

California Dreaming

NY Should Build Reserves to Prepare for a Rainy Day

March 12, 2018

California Governor Jerry Brown's proposed budget for fiscal year 2019 includes a noteworthy \$5.1 billion contribution to the state's rainy day fund, bringing that fund to \$13.5 billion, achieving its constitutional target of 10 percent of California's general fund tax revenues.¹ In contrast, Governor Andrew Cuomo's Executive Budget for Fiscal Year 2019 makes no new deposits into New York State's reserves, which are at \$1.8 billion, a balance that has remained unchanged since fiscal year 2015 and represents only 2.7 percent of general fund tax revenues in fiscal year 2019. As noted by S&P Global Ratings in its March 6, 2018 report on New York State, this level of rainy day reserves is "low compared with that of peers."²

Both California and New York are emerging from a period of steady economic recovery and growth since the Great Recession with uncertainty about the economy and federal actions on the horizon. This blog discusses New York's missed opportunities to adequately fund reserves and the lessons to be learned from California's approach.

Taking Advantage of Growth

Both California and New York have benefited from a 103-month long economic expansion.³ Between 2010 and 2016 California's Gross Domestic Product (GDP) grew 4.9 percent on average each year, while New York's grew 3.7 percent, on par with national growth. GDP growth has been accompanied by strong employment gains—California added 2.7 million jobs to its economy since 2010, growth of 17.8 percent, and New York added nearly 800,000 jobs, 9.0 percent growth.⁴ State budgets have benefited as a result. California's all fund tax revenues grew 47.5 percent during this period, while New York saw smaller but still ample gains of 27.0 percent.⁵

Looking ahead, New York and California are projecting further growth but both Governors Cuomo and Brown cite looming economic and intergovernmental uncertainties. Governor Cuomo, in his Executive Budget presentation, spoke of the numerous challenges confronting New York including declining revenues, significant infrastructure needs, and the uncertainties resulting from the recently enacted federal Tax Cuts and Jobs Act of 2017 (TCJA). The Governor described TCJA as an “economic missile aimed at New York,” and suggested New York “get out of the way before it lands.”⁶ For his part, Governor Brown warned that “what’s out there is darkness, uncertainty, decline and recession.”⁷ He has proposed substantial deposits to a rainy day fund that will significantly increase budget reserves.

California – Preparing for a Downturn

On November 4, 2014 the voters of California approved Proposition 2, a constitutional amendment that requires annual deposits into a Budget Stabilization Account (BSA). The amendment strengthened the previous deposit policies established by Proposition 58 in 2004, which provided the Governor the option to dedicate up to 3 percent of general fund revenues to the BSA. Two deposits of \$472 million and \$1.0 billion were made into the BSA in fiscal years 2007 and 2008, bringing the balance to \$1.5 billion. This was quickly depleted during the Great Recession that followed.⁸

Proposition 2 of 2014 implemented mandatory annual deposits of 1.5 percent of general fund revenues, plus an amount equal to revenues from taxes on capital gains when such revenues are in excess of 8 percent of general fund revenues. Half of the combined total is dedicated to paying down long-term liabilities, and the other half is deposited into the BSA.⁹ Deposits are to be made until the BSA balance reaches an amount equal to 10 percent of general fund tax revenues. After the 10 percent threshold is reached, the required portion of general fund revenues is directed to fund infrastructure investments.¹⁰ The amendment allows the Legislature to suspend or reduce deposits and make withdrawals, provided there is a budget emergency declared by the Governor.¹¹

Table 1 shows California’s recent success in establishing meaningful reserves. The BSA increased from \$1.6 billion in fiscal year 2015 to the proposed \$13.5 billion in fiscal year 2019, growing from 0.6 percent to 4.5 percent of total

expenditures during this period. In addition to the mandatory deposit, which equates to \$1.5 billion in fiscal year 2019, the Governor’s budget proposes an additional \$3.5 billion deposit that would fully fund the reserve at \$13.5 billion, or 10 percent of general fund tax revenues.¹²

Table 1: California's Budget Stabilization Account (BSA)

(dollars in millions)

	<u>FY2015 Actual</u>	<u>FY2016 Actual</u>	<u>FY2017 Actual</u>	<u>FY2018 Estimated</u>	<u>FY2019 Proposed</u>
Total Expenditures	\$250,344	\$250,899	\$260,979	\$290,914	\$296,197
General Fund Tax Revenues	\$122,158	\$117,083	\$120,717	\$128,103	\$133,922
BSA Balance	\$1,606	\$3,529	\$6,713	\$8,411	\$13,461
BSA as a Share of Total Expenditures	0.6%	1.4%	2.6%	2.9%	4.5%
BSA as a Share of General Fund Tax Revenues	1.4%	3.0%	5.6%	6.6%	10.0%

Source: California Department of Finance, "Summary Schedules and Historical Charts," Schedule 2, Charts H and B (January 2018) and *Governor's Budget Summary 2018-19* (January 10, 2018).

New York State—Missed Opportunity

New York has two funds that function similarly to California’s BSA.¹³ The Tax Stabilization Reserve Fund (TSRF) was created through a constitutional amendment in 1943. In each fiscal year, up to 0.2 percent of general fund disbursements can be deposited into the fund, but the fund balance is not allowed to exceed 2 percent of the current year’s general fund expenditures. The State may withdraw from the fund to cover budget gaps and must repay the amount within six years. The TSRF currently has a balance of \$1.26 billion.¹⁴

A second fund, the Rainy Day Reserve Fund (RDRF) was established in 2007 after the TSRF first met its legislative cap. When established, the RDRF’s maximum balance was 3 percent of projected general fund disbursements for the next fiscal year. After the experience of the Great Recession, this was increased to 5 percent by the Legislature.¹⁵ At the discretion of the Governor, a maximum of 0.75 percent of planned spending for the next fiscal year can be transferred from the General Fund into the RDRF. Withdrawals from the fund may only occur in instances of economic downturn or natural disaster. In the budget proposed for fiscal year 2019 the RDRF’s balance is \$540 million, less than 1 percent of planned general fund expenditures.¹⁶

Table 2 shows New York State rainy day reserves have remained unchanged at \$1.8 billion even as the budget has increased. As such, reserves have declined as a share of total expenditures, from 1.2 percent to 1.1 percent, and represent a significantly smaller share of total expenditures and general fund tax revenues than California’s reserves.

Table 2: New York's Rainy Day Funds
(dollars in millions)

	FY2015 Actual	FY2016 Actual	FY2017 Actual	FY2018 Estimated	FY2019 Proposed
Total Expenditures	\$143,891	\$150,708	\$157,014	\$164,437	\$168,185
General Fund Tax Revenues	\$58,646	\$62,581	\$62,264	\$67,288	\$66,741
RDRF and TSRF, Combined Balance	\$1,798	\$1,798	\$1,798	\$1,798	\$1,798
Reserves as a Share of Total Expenditures	1.2%	1.2%	1.1%	1.1%	1.1%
Reserves as a Share of General Fund Tax Revenues	3.1%	2.9%	2.9%	2.7%	2.7%

Source: Office of the New York State Comptroller, *Comptroller’s Annual Report to the Legislature on State Funds Cash Basis of Accounting, Fiscal Year Ended March 31, 2017* (November 2017) and fiscal years 2015 and 2016 editions; CBC staff analysis of data from New York State Division of the Budget, “Open Budget” (January 2018) and *FY 2019 Executive Budget Financial Plan* (January 2018) T-1 and T-2.

In addition to a long period of economic expansion, New York State has also benefited from \$10.7 billion in monetary settlements, mainly from Wall Street financial entities, from fiscal years 2015 to 2018 that could have been used to bolster reserves; however, none of these funds were placed into the rainy day funds.¹⁷

New York Should Take Action

New York’s current level of reserves is small relative to the potential revenue loss from a prospective recession. Looking at revenue trends during the past three recessions, [the Citizens Budget Commission estimated](#) that the four-year impact of a recession on a financial plan that assumed economic growth would be approximately \$43.9 billion.¹⁸ While it is not realistic to build reserves to offset the entire impact of a recession, reserves serve as an important cushion in navigating the significant revenue losses of a sharp downturn. The actual year over year tax revenue losses experienced in the 2002-2003 recession and the Great Recession would translate into losses between \$9.2 billion and \$12.0 billion in the first two years of a prospective recession.¹⁹ In fiscal year 2019

New York State’s rainy day funds total \$1.8 billion, a fraction of potential losses.

Table 3 outlines the level of reserves that would have accumulated had New York made deposits similar to California. New York would have achieved a balance of \$8.4 billion in reserves, \$6.6 billion more than planned in the Fiscal Year 2019 Executive Budget.

Table 3: Simulated New York State Reserves Following California Model, FY2015-FY2019
(dollars in millions)

	CALIFORNIA				
	FY2015 Actual	FY2016 Actual	FY2017 Actual	FY2018 Estimated	FY2019 Proposed
Tax Revenue	\$139,482	\$143,652	\$146,457	\$158,593	\$168,137
BSA Deposits	\$1,606	\$1,923	\$3,184	\$1,698	\$5,050
BSA Balance	\$1,606	\$3,529	\$6,713	\$8,411	\$13,461
Deposit as a Share of Tax Revenues	1.2%	1.3%	2.2%	1.1%	3.0%

	SIMULATED NEW YORK RESERVES				
Tax Revenue	\$72,128	\$74,076	\$74,372	\$78,952	\$77,369
Simulated Reserves Deposits	\$830	\$992	\$1,617	\$845	\$2,324
Simulated Reserves Balance	\$2,628	\$3,620	\$5,237	\$6,082	\$8,406
NYS Actual Reserves Balance	\$1,798	\$1,798	\$1,798	\$1,798	\$1,798

Source: The model uses deposits as a share of total tax revenue, which differs from the constitutional deposit requirement related to general fund revenues. This model calculates deposits to New York’s reserves on top of the \$1.8 billion balance at the beginning of fiscal year 2015 had it deposited an equivalent share of tax revenues as California.

Source: CBC staff analysis of data from New York State Division of the Budget, “Open Budget” (January 2018); New York State Division of the Budget, *FY 2019 Executive Budget Financial Plan* (January 2018); and California Department of Finance, “Summary Schedules and Historical Charts,” Chart H (January 2018) and *Governor’s Budget Summary 2018-19* (January 10, 2018).

California’s savings model—mandatory deposits to reach a maximum amount of 10 percent of general fund tax revenues—is a good example, but is not the only option for New York. Assessing the appropriate level of reserves should be a state-by-state determination that takes into account tax revenue volatility and the likely expenditure impacts from a recession. The degree of risk a state wishes to offset with a rainy day fund is a policy decision. Currently, through its two rainy day funds, New York has the capacity to hold roughly 7 percent of general fund expenditures, or \$4.8 billion in rainy day reserves. Achieving a rainy day reserve equal to New York’s current maximum as allowed by law

would not totally offset impacts from a significant recession, but adding to the reserves over time would represent a significant improvement from the current budgeted level of \$1.8 billion and would mitigate some of the most harmful effects from an economic downturn.

Conclusion

New York State should consider legislation to mandate deposits into a rainy day fund. The level of reserves should be thoroughly analyzed with respect to tax revenue volatility, and a healthy level should be established to protect New Yorkers from the impacts of budget cuts to vital services that would result from an economic downturn or negative financial impacts resulting from the TCJA. New York's current rainy day reserves are not adequate and leave the State ill-prepared. While the State forecasts continued economic growth, economic expansions do not last forever. California has prepared by making significant deposits to reserves; New York should do the same.

By Mariana Alexander and Timothy Sullivan

Footnotes

1. California Department of Finance, Governor's Budget Summary 2018-19 (January 10, 2018), p. 1, www.ebudget.ca.gov/2018-19/pdf/BudgetSummary/FullBudgetSummary.pdf.
2. Eden P. Perry and David G. Hitchcock, S&P Global Ratings, "New York State; Appropriations; General Obligation; Joint Criteria" (March 6, 2018), p. 4.
3. "Dating The Business Cycle," *Seeking Alpha* (January 2, 2018), <https://seekingalpha.com/article/4134799-dating-business-cycle>.
4. Growth is calculated using current dollars from 2010 to 2016. U.S. Bureau of Economic Analysis, North American Industry Classification System Survey, "Gross domestic product (GDP) by state (millions of current dollars)" (Accessed February 15, 2018) and "Total Full-Time and Part-Time Employment by NAICS Industry" (Accessed February 15, 2018), www.bea.gov/regional/index.htm.
5. Tax revenue growth is not adjusted for changes in tax policy and is therefore reflective of more than economic growth. New York State Division of the Budget, *FY 2019 Executive Budget Financial Plan* (January 2018), www.budget.ny.gov/pubs/archive/fy19/exec/fy19fp/FinPlan.pdf; and California Department of Finance, "Summary Schedules and Historical Charts" (January 2018), www.dof.ca.gov/budget/summary_schedules_charts/index.html.

6. Andrew Cuomo, Governor of the State of New York, "Governor Cuomo Outlines FY 2019 Budget: Realizing the Promise of Progressive Government" (presentation, January 16, 2018), www.governor.ny.gov/news/governor-cuomo-outlines-fy-2019-budget-realizing-promise-progressive-government.
7. Conor Dougherty, "Boom and Gloom: An Economic Warning for California," *The New York Times* (February 13, 2018), p. B1.
8. California Department of Finance, *Chart H: General Fund Budget Expenditure Data* (January 2018), http://dof.ca.gov/budget/summary_schedules_charts/documents/CHART-H.pdf.
9. California State Legislature, Legislative Analyst's Office, "Long-Term Capacity for Debt Payments Under Proposition 2" (December 21, 2017), <http://lao.ca.gov/Publications/Report/3727>.
10. California State Legislature, Legislative Analyst's Office, *The 2016-17 Budget: The Governor's Reserve Proposal* (February 2016), p. 2, www.lao.ca.gov/reports/2016/3348/reserve-proposal-021916.pdf.
11. Under Proposition 2, the Governor of California could call a budget emergency only if a natural disaster occurs, such as a flood or an earthquake, or if there is not enough money available to keep general fund spending at the highest level of the past three years (adjusted for changes in the state population and the cost of living). California State Legislature, Legislative Analyst's Office, *The 2016-17 Budget: The Governor's Reserve Proposal* (February 2016), p. 2, www.lao.ca.gov/reports/2016/3348/reserve-proposal-021916.pdf.
12. California Department of Finance, *Governor's Budget Summary 2018-19* (January 10, 2018), www.ebudget.ca.gov/2018-19/pdf/BudgetSummary/FullBudgetSummary.pdf.
13. These reserves are similar to the BSA in that they are not earmarked for any specific use and are intended to be used to stabilize tax volatility. Both states have other reserve funds that are earmarked for specific purposes that are not included in this analysis.
14. Office of the New York State Comptroller, *Fund Classification Manual* (June 30, 2011), p. 21, www.osc.state.ny.us/agencies/fcm/fund-classification-manual-jan2018.pdf; and New York State Division of the Budget, *FY 2019 Executive Budget Financial Plan* (January 2018), Table T-2, www.budget.ny.gov/pubs/archive/fy19/exec/fy19fp/FinPlan.pdf.
15. State Finance Law, Section 92-cc, Subdivision 2, as amended by section 17 of part U of chapter 59 of the laws of 2012.
16. Office of the New York State Comptroller, *Fund Classification Manual* (June 30, 2011), p. 25, <https://www.osc.state.ny.us/agencies/fcm/fund-classification-manual-jan2018.pdf>; and New York State Division of the Budget, *FY 2019 Executive Budget Financial Plan* (January 2018), Table T-2, www.budget.ny.gov/pubs/archive/fy19/exec/fy19fp/FinPlan.pdf.

17. New York State Division of the Budget, FY 2019 Executive Budget Financial Plan (January 2018), p. 40, www.budget.ny.gov/pubs/archive/fy19/exec/fy19fp/FinPlan.pdf.
18. David Friedfel, *Predicting the Peak, Preparing for the Trough: An Examination of the Impact of a Possible Recession on New York State* (Citizens Budget Commission, June 2016), <https://cbcny.org/research/predicting-peak-preparing-trough>.
19. CBC staff analysis of data from New York State Division of the Budget, FY 2019 *Economic and Revenue Outlook* (January 2018), p. 6, www.budget.ny.gov/pubs/archive/fy19/exec/fy19ero/economicRevenueOutlook.pdf.