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Having a Rainy Day Fund, But Not Knowing How to Spend It.

Some states have millions in savings that they don't know when or how to use. A new report suggests ways to better manage their money.

As state lawmakers head into the budget-writing season, some will face the unpleasant task of figuring out how to fill projected shortfalls. In most cases, that conversation will include a debate on whether to withdraw cash from the state's rainy day fund.

Some states count on their rainy day savings during recessions to limit budget cuts, while others strive to put away enough savings to avoid cuts altogether. But many states lack clear guidance about when to take money out of rainy day accounts, for what purposes and how much.

Rainy day funds have been around for decades. Among the 46 states that have them, only half have laws that clearly express what they're seeking to achieve with them, according to a recent Pew Charitable Trusts report. Two states — Wyoming and Kentucky — lack any statutory or constitutional direction about their purpose or proper use.

In Wyoming, for example, the state is facing a projected $300 million shortfall due to declining energy revenues. Tapping the $1.8 billion rainy day fund is a potential solution, but some lawmakers are wary about relying on a one-time infusion to plug a revenue hole that could remain a problem for years to come. With no set policies in place, the discussion about whether to take money out or tap other funds first will take up a considerable amount of time.

"There is no consensus on financing the deficit cash flow of the state for the next three years," said state Rep. Michael Madden, who co-chairs the Revenue Committee.

In Texas, lawmakers have been arguing about how best to use the $7.5 billion rainy day fund, an amount equivalent to 15 percent of the state's general fund expenditures. With lawmakers also looking to take on issues such as improving water and transportation infrastructure and reducing the state's total amount of outstanding debt, they've been divided over whether the current level of reserves is sufficient or excessive.

"It's become a surprisingly emotional issue in the political debate," Dale Craymer, a former legislative aide who was involved in establishing the Texas fund in 1987, told Pew. "The last two sessions, the rainy day fund has taken on this sacred nature that was never really intended. It was intended as a management tool."

Many states' statutes say rainy day funds should help stabilize revenue during economic recessions; a few are more explicit. Virginia's Constitution, for example, says state leaders can use the fund to cover no more than 50 percent of a shortfall in a fiscal year. Thus, the policy also requires lawmakers to make spending cuts or tax changes to balance the budget during periods of revenue decline.

The rules that do guide the use of rainy day funds are sometimes seemingly arbitrary. In particular, savings targets for the funds have typically been a percentage of the state's spending that's politically palatable. During the growth years of the mid-2000s, 21 states hit their savings targets and then stopped putting money away. That resulted "in most of those states relying more heavily on spending cuts and tax increases to balance their budgets during and after the Great Recession," according to Pew.

Pew recommends that states define the purposes of their rainy day funds more clearly and suggests that policymakers study their state's patterns of financial volatility to anticipate how much revenues could drop in a downturn. Such information would help them determine how much they'll want to rely on rainy day accounts to offset shortfalls.

Minnesota's rainy day fund policy, according to the report, is a model worth replicating. It's one of just four states that requires periodic evaluations to make sure its savings targets actually reflect the state's revenue volatility. It's also the only state to determine its risk tolerance — that is, the tolerance policymakers have for not fully covering a potential shortfall, which affects how much the state should save. Minnesota's current savings target is the amount deemed necessary to cover 90 percent of all possible downturn scenarios.

Establishing this type of policy is difficult and will still require compromise.

Connecticut, for example, established new rules for its rainy day fund last year to require automatic deposits whenever the most volatile tax streams — personal and corporate income — produce revenue above historic norms. It will also raise the fund's target to 15 percent of net general fund appropriations. But in order for the bill to get through the legislature, implementation was put off until 2020.

Still, helping a state institutionalize its own buffer against downturns is time well-spent, says Brenna Erford, co-author of the Pew study.

"Of course it's not easy to agree on a purpose for the fund," she said. "But once you have an agreed-upon purpose, the question isn't, 'Should we or shouldn't we?' The debate then becomes, 'Are we now in a scenario where the fund is in play?'"

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