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Missouri's Rainy Day Fund in Need of Revisions

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In 2000, Missouri established a "rainy day fund," or a budget reserve intended to facilitate cash flow and provide the state with funds to respond to a budget shortfall or unanticipated spending needs. While many states have successfully responded to recent revenue declines by using their rainy day funds, flaws in the design of Missouri's fund have proven to be obstacles to its intended use. The state should consider reforms to its rainy day fund so that it may be better used to respond to future budget shortfalls.

History of Missouri's Rainy Fund

In November 2000, voters approved a constitutional amendment to establish a budget reserve fund, commonly known as a rainy day fund (RDF).[1] The amendment combined the "Cash Operating Reserve Fund" with the "Budget Stabilization Fund" and provided the guidelines for its use. The fund is intended to serve two purposes: to provide funds for intra-year cash flow needs and to provide the state with funds to ameliorate a severe budget shortfall if/when one should occur.

Cash Flow Uses – The Commissioner of Administration is authorized to transfer funds from the RDF to the General Revenue (GR) fund and to other state funds during the fiscal year to meet "cash flow" needs and to allow timely payment of state obligations. All such transfers must be repaid with interest no later than May 16th of any fiscal year, and no cash flow transfers may be made after May 15th of a given fiscal year. The state has routinely used the RDF for this purpose.

Budget Stabilization Uses – The RDF may also be used for "Budget Stabilization" purposes, with the following restrictions:

- *Budget Shortfall Provision:* Revenue must fall below what was appropriated.
- *Supermajority Requirement:* The Governor must request an emergency appropriation, and two-thirds of the members of both chambers of the General Assembly must approve the request
- *Limits on Use:* Only one-half of the balance of the fund may be used. If the General Revenue or other state fund owes the RDF an additional amount, one-half of that amount may also be used for budget stabilization needs.
- *Replenishment Rule:* Should a "budget stabilization" transfer be made, the amount plus interest must be repaid over the next three fiscal years. This repayment is ensured because, for three

[1] The Budget Reserve Fund is established in Article IV- Section 27(a) of the Missouri constitution.

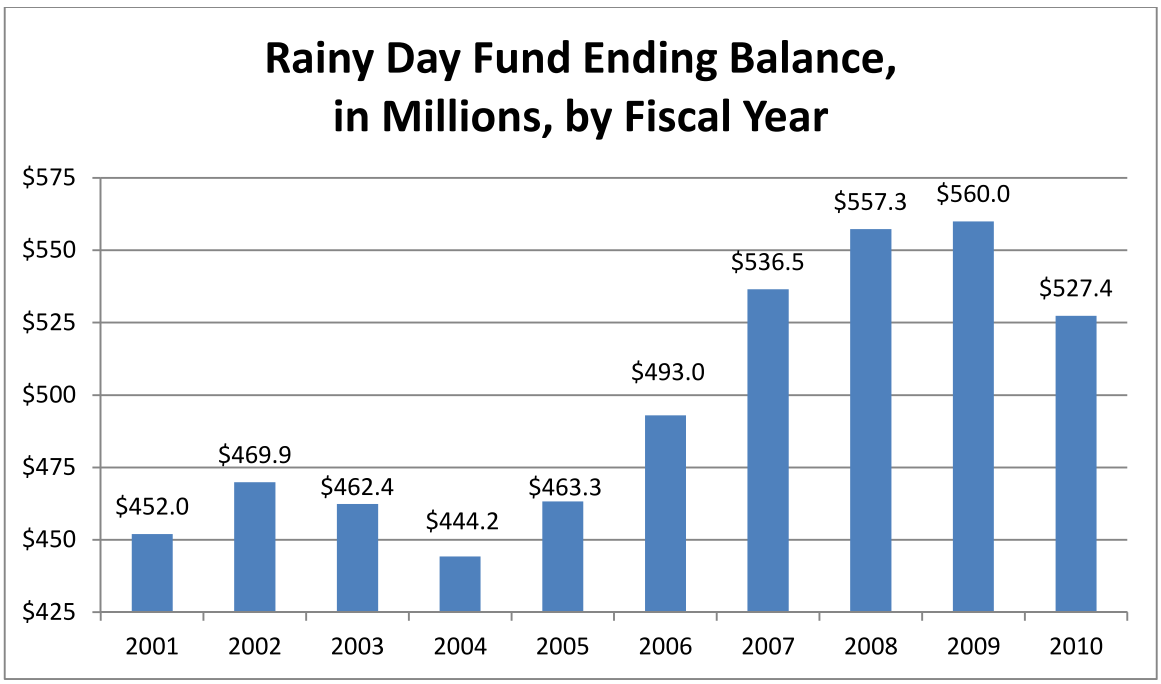
years, one-third of the amount of the transfer is automatically appropriated to the RDF by the GR fund (or other fund that received the transfer), to be paid by the 15th day of the next fiscal year

The balance in the RDF may not exceed 7.5 percent of net GR collections, unless the General Assembly explicitly appropriates any excess to the fund to enhance its balance. Any additional funds are transferred to the GR balance, and the fund is capped overall at 10 percent of the prior year's net GR collection.

As a result of these restrictions in the size and use of the RDF, it is severely limited in its ability to address budget shortfalls, and it has not been used for budget stabilization purposes. The replenishment rule, or the requirement that repayment begin almost immediately and be complete within three years, makes the fund less useful in providing a budget "cushion," or in ameliorating a protracted shortfall similar to what Missouri is currently experiencing. Moreover, it is difficult to attain the "super majority" consensus from both the Governor and General Assembly required by the RDF rules.

Fund Balances in the Rainy Day Fund

Over the last ten years, the rainy day fund has accumulated balances up to $560 million, as shown in the following chart.



Source: *Missouri Office of Administration*

As can be seen, Missouri has substantial balances in its RDF that could be used for dealing with a budget shortfall. As having a RDF is of little value if it cannot be used, Missouri should consider the following modifications.

1. *Eliminate the "supermajority" requirement for using the fund*. This rule poses an unnecessary hurdle to the use of the fund and is not imposed on other budgetary decision making.

2. *Allow a larger portion of the fund to be used for budget stabilization needs.* Arbitrary constraints limit the flexibility of lawmakers to use the fund to bridge budget shortfalls. Structural budget changes may take longer to implement, and the RDF fund can address shortfalls during the interim period.
3. *Permit a more extended "repayment" period*. Economic downturns and the need for stabilization funds may exceed one year time periods. It would be reasonable to delay repayment until economic and revenue growth returns to historical norms.
4. *Remove or increase the cap on the RDF size*. Allowing further growth in the fund's size during economic expansion would improve the fund's ability to address temporary shortfalls. However, deposit rules that require contributions to the fund even during economic downturns may be counterproductive and should be loosened.

As Missouri's RDF was established via a constitutional amendment, voters must approve any reforms. While this step is an additional procedural hurdle, in November 2010 voters in five states considered measures to reform their rainy day funds, and all five measures passed.[2] The economic downturn and resulting budget crisis provide an opportunity to address RDF inadequacies and better prepare for a future downturn while the impacts of the current crisis are fresh in voters' minds.

While implementing these reforms would provide the state with a more useful tool in addressing budget shortfalls that may occur in the future, it **would not be a substitute for dealing with the problems of an eroding tax base and lack of adequate revenues**. Use of the RDF provides temporary assistance, **but is not a long-term solution**. Missouri should consider reforming its RDF along with enacting some reasonable revenue enhancements, such as updating the tobacco tax and collecting sales taxes owed on Internet sales.

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[2] Voters in Hawaii, North Dakota, Oklahoma, South Carolina, and Virginia approved measures to either increase the caps on their funds or enhance the state's ability to make deposits into the funds.