

Advisory Council Recommendation for “Rainy Day” Funds (Draft)

June 23, 2008

The Advisory Council recommends the following:

- The target for the Rainy Day Funds saving rate should be to maintain average growth in spending during the average recession. Both the Education Stability Fund (ESF) and the Rainy Day fund are expected to serve the stabilizing function and should be considered together. The saving rate should be based on achieving a 50% to 75% probability of having sufficient resources in the funds.
- From the information presented, this would require a saving rate of between 3% and 4% of general fund revenue during expansions. The funding for the Education Stability Fund is variable, but it amounts to about 1.5% of the general fund revenue. Thus, the revenue target for the Rainy Day Fund itself should be 1.5% to 2.5% of general fund revenue during periods of expansion.
- The maximum for the Rainy Day funds should be 12% to 15% of the biennial budget. This would be sufficient to maintain spending through 90% of all recessions. Current maximums for the two funds would achieve the lower end of this range when both are fully funded.
- The current policy of adding the general fund ending balance, up to 1% of the general fund revenue, should be continued. Both the Governor’s budget and the Co-chairs’ budget should show an ending balance of at least 1% during periods of expansion. However, historical analysis shows that this method would not have been sufficient to fully fund the Rainy Day fund.
- Sources should be identified that would provide the additional 0.5% to 1.5% of general fund revenue on average during periods of expansion. More money should be set aside in periods of above average growth allowing for a lower rate of savings during expansion periods of below average growth.
- One proposal is to change the forecast method to allow for any revenue up to one standard deviation above the current forecast method to be allocated to the Rainy Day fund. Historical analysis shows that this change would have restored the Rainy Day fund within two biennia of recent recessions, and it is recommended as the most promising method of funding. If this is not adopted, then another source of additional money for the Rainy Day fund should be found.
- Utilization of the funds during a recession should take account of future prospects for replenishing the funds. With current funding methods, the ESF should be

utilized first during periods of recession since it has a relatively stable source of replacement funding.

- We do not recommend any changes to current policies for using the funds.