Appendix D: Rainy Day Fund

Background on State "Rainy Day" Funds

Budget stabilization funds, or "rainy day" funds as they often are called, are now common in most states. By early 2002, 47 states, the District of Columbia and Puerto Rico had created rainy day funds. The only states without such funds are Arkansas, Montana, and Oregon.

The original concept of a budget stabilization fund is straightforward: money is saved when state finances are healthy for use when the state's economy takes a downturn. Over time, however, this definition of a stabilization fund has been expanded to encompass other budgetary concerns.

Deposits to stabilization funds typically are based on year-end surpluses, are made by appropriations, or combine both. In states where the deposit is tied to a budget surplus, the deposit usually occurs through a transfer authorized by the executive budget officer or treasurer.

A majority of states limit the use of their budget stabilization funds to cover revenue shortfalls or some other budget deficiency. Several states also allow the funds to be used for emergencies. A few states have not placed any specific limitations on how the fund can be spent; funds can be appropriated for any reason the Legislature deems necessary. In almost a dozen states, some or all withdrawals can occur only with a supermajority vote of the Legislature.

At least 32 states have capped the size of their budget stabilization funds. In a third of those states, the cap is 5 percent of general fund appropriations, expenditures, prior year revenues, or some other similar base. The next most common cap is 10 percent, and applies to five funds, three of which are authorized by state constitutions. With a few exceptions, the balances in most budget stabilization funds have not reached their legal caps.

Up until the late 1990s, budget stabilization funds were generally considered to contain insufficient monies to be really useful. Although Wall Street analysts recommend that states maintain budget stabilization funds equal to 3 percent to 5 percent of their general fund budgets, most states fell far below that level.

Due to extraordinary growth in states' personal income, by the late 1990s many states reported rainy day fund balances at historical highs. Even as late as January 2002,

about 28 states and the District of Columbia were reporting fund balances greater than 3 percent of general fund expenditures and more than half of those jurisdictions had balances in excess of 5 percent of annual spending.

History of Rainy Day Funds in Washington State

1981 – The **Budget Stabilization Account** (RCW 43.88.520 - 540) was established by the Legislature. The account would receive transfers (by legislative appropriation) from the state general fund equal to 1 percent of general state revenues, plus the unobligated cash surplus in the general fund at the end of each biennium (also by legislative appropriation). The account was capped at 5 percent of biennial general state revenues. The Budget Stabilization Account could be appropriated by the Legislature to provide for the continuation of agency programs at or near existing appropriation levels when revenue projections decline.

1982 – The **Budget Stabilization Account** is modified to require transfers to the account equal to the annual growth rate in real personal income minus three percentage points, multiplied by general state revenues for the immediate preceding fiscal year. Expenditures from the account can be made only by a 60 percent vote of the Legislature, but the allowable uses are expanded to include labor force training and other purposes that would reduce unemployment caused by the economic cycle.

1993 – The Budget Stabilization Account is repealed by the voters in Initiative 601 and replaced with the **Emergency Reserve Fund** (RCW 43.135.045). The Emergency Reserve Fund receives all general fund revenue in excess of the expenditure limit, up to a maximum of 5 percent of biennial general fund revenues. Monies in the Emergency Reserve Fund may be appropriated by a two-thirds vote of the Legislature, but only if the expenditure is below the state spending limit. When the Emergency Reserve Fund reaches the 5 percent maximum, the excess is transferred to the Education Construction Fund.

2000 – The **Emergency Reserve Fund** is modified by three legislative actions: (1) $35 million from interest earnings in the Emergency Reserve Fund are transferred annually to the Transportation Multimodal Account (Senate Bill 6876); (2) the maximum level of the Emergency Reserve Fund is changed from 5 percent of biennial revenues to 5 percent of annual revenues (House Bill 3169); and (3) 75 percent of excess revenue from the Emergency Reserve Fund is transferred to the Student Achievement Fund, and the remainder flows to the general fund (Initiative 728).

2002 - The supermajority vote requirement for the Legislature to appropriate money from the **Emergency Reserve Fund** is suspended for the 2001-03 Biennium (Senate Bill 6819).

Supermajority Vote Requirements

Supermajority voting requirements are highly popular features of most states' rainy day fund statutes. While two-thirds, three-fifths or 60 percent voting requirements to tap rainy day accounts can help to ensure that use of the funds represents a truly bipartisan decision of the state Legislature, supermajorities can often be used as an impediment during times of true fiscal crisis, preventing the majority party from governing and responding in a timely way to a critical fiscal situation.

For example, some legislators may be reluctant to vote to spend rainy day funds out of fear that economic problems may be worse in future years than they are now. Others argue that use of such "one-time" monies is not a long-term solution to a budget problem or could somehow damage the state's credit or bond rating.

The Center on Budget and Policy Priorities argues that since rainy day funds are designed to provide a quick infusion of resources during a downturn to help avoid debilitating cuts to public services at the very time the services and programs are needed most, it makes little sense to save money as a means of preventing possible cuts in the future if doing so means making definite cuts in the present.

While the notion of having a supermajority requirement to spend rainy day funds which may have taken years to accumulate has some merit, the real world problem has always been getting a supermajority of legislators to agree on when it is truly raining from a budgetary perspective. During the 2002 session of the Washington Legislature, despite a real decline in general fund revenues for the first time in years, majority Democrats in the Senate and House claimed they could not persuade sufficient Republicans to join them in tapping the state's rainy day fund with a two-thirds vote. Democrats then amended the supermajority requirement to access the state's rainy day fund from two-thirds to a 50 percent vote.

Cap on the Size of the Fund

Many states set upper limits on the size of their emergency funds, generally based on 3 to 5 percent of annual spending or revenues. Five percent tends to be the most common amount, stemming from suggestions from economists and other private and public fiscal experts that states should establish reserve accounts of at least 5 percent of annual spending or revenues. For states with biennial budget requirements, the percentage amount often applies to two years' worth of spending or revenues.

Many state rainy day funds also have what are termed "spillover" provisions that dictate how monies in excess of the statutory or constitutional cap should be used. Many states simply cap the fund at a specified percentage and let the excess stay within the general fund. Others direct the excess to purposes such as capital construction, debt service and tax relief.

In practice, it has been very difficult for state legislators to let their rainy day funds build up to 3, 4 or 5 percent of budget or revenue growth because the larger the fund grows, the more it becomes a target for increased spending or tax relief. For example, in 2000, Washington's rainy day fund was projected to have a balance of almost $800 million by the end of the 1999-01 Biennium. However, during that session, the Legislature passed a measure which lowered the fund's cap from 5 percent of biennial revenue to 5 percent of annual revenue and directed all interest on the fund to pay for transportation projects. Lower interest rates and the 2001 Nisqually earthquake further depleted the rainy day fund so that when legislators came to Olympia for the 2002 session, less than half of the $800 million was available to help close a $1.5 billion budget deficit.

Just as important, then, to how excess funds above the percentage cap are disposed is the question of how to protect depletion of rainy day funds during times of economic prosperity. During the campaign for Initiative 695, proponents repeatedly pointed to the size of the state's rainy day fund as justification that government had too much money and that elimination of the motor vehicle excise tax would do little to harm the provision of public services.

Criteria for Making Deposits and Withdrawals

Perhaps the most critical feature of any rainy day fund is the method by which funds are deposited into and withdrawn from the account. Many states use an "automatic deposit" feature that is tied to either a percentage of annual revenues or spending. Others require all or a portion of the excess general fund balance at the end of the fiscal period to be deposited into the fund. Such "forced" savings plans make good financial sense provided the amount is regular, predictable, and unlikely to severely hamper the provision of public services.

What is less common, however, are criteria for making withdrawals from the fund. Most states simply rely on the supermajority voting requirement to serve as the gatekeeper for when funds should be withdrawn. The underlying logic of this approach is that if two-thirds or three-fifths of the Legislature votes to tap the monies, then it must truly be an emergency. However, as the 2002 session of the Washington Legislature proved, there is rarely universal or even supermajority agreement on when it is appropriate to make a withdrawal from a rainy day fund.

It would be possible to define a "rainy day" in statute and create a "trigger" mechanism that would automatically make funds available for appropriation. Although rainy days are often discussed in terms of revenue declines, it would be more appropriate to use an economic indicator outside the control of the Legislature. Otherwise the Legislature could simply cut taxes to the point that revenues meet the rainy day criteria and thereby drain the fund.

Typical indicators might include employment growth, personal income growth or real (inflation-adjusted) personal income growth. Personal income is a very common measure of the overall size of the economy. It is similar to the concept of gross

domestic product at the national level and is a fundamental piece of the state's official economic and revenue forecast.

For example, personal income growth reached the extremely high levels of almost 8 percent in the late 1990s but has since decreased to only 0.2 percent in 2002. A possible threshold could be set at (for example) 2 percent growth of personal income and when the official revenue forecast projected slower growth, funds could then be transferred.

States with Economic Triggers for Withdrawals from Rainy Day Fund

Arizona (ARS 35-144)
The Budget Stabilization Fund is capped at 7 percent of fiscal year general fund revenue. Any surplus is transferred to the general fund. If real personal income growth is less than 2 percent and less than the seven-year trend, transfers may be made to the general fund. A two-thirds vote is required for other transfers.

Colorado (CRS 24-75-201.1, 201.5)
The Required Reserve must be maintained at 4 percent of general fund appropriations. The reserve is used automatically when revenue declines from forecasted level. If expenditures are made from the Required Reserve, the Governor must submit a plan to the Legislature to maintain at least a 2 percent reserve.

Indiana (IC 4-10-18-3)
Deposits are made to the Counter-Cyclical Revenue and Economic Stabilization Fund when personal income grows faster than 2 percent. If annual growth in personal income is less than negative 2 percent, automatic transfers are made to the general fund in an amount determined by the following formula: annual general fund revenues multiplied by the percentage by which personal income growth is less than negative 2 percent. (If personal income grows at negative 5 percent, the automatic transfer would be 3 percent of general fund revenues.)

Michigan (MSA 18-1351 – 1359)
Deposits are made to the Countercyclical Revenue and Economic Stabilization Fund when personal income grows faster than 2 percent. If annual growth in personal income is negative, transfers shall be made to the general fund in an amount equal to the percentage decline in personal income multiplied by annual general fund revenues (not to exceed the amount necessary to balance the budget).

Minnesota (MS 16A.152)
The Governor may make withdrawals from the Budget Reserve Account when a deficit in the general fund is projected and "objective measures, such as reduced growth in total wages, retail sales, or employment, reflect downturns in the state's economy."

Texas (Texas Const. Art. 3, sec. 49-g)
The Legislature may appropriate moneys from the Economic Stabilization Fund if general revenues are less than the appropriations made by the preceding Legislature, or if anticipated revenues for a succeeding biennium are less than revenues available for the current biennium. Other appropriations from the fund may be made by a two-thirds vote of the Legislature.

Other Considerations in Designing an Effective Rainy Day Fund

Rainy day funds have often provided little stability for state budgets because they are only one part of a state's financial health. Faster than normal revenue growth has historically been accompanied by tax cuts and/or other diversions of revenue to non-general fund spending that prevent the fund from reaching a level that is truly useful during an economic downturn.

In Washington State the failure to accumulate a large rainy day fund is associated with the Initiative 601 spending limit and the initiative process. The tax cut and revenue diversions stemming from Referendum 47 and Referendum 49 were cast with consideration of supporting future expenditures at or below the I-601 growth rate. Had these been the only tax cuts and revenue diversions adopted in the last five years, the balance in the Emergency Reserve Fund would have been much greater.

However, the growth rate of current state services is inherently faster than population and inflation. To live within the I-601 limit would require the continued downsizing of state government. A rainy day fund could be more effective if it were adopted in conjunction with a new spending limit that prevents spending fast-growing revenues during boom times without requiring the dismantling of current state services. Some have suggested that a spending limit based on a percentage of personal income could provide the flexibility for policymakers to grow state government, while still providing a limit to prevent double-digit government growth during economic "boom" times. Such a spending limit could also provide some discipline for the Legislature to accumulate larger budget reserves.

Initiatives in the last five years have been the other major reason why the Emergency Reserve Fund has not provided more counter-cyclical relief. Large reserves were used as justification for why certain initiatives (I-695 and I-747) were sustainable. It is not evident that a spending limit would influence the public and prevent the adoption of initiatives that reduce revenue or divert it from the general fund. Changes in the initiative process to limit tax reduction or diversions would also be useful in strengthening and protecting a rainy day fund. For example, if the voter's pamphlet was required to show the long-term fiscal implication of an initiative, it could provide some support to maintaining higher reserves.

Sample Draft Revenue Stabilization Account Constitutional Provision

The following section provides sample language for a constitutional amendment to enact a rainy day fund.

"A new section shall be added to Article VII of the Washington State Constitution as follows:

(a) A revenue stabilization fund shall be established and maintained in the treasury.

(b) If the forecast growth of general state revenues for any fiscal year from the prior fiscal year is estimated to be greater than [one][three] percent, as adjusted for inflation, there shall be appropriated to the revenue stabilization fund in that fiscal year an amount equal to one percent of the forecasted general state revenues for that fiscal year. Nothing in this paragraph (b) shall prevent the appropriation of additional amounts to the revenue stabilization fund.

(c) If the forecast growth of general state revenues for any fiscal year is estimated to be less than [zero], as adjusted for inflation, there shall be appropriated from the revenue stabilization fund to the general fund in that fiscal year, an amount equal to the difference between the forecast general state revenues for that fiscal year (as adjusted for inflation from the prior year) and the estimated general state revenues for the year prior to that fiscal year. Any amount may be withdrawn and appropriated from the revenue stabilization fund at any time by the favorable vote of at least three-fifths of the members elected to each house.

(d) Amounts in the revenue stabilization fund may be invested as provided by law and retained in that fund. The legislature may at any time for any fiscal year by the favorable vote of a majority of the members elected to each house, withdraw and appropriate amounts in the revenue stabilization fund, including investment earnings, when the balance in the fund equals more than [five][ten] percent of the estimated general state revenues in the prior fiscal year.

(e) As used in this section, general state revenues shall have the meaning set forth in Article VIII, Section 1. Forecasts and estimates shall be made by a state forecast council appointed as provided by statute and approved by the favorable vote of three-fifths of the members of the Senate. Adjustments for inflation shall be based on an index selected by the forecast council that is applicable to the state or to one or more selected metropolitan areas within the state that is prepared by an agency of the United States.

(f) The legislature shall enact appropriate laws to carry out the purposes of this section. The legislature, by the favorable vote of three-fifths of the members elected to each house, may adjust the term [one] [three] percent in subsection (b) to

no greater than (x) percent , and may adjust the term "zero" as used in subsection (c), to no greater than one percent and no less than negative one.

(g) This section shall be effective as of the third fiscal year following the fiscal year in which it is approved by the qualified electors of the state."

Fiscal Performance of the Proposed Rainy Day Fund Triggers

Proposal and Simulation

1. INTRODUCTION

Two criteria for an effective rainy day fund are the following: (1) the fund collects and dispenses appropriate amounts of money at appropriate times; and (2) it is simple to operate. Of the various alternatives studied by the Washington State Tax Structure Study Committee, the rainy day fund proposed here comes closest to satisfying these criteria.

The purpose of this section is to describe the operation of the proposed rainy day fund and to simulate its behavior over time. In particular, the operation of the rainy day fund is simulated from FY 1989 to FY 2002 using actual data and forecasts published by the Washington State Office of the Forecast Council (OFC). Thus, the simulation shows exactly how the rainy day fund would have performed during this period of time.

2. RAINY DAY FUND

Following is a brief description of the rainy day fund:

1. Objective. The rainy day fund is designed to provide money for the general fund for fiscal years in which general fund revenue is expected to increase less than the inflation rate, as measured by the Seattle consumer price index. In such a year, the so-called rainy day, the amount of money withdrawn from the rainy day fund and deposited into the general fund is just sufficient to keep general fund revenue constant with respect to the prior year's level after adjusting for inflation. In other years, a specified amount of money is appropriated from the general fund and deposited into the rainy day fund.

2. Data and forecasts. The source of data and forecasts required to operate the rainy day fund is the quarterly publication prepared by the OFC entitled "Washington Economic and Revenue Forecast." In particular, the rainy day fund makes use of actual and forecast fiscal-year estimates of general fund revenue (cash basis) and the Seattle consumer price index obtained from the November issues of the publication.

3. Restrictions. The operation of the rainy day fund is subject to three restrictions: (1) no more than 1 percent of the general fund revenue in a year will be deposited into the fund; (2) no more than the current balance of the rainy day fund in any year will be withdrawn from the fund (i.e., the fund's balance cannot be negative); and (3) the total amount of money in the rainy day fund in any year will not exceed 10 percent of the general fund revenue.

4. Operation. As part of the budgetary process, each November, just before the legislative session, OFC produces economic and revenue forecasts for the upcoming fiscal year, including predictions of general fund revenue (cash basis) and the Seattle consumer price index. In accordance with the objective of the rainy day fund, the difference between the predicted growth rate for general fund revenue and the predicted growth rate for the Seattle consumer price index, expressed as a percentage, ultimately determines how much will be contributed to or withdrawn from the rainy day fund in the upcoming fiscal year.

   If the percentage point difference is positive, an amount of money equal to that percentage point difference multiplied by the general fund revenue in the current fiscal year (i.e., the year in which this determination is taking place) will be deposited into the rainy day fund during the upcoming fiscal year. In no case, however, will the deposit amount to more than 1 percent of the general fund revenue in the upcoming fiscal year.

   If the percentage point difference is negative, an amount of money equal to the percentage point difference multiplied by the general fund revenue in the current fiscal year will be withdrawn from the rainy day fund during the upcoming fiscal year. In no case, however, will the withdrawal amount to more than the balance of the rainy day fund at the end of the current fiscal year.

   Since the operation of the rainy day fund uses forecasts, which are subject to error, a second step is required. In the following November, which will be five months into the fiscal year in question, the above calculations will be repeated using up-to-date data and forecasts from OFC. Based on the new calculations and in accordance with the objective of the fund, an adjustment to the previously determined deposit to or withdrawal from the fund will be made.

   As an illustration, consider how the rainy day fund would have operated in FY 2002, which was in the middle of the current recession. In November 2000, when there was little sign of the downturn, OFC predicted that general fund revenue would increase 1.7 percent from $10,735.8 million in FY 2001 to $10,923.4 million in FY 2002, while the Seattle consumer price index would increase 2.2 percent from 1.818 (1982-84=1.000) in FY 2001 to 1.858 in FY 2002 (see Table 2). The difference between these

two growth rates is -0.5 (=1.7-2.2) percent. Accordingly, an amount equal to $48.6 (=0.005[10,753.8]) million would have been withdrawn from the rainy day fund, raising general fund revenue to $10,972.0 (=10,923.4+48.6) million. At this level the expected general fund revenue for FY 2002 equals the level for FY 2001 after adjusting for inflation (i.e., 10,972.0/1.858=10,735.8/1.818=5,905.3 in 1982-84 dollars).

In November 2001, the fifth month of FY 2002, the seriousness of the recession was fully recognized. OFC's revised forecasts now called for a 3.7 percent decline in general fund revenue (from $10,828.8 million in FY 2001 to $10,427.9 million in FY 2002) and a 2.6 percent increase in the Seattle consumer price index (from 1.828 in FY 2001 to 1.876 in FY 2002). The difference in the growth rates was -6.3 (=-3.7-2.6) percent, implying a withdrawal from the rainy day fund amounting to $685.2 million (=0.063[10,828.2]) million. Since a withdrawal of $48.6 million had already been authorized the year before, an additional withdrawal of $636.6 (=685.2-48.6) million would have been made, assuming that there was sufficient money in the rainy day fund.

5. Override. At any time, the Legislature with a 60 percent vote of approval may contribute money to or withdraw money from the rainy day fund. Such occasions may arise from unanticipated events, such as an economic boom or a natural disaster, or simply from the imperfect operation of the fund.

3. SIMULATION

Tables 1, 2, and 3 show how the proposed rainy day fund would have worked from FY 1989 to the present. Table 1 simulates the operation of the fund with actual data on general fund revenue and the Seattle consumer price index. This is tantamount to assuming that the forecasts made each November are perfectly accurate. Following the same line of calculations made in the above example, the first seven columns in Table 1 lead to an estimate of the potential rainy day fund contribution or withdrawal. The actual contribution or withdrawal, shown in the next column, will be different from the potential contribution or withdrawal if one of the two restrictions on fund size, such as the fund balance cannot drop below zero, is violated. The next four columns show the operation of the fund under two different starting assumptions: (1) the fund balance is zero at the end of FY 1988; and (2) the fund balance is $500 million at the end of FY 1988. The last column shows the maximum allowable balance, which in this case is assumed to be 10 percent of the general fund revenue in the year.

Table 2 shows the operation of the fund using November forecasts of general fund revenue and the Seattle consumer price index made by OFC instead of actual data. Note that in November of any year, OFC is not only forecasting these variables for the upcoming fiscal year but also does not know their exact values in the current fiscal year (labeled “prior year” in Table 2).

Finally, using FY 2002 as an example, Table 3 shows the second step of the rainy day fund process, namely the adjustment to the fund's inflows or outflows as a result of the revised forecasts one year later.

Table 1 shows that in the ideal world of perfect forecasts the rainy day fund works well. The fund builds up money when revenue growth is relatively strong and dispenses it when revenue is needed to supplement general fund revenue (FY 1991, FY 1996, FY 2001, and FY 2002). The simulation of the fund with a zero beginning balance shows the difficulty of building up a rainy day fund from scratch. The second simulation shows that once the fund is built up, it can be easily maintained. Table 2 shows that in the real world of imperfect forecasts, the rainy day fund works less well. In particular, the timing and the amounts of money contributed to or withdrawn from the fund are not always appropriate because of inaccurate forecasts. For example, based on forecasts made in November 1998, $49 million would have been withdrawn from the rainy day fund for use in FY 1990. As shown in Table 1, actual data reveal that, instead of withdrawing $49 million from the fund, $65.1 million should have been deposited. Table 2 clearly demonstrates the need to correct for inaccurate errors.

Table 3 shows the correction for FY 2002 that would have been made in November 2001, one year after the initial forecasts had been prepared. The correction is very large, implying that there is a great need to provide additional money to the general fund revenue in FY 2002. The correction is also timely, since November 2001 is only the fifth month of FY 2002. In general, such corrections permit the rainy day fund to operate much like it would have operated had there been accurate forecasts in the first place (i.e., much like the simulation shown in Table 1).

4. COMMENTS

1. Administration of the rainy day fund. A simple way to administer the fund is to incorporate its operation into the activities of the Washington State Economic and Revenue Forecast Council, which is composed of members of the legislative and the executive branches of state government. The principal responsibility of the council is approving the economic and revenue forecasts produced by OFC. Overseeing the operation of the rainy day fund would be a natural extension of the council's current responsibility.

2. February forecasts. The proposed rainy day fund makes use of forecasts produced in November. The predictions for the upcoming fiscal year would in general be more accurate if they were made three months later in February, since more would be known about the future course of the economy at that time. A February determination, however, may be too late in the legislative session to be helpful.

3. Quarterly updates. Since economic and revenue forecasts are prepared quarterly, there is no reason why the rainy day fund could not be

maintained on a quarterly or at least semi-annual basis. It would make operation of the fund more responsive to the immediate revenue needs of state government.

4. Actual data versus forecasts. Some states use actual data on such variables as personal income to determine the inflows and outflows of their rainy day funds, sidestepping the problem of using inaccurate forecasts. The problem with this approach is that the delay in waiting for accurate published estimates makes it difficult to control the flow of funds in a timely manner. For example, by the time one has learned that personal income growth over the last year was sluggish, justifying a withdrawal from the rainy day fund, the economy and revenue collections might have speeded up again. In general, it seems more reasonable to forecast the need for money, if any, from the rainy day fund and then make the necessary adjustment if that forecast turns out to be incorrect.

5. Consumer price index. Using the Seattle consumer price index as a measure of inflation has its shortcomings: (1) it is not a measure of inflation for government; (2) it tends to overestimate inflation for consumer goods and services; (3) it applies only to the greater Seattle area (about two-thirds of the state economy); and (4) its estimates are sometimes inaccurate because of small-sample errors.

   But there are good reasons for using it: (1) it is published; (2) it is the only measure of local inflation available; (3) it is probably not a bad surrogate for the local inflation rate for government; (4) it is better than a fixed "adjustment factor," since inflation rates, even in the long run, vary over time; and (5) while it is subject to small-sample errors, these errors tend to be random in nature and result in relatively small measurement errors when estimating inflation over long periods of time (two or more years).

   With regard to the third reason above, estimates have been made of the ten-year average inflation rates for the Seattle consumer price index, the U.S. consumer price index, and the U.S. implicit price deflator for state and local government expenditures. Noting the similarity between the inflation rate for the U.S. consumer price index (2.7 percent) and the U.S. government deflator (2.6 percent), it would appear that the use of the consumer price index as a surrogate for the government deflator is justified. Noting the significantly higher inflation rate for the Seattle consumer price index (3.3 percent), attributable to the rapid growth of the local economy during the 1990s, it would appear that it is better to use a local price index than a national price index.

6. Alternative fund triggers and limits. Concerns have been expressed about the large size of the contributions that would be made to the rainy day fund in some years and the potentially large size of the fund itself under

the proposed operating parameters. In the course of this study, simulations have also been conducted assuming less demanding triggers for the fund, such as adding money to the rainy day fund only if the difference between the forecast growth of general fund revenue and the inflation rate is 1 percent or more, or restricting the maximum allowable size of the fund to 5 percent of general fund revenue. The impact of these changes is to significantly reduce the size of the rainy day fund and thus its effectiveness as a means of stabilizing state government revenue. For example, a simulation in which both of the above changes are made shows that the rainy day fund is totally depleted by the end of FY 2000, the year before the big downturn in general fund revenue.

Table 1. Rainy Day Fund Operation Based on Actual Data (millions of dollars)

	General Fund Revenue Cash Basis	Percent Change	Seattle Consumer Price Index (82-84=1.000)	Percent Change	Percent Change Difference	Rainy Day Fund Contribution or Withdrawal Percent
Initial Balance	na	na	na	na	na	na
FY1989	$5,686.0	8.3	1.153	3.8	4.6	1.0
FY1990	$6,505.4	14.4	1.219	5.7	8.7	1.0
FY1991	$6,801.9	4.6	1.312	7.6	-3.1	-3.1
FY1992	$7,297.6	7.3	1.365	4.0	3.2	1.0
FY1993	$7,564.6	3.7	1.411	3.4	0.3	0.3
FY1994	$8,013.4	5.9	1.451	2.8	3.1	1.0
FY1995	$8,551.3	6.7	1.502	3.5	3.2	1.0
FY1996	$8,581.2	0.3	1.544	2.8	-2.4	-2.4
FY1997	$9,056.6	5.5	1.606	4.0	1.5	1.0
FY1998	$9,640.9	6.5	1.653	2.9	3.5	1.0
FY1999	$9,979.2	3.5	1.702	3.0	0.5	0.5
FY2000	$10,433.2	4.5	1.757	3.2	1.3	1.0
FY2001	$10,828.9	3.8	1.828	4.0	-0.2	-0.2
FY2002	$10,453.9	-3.5	1.876	2.6	-6.1	-6.1

	Potential Rainy Day Fund Contribution or Withdrawal	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=0)	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=500)	Rainy Day Fund Maximum Allowable Balance 10 percent
Initial Balance	na	na	0.0	na	500.0	na
FY1989	$56.9	$56.9	$56.9	$56.9	$556.9	$568.6
FY1990	$65.1	$65.1	$121.9	$65.1	$621.9	$650.5
FY1991	-$199.8	-$121.9	$0.0	-$199.8	$422.1	$680.2
FY1992	$73.0	$73.0	$73.0	$73.0	$495.1	$729.8
FY1993	$21.1	$21.1	$94.0	$21.1	$516.2	$756.5
FY1994	$80.1	$80.1	$174.2	$80.1	$596.3	$801.3
FY1995	$85.5	$85.5	$259.7	$85.5	$681.8	$855.1
FY1996	-$209.2	-$209.2	$50.5	-$209.2	$472.6	$858.1
FY1997	$90.6	$90.6	$141.0	$90.6	$563.1	$905.7
FY1998	$96.4	$96.4	$237.5	$96.4	$659.6	$964.1
FY1999	$52.5	$52.5	$290.0	$52.5	$712.1	$997.9
FY2000	$104.3	$104.3	$394.3	$104.3	$816.4	$1,043.3
FY2001	-$25.9	-$25.9	$368.4	-$25.9	$790.5	$1,082.9
FY2002	-$659.3	-$368.4	$0.0	-$659.3	$131.2	$1,045.4

Table 2. Rainy Day Fund Operation Based on Forecasts (millions of dollars)*

	General Fund Revenue Cash Basis	Prior Year Estimate	Percent Change	Seattle CPI (82-84=1.000)**	Prior Year Estimate	Percent Change	Percent Change Difference
Initial Balance	na	na	na	na	na	na	na
FY1989	$5,202.4	$4,996.1	4.1	3.629	3.477	4.4	-0.2
FY1990	$5,707.6	$5,489.4	4.0	1.271	1.212	4.9	-0.9
FY1991	$6,390.1	$6,185.9	3.3	1.323	1.267	4.4	-1.1
FY1992	$7,124.7	$6,747.2	5.6	1.395	1.345	3.7	1.9
FY1993	$7,479.7	$7,100.5	5.3	1.435	1.385	3.6	1.7
FY1994	$7,750.8	$7,483.3	3.6	1.461	1.414	3.3	0.3
FY1995	$8,279.7	$7,856.7	5.4	1.497	1.448	3.4	2.0
FY1996	$8,720.2	$8,496.7	2.6	1.555	1.503	3.5	-0.8
FY1997	$9,049.2	$8,619.3	5.0	1.587	1.541	3.0	2.0
FY1998	$9,430.6	$9,009.4	4.7	1.638	1.590	3.0	1.7
FY1999	$9,856.5	$9,576.1	2.9	1.688	1.647	2.5	0.4
FY2000	$9,909.1	$9,881.6	0.3	1.737	1.699	2.2	-2.0
FY2001	$10,451.7	$10,275.7	1.7	1.787	1.753	1.9	-0.2
FY2002	$10,923.4	$10,735.8	1.7	1.858	1.818	2.2	-0.5
FY2003	$10,780.7	$10,427.9	3.4	1.906	1.876	1.6	1.8

	Rainy Day Fund Contribution or Withdrawal Percent	Potential Rainy Day Fund Contribution or Withdrawal	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=0)	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=500)	Rainy Day Fund Maximum Allowable Balance 10 percent
Initial Balance	na	na	na	0.0	na	$500.0	na
FY1989	-0.2	-$12.1	$0.0	$0.0	-$12.1	$487.9	$520.2
FY1990	-0.9	-$49.0	$0.0	$0.0	-$49.0	$438.9	$570.8
FY1991	-1.1	-$69.2	$0.0	$0.0	-$69.2	$369.7	$639.0
FY1992	1.0	$71.2	$71.2	$71.2	$71.2	$440.9	$712.5
FY1993	1.0	$74.8	$74.8	$146.0	$74.8	$515.7	$748.0
FY1994	0.3	$18.8	$18.8	$164.8	$18.8	$534.5	$775.1
FY1995	1.0	$82.8	$82.8	$247.6	$82.8	$617.3	$828.0
FY1996	-0.8	-$70.5	-$70.5	$177.1	-$70.5	$546.8	$872.0
FY1997	1.0	$90.5	$90.5	$267.6	$90.5	$637.3	$904.9
FY1998	1.0	$94.3	$94.3	$361.9	$94.3	$731.6	$943.1
FY1999	0.4	$42.0	$42.0	$404.0	$42.0	$773.6	$985.7
FY2000	-2.0	-$193.5	-$193.5	$210.4	-$193.5	$580.1	$990.9
FY2001	-0.2	-$23.3	-$23.3	$187.1	-$23.3	$556.8	$1,045.2
FY2002	-0.5	-$48.6	-$48.6	$138.5	-$48.6	$508.2	$1,092.3
FY2003	1.0	$107.8	$107.8	$246.3	$107.8	$616.0	$1,078.1

*Forecasts are produced in November of prior fiscal year.

**FY1989 estimate is for U.S. consumer price index (67=1.000) and FY1990, FY1991, FY1992, and FY1993 estimates are for U.S. consumer price index (82-84=1.000).

Table 3. Rainy Day Fund Adjustment for FY2002 (millions of dollars)

	General Fund Revenue Cash Basis	Prior Year Estimate	Percent Change	Seattle Consumer Price Index (82-84=1.000)	Prior Year Estimate
FY2002 November 2000 Forecast	$10,923.4	$10,735.8	1.7	1.9	1.8
FY2002 November 2001 Forecast	$10,427.9	$10,828.8	-3.7	1.9	1.8
Adjustment	na	na	na	na	na

	Percent Change	Percent Change Difference	Rainy Day Fund Contribution or Withdrawal Percent	Potential Rainy Day Fund Contribution or Withdrawal
FY2002 November 2000 Forecast	2.2	-0.5	-0.5	-48.6
FY2002 November 2001 Forecast	2.6	-6.3	-6.3	-685.2
Adjustment	na	na	na	-636.6

Table 4. Budget Stabilization Funds as a Percent of State Expenditures

	Budget Stabilization Fund			Expenditures			Budget Stabilization Percent			
State	**2000**	**2001**	**2002**	**2000**	**2001**	**2002**	**2000**	**2001**	**2002**	**Rank**
Alabama	$3	$8	$13	$5,215	$5,248	$5,286	0.06%	0.15%	0.25%	42
Alaska	2,734	3,078	2,857	2,262	2,287	2,413	120.87%	134.59%	118.40%	1
Arizona	408	374	266	6,012	6,370	6,546	6.79%	5.87%	4.06%	23
Arkansas	0	0	0	3,177	3,259	3,392	0.00%	0.00%	0.00%	43
California	8,666	6,348	2,596	66,494	80,087	78,763	13.03%	7.93%	3.30%	26
Colorado	583	256	0	5,992	6,670	6,976	9.73%	3.84%	0.00%	44
Connecticut	564	595	595	10,913	11,955	11,894	5.17%	4.98%	5.00%	14
Delaware	114	120	126	2,246	2,429	2,457	5.08%	4.94%	5.13%	13
Florida	1,666	1,187	941	18,554	20,033	20,290	8.98%	5.93%	4.64%	19
Georgia	551	579	618	13,782	14,770	14,773	4.00%	3.92%	4.18%	21
Hawaii	6	21	54	3,201	3,381	3,651	0.19%	0.62%	1.48%	39
Idaho	36	53	73	1,681	1,829	2,044	2.14%	2.90%	3.57%	25
Illinois	0	225	230	23,084	24,497	24,876	0.00%	0.92%	0.92%	41
Indiana	540	526	526	8,967	9,623	9,598	6.02%	5.47%	5.48%	9
Iowa	444	462	463	4,763	4,874	4,848	9.32%	9.48%	9.55%	3
Kansas	0	0	0	4,368	4,430	4,509	0.00%	0.00%	0.00%	45
Kentucky	279	240	239	6,549	7,041	7,332	4.26%	3.41%	3.26%	28
Louisiana	59	150	150	5,811	6,306	6,412	1.02%	2.38%	2.34%	33
Maine	144	144	123	2,317	2,645	2,593	6.21%	5.44%	4.74%	17
Maryland	582	888	563	9,022	10,230	10,789	6.45%	8.68%	5.22%	12
Massachusetts	1,608	2,295	1,715	20,838	21,939	22,616	7.72%	10.46%	7.58%	5
Michigan	1,264	1,031	500	9,576	9,722	9,306	13.20%	10.60%	5.37%	11
Minnesota	1,380	1,109	1,140	11,476	13,115	12,940	12.03%	8.46%	8.81%	4
Mississippi	232	189	192	3,515	3,512	3,552	6.60%	5.38%	5.41%	10
Missouri	143	151	156	7,350	7,730	7,820	1.95%	1.95%	1.99%	36
Montana	0	0	0	1,105	1,260	1,420	0.00%	0.00%	0.00%	46
Nebraska	142	170	110	2,344	2,478	2,660	6.06%	6.86%	4.14%	22
Nevada	136	136	136	1,608	1,838	1,847	8.46%	7.40%	7.36%	6
New Hampshire	20	55	55	1,028	1,063	1,151	1.95%	5.17%	4.78%	16
New Jersey	698	720	720	19,459	20,756	22,489	3.59%	3.47%	3.20%	30
New Mexico	0	0	0	3,390	3,827	3,896	0.00%	0.00%	0.00%	47
New York	547	627	627	37,170	39,702	41,993	1.47%	1.58%	1.49%	38
North Carolina	38	158	339	13,854	13,446	14,528	0.27%	1.18%	2.33%	34
North Dakota	0	0	0	773	822	847	0.00%	0.00%	0.00%	48
Ohio	1,003	1,011	1,011	19,244	21,144	22,138	5.21%	4.78%	4.57%	20
Oklahoma	158	340	170	4,545	4,819	5,206	3.48%	7.06%	3.27%	27
Oregon	0	0	0	4,849	5,253	5,458	0.00%	0.00%	0.00%	49
Pennsylvania	1,097	1,127	1,223	19,295	19,981	20,690	5.69%	5.64%	5.91%	8
Rhode Island	71	80	81	2,231	2,485	2,651	3.18%	3.22%	3.06%	31
South Carolina	145	61	63	5,156	5,520	5,552	2.81%	1.11%	1.13%	40
South Dakota	37	38	40	771	803	851	4.80%	4.73%	4.70%	18
Tennessee	165	178	178	6,593	7,233	7,551	2.50%	2.46%	2.36%	32
Texas	85	198	550	27,493	28,641	31,171	0.31%	0.69%	1.76%	37
Utah	110	120	125	3,364	3,711	3,890	3.27%	3.23%	3.21%	29
Vermont	41	43	44	855	881	893	4.80%	4.88%	4.93%	15
Virginia	575	678	865	11,282	12,238	12,306	5.10%	5.54%	7.03%	7
Washington	754	463	421	10,220	10,826	11,217	7.38%	4.28%	3.75%	24
West Virginia	73	79	63	2,639	2,707	2,974	2.77%	2.92%	2.12%	35
Wisconsin	0	0	0	11,271	11,078	11,383	0.00%	0.00%	0.00%	50
Wyoming	39	65	130	518	630	630	7.53%	10.32%	20.63%	2
Total	$27,389	$26,372	$21,087	$468,216	$507,118	$521,066	5.85%	5.20%	4.05%	

Source: Fiscal Survey of the States: Dec. 2001, National Governors Association and the National Association of State Budget Officers