
802-223-6677
www.publicassets.org