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Is It Time to Dig Into Rainy Day Funds?

Despite reserves bulging and revenue receding, state legislators and governors are reluctant to spend savings.

After years of strong revenue growth, states nationwide have greatly increased their savings—rainy day fund balances are at record levels relative to state spending in 22 states. But revenues are declining and legislators and governors in several states are asking whether this is the right time to withdraw money from their rainy day funds.

These funds are reserve accounts in which states save money in good years to help balance their budgets in bad ones. Budget experts, including credit rating agencies, recommend using the reserves to limit painful service cuts or tax increases when states face budget shortfalls caused by temporary events such as recessions or natural disasters. But rainy day funds are not well suited for helping states close shortfalls caused by structural imbalances in which ongoing spending chronically exceeds ongoing revenue.

Although this maxim is easy to understand in theory—use the rainy day fund for temporary shortfalls, not structural ones—applying it can be more difficult. It’s not always obvious where and when temporary problems end and structural problems begin. Furthermore, rainy day funds have grown so much that some policymakers have begun to wonder whether their savings are larger than necessary. Some states continue to increase savings by raising caps on reserve funds or appropriating dollars to emergency funds, but others have started to discuss spending down rainy day funds even in the absence of a shortfall.

Continue reading.

Route Fifty

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