MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Legislative Fiscal Analyst
CLAYTON SCHENCK

DATE: May 21, 2008

TO: Legislative Finance Committee

FROM: Jon Moe, Fiscal Specialist

RE: Rainy Day Fund -- Revisited

INTRODUCTION

In recent sessions, legislation to establish a rainy fund has been introduced by a variety of legislators but each legislature has been unable to pass a bill. For the last two sessions, the Legislative Finance Committee has supported the concept in one form or another. In the 2007 session, it was SB 137, a bill that was introduced "by the request of the Legislative Finance Committee and the Governor." While originally considered as a committee bill of the Legislative Finance Committee, the Governor's office, with a couple of suggested changes, supported the concept and joined in the bill request. Senator Laible carried the bill. SB 137 passed the Senate but stalled in the House, being tabled in the House Appropriations Committee late in the session.

DISCUSSION POINTS

With another session bearing down on us, it is time to consider whether or not this state should have a "rainy day fund." With that in mind, the following discussion is offered.

DOES THE LEGISLATIVE FINANCE COMMITTEE AGAIN WISH TO PURSUE RAINY DAY FUND LEGISLATION?

The arguments for having a "rainy day fund" have not changed. The following list of pros and cons comes from previous research of this office (Legislative Fiscal Division)[1]:

Arguments for:

- Rainy day funds provide a mechanism for preserving excess funds during strong economic periods for use during periods of fiscal fragility due to economic downturns or unforeseen circumstances, such as reductions in federal spending or adverse legal decisions.

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[1] Report on *Budget Stability: Rainy Day Funds and Fund Balance Reserves* prepared for the Legislative Finance Committee September 19, 1996.

- Availability of rainy day fund balances reduces pressures on policy makers to impose tax increases or budget cuts, both of which have a long-term impact on taxpayers and the economy.
- Absorbing surplus funds during times of prosperity and releasing then during periods of slowdown provides a more stable and predictable budgeting process, and therefore facilitates planning.
- Establishment of a rainy day fund can save the state money. Bond rating agencies favorably view the existence of reserve funds as a mechanism for addressing fiscal crisis. Consequently, states can realize reduced interest costs due to higher bond ratings. Moreover, availability of rainy day fund monies could eliminate the need for special legislative sessions and the associated expense. The estimated cost of a special session in Montana is around $40,000 per day (after the first day).
- The availability of rainy day fund reserves (when sufficient) affords lawmakers the flexibility of postponing major fiscal decisions until a regular session, rather that being required to call a special session. Legislators are unable to deliberate policy issues as thoroughly during a special session due to time constraints.

Arguments against:

- Opponents of rainy day funds would ague that citizens do not have a direct voice in governmental fiscal policy, but are represented by their elected officials. The average taxpayer may feel vulnerable to tax and spending policies influenced by powerful interest groups – including the use of the budget surpluses such as rainy day funds.
- Contingent tax policy can be used to address budget instability, rather than keeping excess funds on a continuing basis whether they are needed or not.
- As the demand for governmental services continues to grow, it is difficult to justify saving money for tomorrow that is needed today.

Forty-seven states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands each have at least one rainy day fund. Arkansas, Kansas and Montana do not.[2] The value of having a rainy day fund was very evident in the most recent downturn in revenues (following the "dot com" bust and the September 11 events). While most other states had rainy day funds to help offset the revenue shortfalls, Montana solutions to a $230 million shortfall included budget cuts and revenue enhancement legislation, including the transfer to the general fund of $26 million from the State Fund's old fund to avoid even deeper budget cuts. The bottom line is that if Montana had set money aside in a rainy day fund in past years, the solutions to the revenue shortfall would not have been as severe. On the other hand, the state managed to get through the fiscal crises without a rainy day fund, although in some ways the state continues to pay for it, for example with the pending old fund crisis which may require around a $33 million bailout in the next few years.

The attached recent *Legisbrief* from the National Conference of State Legislatures is a timely reminder of the presence and uses of rainy day funds in various states.

[2] *Rainy Day Fund Facts*, State Legislatures, April 2008, page10.

DOES THE COMMITTEE WANT TO STAY WITH A CONCEPT AT LEAST SIMILAR TO THAT OF SB 137 OF THE 2007 SESSION?

A couple of similar concepts are attached:

- *Option A* is basically the same as SB 137. Only the dates are changed in the version that passed out of the Senate to conform the draft bill to the time period it would take effect. This bill includes two mechanisms for funding the rainy day account: 1) a transfer of general fund determined prior to the 2011 session by the Office of Budget and Program Planning to be an anticipated excess over a $100 million fund balance reserve, and 2) a mechanism to transfer a portion of excess unreserved general fund balance after the end of each biennium, with the first possible transfer occurring in December 2011.

- *Option B* is different only in that the transfer determined prior to the 2011 session by the Office of Budget and Program Planning is replaced by a transfer of an amount determined by the legislature and included in the bill prior to its enactment. The transfer determined by the legislature could be a minimal amount to provide a starting amount for the newly created rainy day fund and would be in addition to the mechanism that might cause a transfer of excess general fund balance in December of 2011.

Both of the options are similar to the SB 137 version which was approved in the last interim by the Legislative Finance Committee for introduction as a committee bill in the 2007 regular session.

In recent legislative sessions, proposed rainy day bills have taken various forms, including direct transfers into a new rainy day account or the creation of mechanisms to automatically transfer all or part of a surplus fund balance to a rainy day account. Once a rainy day fund has been established, the legislature could legislatively transfer amounts into the fund during any legislative session.

WHAT WOULD IT TAKE TO GET A RAINY DAY BILL PASSED?

There always seems to be considerable support for the creation of a rainy day fund, but for one reason or another, the legislature has not been able to get one passed. It is probably best characterized as an issue of fiscal priority and political philosophy. A common sense fiscal policy might suggest that setting aside moneys in the good times to provide fiscal stability in the bad times is a prudent philosophy. But others can argue that there are plenty of other priorities for using excess funds, from either the perspective of providing other needed government services or the perspective of giving those funds back to taxpayers in the form of rebates or tax reductions. Overcoming the barriers of differing political philosophies is a topic for legislative debate. Overcoming the barriers of fiscal priorities might better be characterized as an education issue. In other words, how can we (the Legislative Finance Committee and the Legislative Fiscal Division staff) better educate the entire legislature on the merits of establishing and funding a rainy day fund as a fiscal priority?

Legislative Finance Committee Role

The role of this committee starts as it always has with approval and support of a committee bill draft, selecting a sponsor, and generally seeing to the introduction of the bill. Once the committee bill is introduced, the committee has seemed to let the bill take its course, leaving the process in the hands of the sponsor and the committees in which the bill is heard. It is never quite clear what goes on behind the scenes but here are some thoughts on what steps the committee members might take in helping shepherd a committee bill through the legislative process:

- Support of a committee bill in the Legislative Finance Committee should include a responsibility for a proactive support of the bill through the legislative process
- Committee members could take the case for key committee bills to other interim committees to educate those members on the merits of the bill in advance of the session
- Committee members could discuss merits of the committee bill with their respective caucus
- Committee members could express their support to their leadership
- Committee members could be a proponent for the committee bill when it heard during the session
- Committee members could speak for the bill when it is heard in the committee of the whole

Legislative Fiscal Division Role

The Legislative Fiscal Division staff can contribute to Legislative Finance Committee role in a few ways:

- Fiscal staff should track the progress of the LFC committee bills and keep all LFC committee members informed on the status of each bill and when session committees are scheduled to hear the LFC committee bills so that LFC members know when they can participate
- Fiscal staff could assist all members with educational materials on the topic of each bill as needed by LFC committee members, such as fact sheets
- Fiscal staff could make sure the sponsor has what he or she needs
- Fiscal staff can offer to be an informational witness at hearings for LFC committee bills

CONCLUSION

Montana is one of only a few states that do not have a "rainy day fund" to provide some stability to the revenue and budgeting processes. Several legislators individually and the Legislative Finance Committee collectively have tried to establish a rainy day fund in one form or another through legislative initiatives, without success. The Legislative Fiscal Division has consistently suggested that it would be prudent to have such a fund in place. Recent history would also suggest that the ups and downs experienced in Montana would have been easier handled if the Montana Legislature had set money aside in past "good times" to mitigate the revenue shortfalls that are seemingly inevitable.

Although the nation is experiencing a downturn, it has not been as severely felt in Montana. Revenue remains relatively strong. While there may not be an excess of revenues available for legislative consideration in the upcoming session, it is still possible to establish a rainy day fund. By simply setting up the fund with a mechanism to fund it in future periods in which revenues are strong, and by at least transferring a minimal amount (maybe up to $5 or $10 million) as a start, Montana could have a rainy day fund in place. In future biennia, as revenues strengthen again, the mechanism put in place this coming session would begin to feed money into the new fund. Also, in any subsequent session, the legislature can transfer additional funds to the rainy day fund. It is time for the legislature to take this prudent step and begin to shore up its reserves and provide a higher degree of stability to the Montana budget process.

Option A

COMPONENTS OF A RAINY DAY FUND PROPOSAL (SB 137 OF 2007 SESSION - MODIFIED FOR POTENTIAL 2009 LEGISLATIVE PROPOSAL)

Terminology: Budget stabilization account

Type of Fund: Sub fund of the general fund (separate accounting entity, i.e., 01102)

Fund Size (Cap on size that the fund can be): (in Section 1 of the bill**)**

Balance in the budget stabilization account not to exceed 9 percent of the general fund appropriations and transfers for the biennium prior to the year in which the transfer is made…the determination of the maximum balance will be made by December 31 of each odd-numbered calendar year (the first determination would occur by December 31, 2009)

Source of monies going into the fund:

Section 1 provides for a transfer of 50 percent of the amount by which the audited general fund unreserved ending fund balance exceeds 5 percent of all general fund appropriations and transfers during the prior biennium…by December 31 of odd-numbered calendar years, from the state general fund to the budget stabilization account …with the first occurring by December 31, 2011 if moneys are available

Section 4 of the bill provides for an initial transfer that would take place on or before January 1, 2011, in an amount "by which the anticipated general fund unreserved ending fund balance is in excess of $100 million."

Use of Fund:

The Governor would use funds to avoid or offset 17-7-140 spending reductions (Governor spends from the account when "trigger" occurs) (Section 1 of the bill)

Governor may not use the money in the account for any other purpose unless appropriated by the legislature

Withdrawals from the Fund:

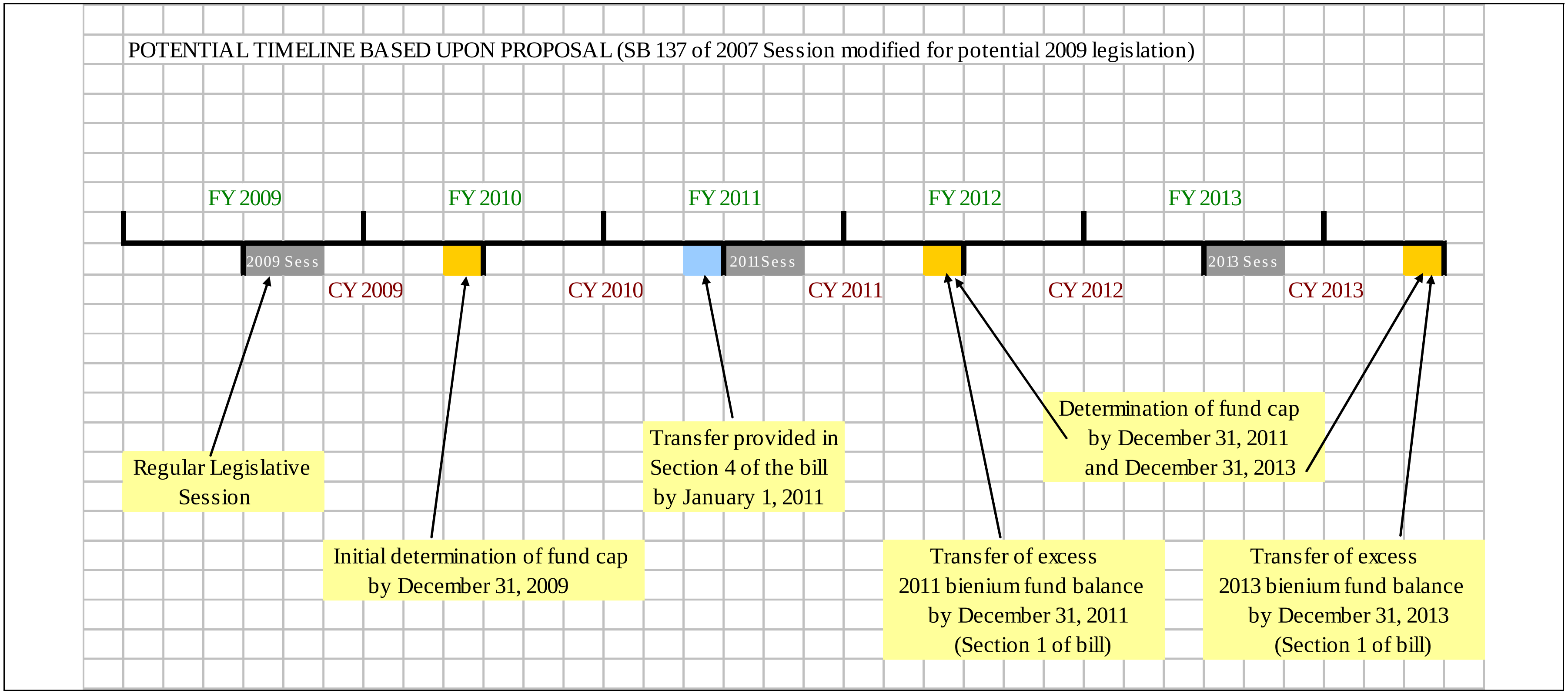
The Governor is given authority to transfer from the budget stabilization account to the general fund so money is available to avoid 17-7-140 spending reductions (Section 2)

Governor may not transfer, during a biennium, more than 80 percent of the balance budget stabilization account to the general fund, or transfer more than would reduce the balance to $5 million (Section 1)

Once funding is transferred or appropriated to the account and is at least $5 million, balance to never fall below $5 million (Section 1)

Effective Date: Upon passage and approval to allow earlier transfer (including the transfer in Section 4), but delaying the transfer of an excess fund balance amount described above (and in Section 1 of the bill) until December 2011.

Option A


POTENTIAL TIMELINE BASED UPON PROPOSAL (SB 137 of 2007 Session modified for potential 2009 legislation)
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
2009 Sess
2011 Sess
2013 Sess
CY 2009
CY 2010
CY 2011
CY 2012
CY 2013
Regular Legislative Session
Initial determination of fund cap by December 31, 2009
Transfer provided in Section 4 of the bill by January 1, 2011
Determination of fund cap by December 31, 2011 and December 31, 2013
Transfer of excess 2011 bienium fund balance by December 31, 2011 (Section 1 of bill)
Transfer of excess 2013 bienium fund balance by December 31, 2013 (Section 1 of bill)

Option A

_______ BILL NO. xxx

INTRODUCED BY _____

BY REQUEST OF THE LEGISLATIVE FINANCE COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT REVISING LAWS RELATED TO PROJECTED GENERAL FUND DEFICITS; PROVIDING FOR BUDGET STABILITY BY CREATING A BUDGET STABILIZATION ACCOUNT; PROVIDING THAT A GENERAL FUND UNRESERVED ENDING FUND BALANCE IN EXCESS OF A STATUTORY AMOUNT IS TRANSFERRED TO THE BUDGET STABILIZATION ACCOUNT; PROVIDING LIMITS ON THE AMOUNT THAT CAN BE MAINTAINED IN THE BUDGET STABILIZATION ACCOUNT; PROVIDING FOR THE USE OF THE BUDGET STABILIZATION ACCOUNT TO OFFSET REDUCTIONS IN SPENDING; CLARIFYING THE APPLICABILITY OF THE REDUCTION IN SPENDING LAW TO BASE AID FOR SCHOOLS; PROVIDING FOR A FUND TRANSFER; AMENDING SECTIONS 17-7-140 AND 20-9-351, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND AN APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 1. Budget stabilization account -- funding -- use.** (1) There is a budget stabilization account within the state general fund. Subject to subsection (2), there is transferred from the state general fund to the budget stabilization account 50% of the amount by which the audited general fund unreserved ending fund balance exceeds 5% of all general fund appropriations and transfers from the general fund for the prior biennium. A transfer from the state general fund to the budget stabilization account must be made by December 31 of each odd-numbered calendar year.

(2) (a) The balance in the budget stabilization account may not exceed 9% of the general fund appropriations and transfers from the general fund for the biennium prior to the year in which a transfer to the budget stabilization account is made.

(b) Once the balance in the account equals 9% of the general fund appropriations and transfers from the general fund for the biennium described in subsection (2)(a), the transfer authorized in subsection (1) may not be made.

(3) The governor may transfer money from the budget stabilization account to the state general fund in order to avoid or offset the amount of a reduction in spending pursuant to 17-7-140. The

governor may not use the money in the account for any other purpose. The governor may not transfer more than 80% of the balance in the account to the state general fund during a biennium and may not transfer an amount that would cause the balance in the account to be less than $5 million.

(4) The legislature may appropriate money in the budget stabilization account for any public purpose.

Section 2. Section 17-7-140, MCA, is amended to read:

"17-7-140. Reduction in spending. (1) (a) As the chief budget officer of the state, the governor shall ensure that the expenditure of appropriations does not exceed available revenue. Except as provided in subsection (2), in the event of a projected general fund budget deficit, the governor <u>may transfer money from the budget stabilization account established in [section 1] to the general fund and if necessary</u>, taking into account the criteria provided in subsection (1)(b), shall direct agencies to reduce spending in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1% of all general fund appropriations during the biennium. An agency may not be required to reduce general fund spending for any program, as defined in each general appropriations act, by more than 10% during a biennium. Departments or agencies headed by elected officials or the board of regents may not be required to reduce general fund spending by a percentage greater than the percentage of general fund spending reductions required for the total of all other executive branch agencies. The legislature may exempt from a reduction an appropriation item within a program or may direct that the appropriation item may not be reduced by more than 10%.

(b) The governor shall direct agencies to manage their budgets in order to reduce general fund expenditures. Prior to directing agencies to reduce spending as provided in subsection (1)(a), the governor shall direct each agency to analyze the nature of each program that receives a general fund appropriation to determine whether the program is mandatory or permissive and to analyze the impact of the proposed reduction in spending on the purpose of the program. An agency shall submit its analysis to the office of budget and program planning and shall at the same time provide a copy of the analysis to the legislative fiscal analyst. The office of budget and program planning shall review each agency's analysis, and the budget director shall submit to the governor a copy of the office of budget and program planning's recommendations for reductions in spending. The budget director shall provide a copy of the recommendations to the legislative fiscal analyst at the time that the recommendations are submitted to the governor and shall provide the legislative fiscal analyst with any proposed changes to the recommendations. The legislative finance committee shall meet within 20 days of the date that the proposed changes to the recommendations for reductions in spending are provided to the legislative fiscal analyst. The legislative fiscal analyst shall provide a copy of the legislative fiscal analyst's review of the proposed reductions in spending to the budget director at least 5 days before the meeting of the legislative finance committee. The committee may make recommendations concerning the proposed reductions in spending. The governor shall consider each agency's analysis and the recommendations of the office of budget and program planning and the legislative finance committee in determining the agency's reduction in spending. Reductions in spending must be designed to have the least adverse impact on the provision of services determined to be most integral to the discharge of the agency's statutory responsibilities.

(2) Reductions in spending for the following may not be directed by the governor:

(a) payment of interest and principal on state debt;

(b) the legislative branch;

(c) the judicial branch;

(d) the school BASE funding program, including special education;

(e) salaries of elected officials during their terms of office; and

(f) the Montana school for the deaf and blind.

(3) (a) As used in this section, "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than:

(i) 2% of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session;

(ii) 3/4 of 1% in October of the year preceding a legislative session;

(iii) 1/2 of 1% in January of the year in which a legislative session is convened; and

(iv) 1/4 of 1% in March of the year in which a legislative session is convened.

(b) In determining the amount of the projected general fund budget deficit, the budget director shall take into account revenue, established levels of appropriation, anticipated supplemental appropriations for school equalization aid, and anticipated reversions.

(4) If the budget director determines that an amount of actual or projected general fund receipts will result in an amount less than the amount projected to be received ~~in the revenue estimate established pursuant to 5-5-227~~, the budget director shall notify the revenue and transportation interim committee of

the estimated amount. In determining the amount projected to be received, the budget director shall take into consideration the revenue estimate established pursuant to 5-5-227 and the revenue impact of legislation enacted during the legislative session in which the revenue estimate was adopted. Within 20 days of notification, the revenue and transportation interim committee shall provide the budget director with any recommendations concerning the amount. The budget director shall consider any recommendations of the revenue and transportation interim committee prior to certifying a projected general fund budget deficit to the governor."

Section 3. Section 20-9-351, MCA, is amended to read:

"20-9-351. Funding of deficiency in BASE aid. If the money available for BASE aid ~~is not the result of a reduction in spending under 17-7-140 and~~ is not sufficient to provide the guaranteed tax base aid required under 20-9-366 through 20-9-369 and BASE aid support determined under 20-9-347, the superintendent of public instruction shall request the budget director to submit a request for a supplemental appropriation in the second year of the biennium that is sufficient to complete the funding of BASE aid for the elementary and high school districts for the current biennium."

NEW SECTION. **Section 4. Initial fund transfer.** The office of budget and program planning shall calculate the amount, as of June 30, 2011, by which the anticipated general fund unreserved ending fund balance is in excess of $100 million. Subject to [section 1(2)], the department of administration shall transfer the calculated amount to the budget stabilization account on or before January 1, 2011.

NEW SECTION. **Section 5. Codification instruction.** [Section 1] is intended to be codified as an integral part of Title 17, chapter 7, part 1, and the provisions of Title 17, chapter 7, part 1, apply to [section 1].

NEW SECTION. **Section 6. Effective date.** [This act] is effective on passage and approval.

NEW SECTION. **Section 7. Applicability.** Transfers under [section 1(1)] apply beginning December 2011.

- END -

Components of a Rainy Day Fund Proposal (SB 137 of 2007 Session - Without the OBPP transfer proposed in that bill)

<u>Terminology</u>: Budget stabilization account

<u>Type of Fund</u>: Sub fund of the general fund (separate accounting entity, i.e., 01102)

<u>Fund Size (Cap on size that the fund can be)</u>: (in Section 1 of the bill**)**

Balance in the budget stabilization account not to exceed 9 percent of the general fund appropriations and transfers for the biennium prior to the year in which the transfer is made…the determination of the maximum balance will be made by December 31 of each odd-numbered calendar year (the first determination would occur by December 31, 2009)

<u>Source of monies going into the fund</u>:

<u>Section 1</u> provides for a transfer of 50 percent of the amount by which the audited general fund unreserved ending fund balance exceeds 5 percent of all general fund appropriations and transfers during the prior biennium…by December 31 of odd-numbered calendar years, from the state general fund to the budget stabilization account …with the first occurring by December 31, 2011 if moneys are available

<u>Section 4</u> (optional) of the bill provides for a transfer by the legislature to the budget stabilization account in whatever amount the legislature might determine.

<u>Use of Fund</u>:

The Governor would use funds to avoid or offset 17-7-140 spending reductions (Governor spends from the account when "trigger" occurs) (Section 1 of the bill)

Governor may not use the money in the account for any other purpose unless appropriated by the legislature

<u>Withdrawals from the Fund</u>:

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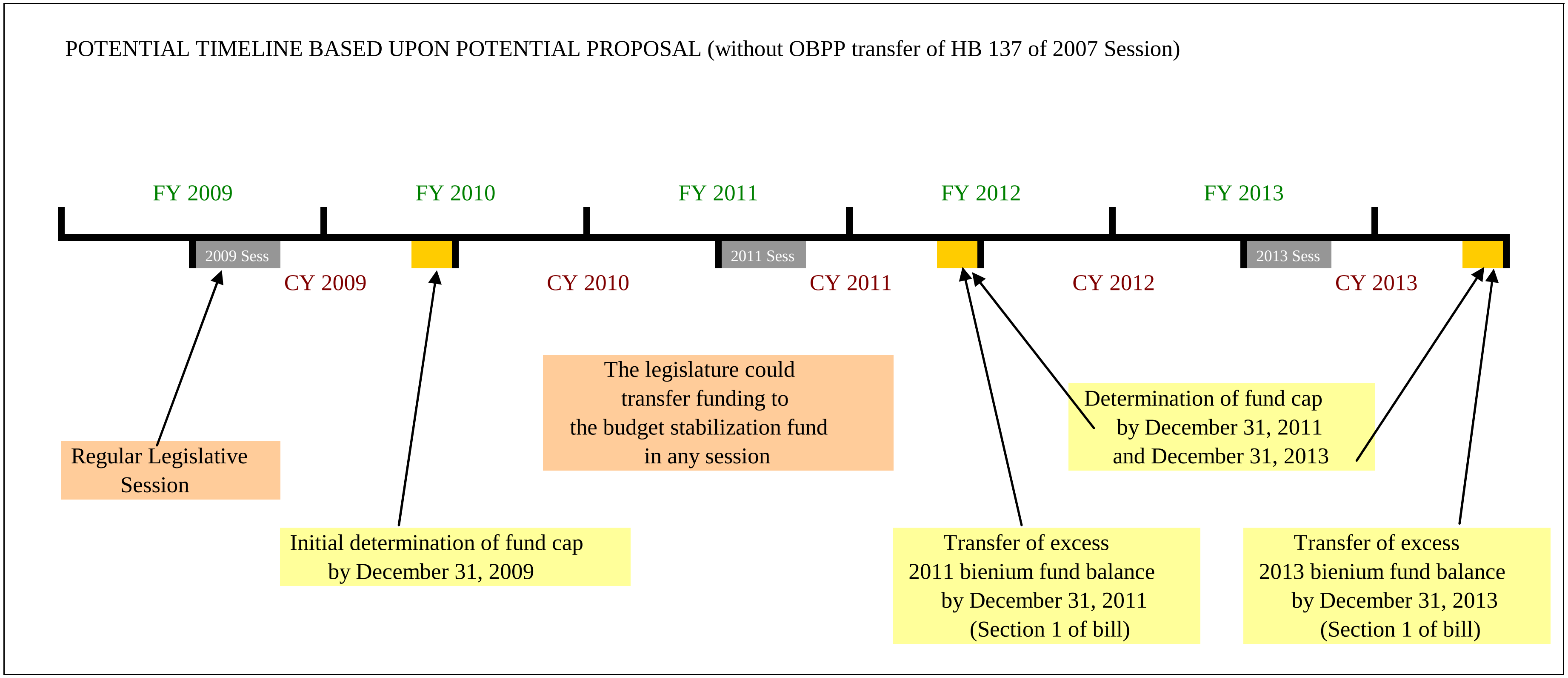
Once funding is transferred or appropriated to the account and is at least $5 million, balance to never fall below $5 million (Section 1)

<u>Effective Date</u>: Upon passage and approval to allow earlier transfer (including the transfer in Section 4), but delaying the transfer of an excess fund balance amount described above (and in Section 1 of the bill) until December 2011.

Option B


POTENTIAL TIMELINE BASED UPON POTENTIAL PROPOSAL (without OBPP transfer of HB 137 of 2007 Session)
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
2009 Sess
2011 Sess
2013 Sess
CY 2009
CY 2010
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CY 2013
Regular Legislative Session
Initial determination of fund cap by December 31, 2009
The legislature could transfer funding to the budget stabilization fund in any session
Determination of fund cap by December 31, 2011 and December 31, 2013
Transfer of excess 2011 bienium fund balance by December 31, 2011 (Section 1 of bill)
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_______ BILL NO. xxx

INTRODUCED BY _____

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(2) (a) The balance in the budget stabilization account may not exceed 9% of the general fund appropriations and transfers from the general fund for the biennium prior to the year in which a transfer to the budget stabilization account is made.

(b) Once the balance in the account equals 9% of the general fund appropriations and transfers from the general fund for the biennium described in subsection (2)(a), the transfer authorized in subsection (1) may not be made.

(3) The governor may transfer money from the budget stabilization account to the state general fund in order to avoid or offset the amount of a reduction in spending pursuant to 17-7-140. The

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(2) Reductions in spending for the following may not be directed by the governor:

(a) payment of interest and principal on state debt;

(b) the legislative branch;

(c) the judicial branch;

(d) the school BASE funding program, including special education;

(e) salaries of elected officials during their terms of office; and

(f) the Montana school for the deaf and blind.

(3) (a) As used in this section, "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than:

(i) 2% of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session;

(ii) 3/4 of 1% in October of the year preceding a legislative session;

(iii) 1/2 of 1% in January of the year in which a legislative session is convened; and

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(b) In determining the amount of the projected general fund budget deficit, the budget director shall take into account revenue, established levels of appropriation, anticipated supplemental appropriations for school equalization aid, and anticipated reversions.

(4) If the budget director determines that an amount of actual or projected general fund receipts will result in an amount less than the amount projected to be received ~~in the revenue estimate established pursuant to 5-5-227~~, the budget director shall notify the revenue and transportation interim committee of

the estimated amount. In determining the amount projected to be received, the budget director shall take into consideration the revenue estimate established pursuant to 5-5-227 and the revenue impact of legislation enacted during the legislative session in which the revenue estimate was adopted. Within 20 days of notification, the revenue and transportation interim committee shall provide the budget director with any recommendations concerning the amount. The budget director shall consider any recommendations of the revenue and transportation interim committee prior to certifying a projected general fund budget deficit to the governor."

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NEW SECTION. **Section 4. Fund transfer.** On or before October 1, 2009, the department of administration shall transfer $___ million from the general fund to the budget stabilization account established in [section 1].

NEW SECTION. **Section 5. Codification instruction.** [Section 1] is intended to be codified as an integral part of Title 17, chapter 7, part 1, and the provisions of Title 17, chapter 7, part 1, apply to [section 1].

NEW SECTION. **Section 6. Effective date.** [This act] is effective on passage and approval.

NEW SECTION. **Section 7. Applicability.** Transfers under [section 1(1)] apply beginning December 2011.

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