BLOG | CITY BUDGET

Clear as Day

New York City Needs a Rainy Day Fund

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New York City is responding to the coronavirus pandemic and a seismic economic disruption. To mitigate the pandemic and balance its budget in the face of dramatic revenue shortfalls, the City will receive some federal aid, but also will have to use a variety of strategies, potentially including significant service cuts. One resource in woefully short supply is budgetary reserves. Next year New York City has only set aside $1.25 billion in reserves, which is less than one-quarter of the $6 billion near-term revenue loss estimated by the Office of the New York City Comptroller, and pales in comparison to $20 billion three-year shortfall the Citizens Budget Commission (CBC) estimates if a recession is similar to those in the recent past.

This paucity of reserves would not have been the case if the City been permitted to set aside resources in a well-designed Rainy Day Fund (RDF) during the last 10 prosperous years. In fact, following CBC's recommended strategy would have netted the City nearly $9 billion in reserves. While the City will have to address the current crisis with the tools and resources at hand, now is the perfect time for State and City leaders to do what it takes to get it right for next time.

In November 2019 New Yorkers voted resoundingly to amend the New York City Charter to create and be able to use an RDF. Approval at the ballot box is the first of three crucial steps needed to make the RDF a reality; additional changes are required in State law to authorize and use the RDF and in City law to ensure the fund is properly designed. Getting these details right is paramount to ensure the RDF protects New Yorkers during economic recessions and severe emergencies, maintains the strong fiscal framework implemented following New York City's 1975 fiscal crisis, and does not devolve into a slush fund for elected officials.

The CBC and others have explained how the City's current methods for "saving" money are not transparent and consistently fall short of amassing the reserves required to preserve service stability during and immediately following a recession. (See the CBC report *To Weather a Storm*.) The 2019 City Charter Revision Commission recognized the need to have a well-crafted RDF and included language on the ballot specifying the purpose of the RDF was "to save money for use in future years, such as to address unexpected financial hardships." Seventy-one percent of voters approved this last November, creating powerful momentum for complementary changes needed in State statute to authorize the RDF.

Creation and use of the RDF requires an amendment to the Financial Emergency Act for the City of New York (FEA) enacted in the wake of the 1975 fiscal crisis to impose fiscal discipline on the City. The FEA imposes a stringent standard on the City—one not imposed on any other local government or the State—to balance its budget and actual results in accordance with generally accepted accounting principles (GAAP). Fiscal monitors favor this standard because it gives the clearest picture of government activities and requires current year expenditures to be funded by current year revenues.[1] However, this requirement effectively prevents use of an RDF—which would fund current-year expenditures with prior year revenues—and would have to be altered to allow an exception for an RDF.

The FEA's high bar has facilitated the City's generally solid fiscal condition, well-respected financial reporting, and ready access to the bond market. Any changes to the FEA should be as narrow as possible in order to preserve the beneficial aspects of the law; wider than essential changes open the door for misuse. The RDF exception should specify the only two permissible uses for an RDF are a recession or severe emergency. State law should define a recession as two successive quarters of economic decline as indicated by private employment or gross city product. An emergency should be defined as severe when it is accompanied by a revenue shortfall or expenditure increase equal to or greater than 1 percent of the budget. This is similar to how New York State's RDF is structured.[2] Thus far, two bills have been introduced in the Legislature to make changes that would authorize and allow use of an RDF. However, in their current forms both would allow use in a broader set of circumstances, allowing for possible misuse of the fund.[3]

In addition to changing the FEA, the State should empower the City to enact legislation that defines a framework and rules for the RDF. First, conditions on withdrawals set in State statute should be mirrored in City law. An RDF is *not* a revolving fund to smooth revenue and spending from year to year, and rules are necessary to ensure funds are available when needed and not used on other spending priorities that may arise during the normal course of budgeting.[4] Second, withdrawals from the RDF should be limited to no more than two-thirds of the fund balance in any year, to ensure funds are available for the second year of a recession or emergency.

Third, enacting rules regarding deposits to the RDF will help ensure sufficient funds are accumulated. Research shows mandatory deposits are most effective.[5] One approach is to capture revenue growth above a certain threshold; this essentially diverts some economically sensitive revenue during an economic expansion from the general fund to the RDF. CBC recommends mandatory deposits equal to 75 percent of the tax revenue growth above 3 percent; our analysis based on recent City's experience shows this would provide sufficient revenue to fund municipal operations while building significant resources in the RDF.[6]

If the size is too small, the RDF will not be able to offset the most drastic service cuts or revenue increases that municipalities generally turn to during a recession. CBC recommends a target size of 17.2 percent of tax revenue, which can serve as a cap on the size of the RDF.[7]

Getting the RDF right is important to the City's continued fiscal prosperity, and the next step is for the Legislature to authorize its creation. Improving the bills already introduced to ensure sufficient restrictions on the use of the fund is critically important. Permitting the City to deposit and withdraw funds each year at the discretion of the Mayor would create a potential slush fund rather than an RDF. For example, there would be nothing to stop the Mayor from growing the budget to an unaffordable level in just one year, perhaps before an election, by using savings from prior years.

As economic uncertainty grows with the spread of coronavirus, concern about the fiscal preparedness of New York City has increased and serves as a stark reminder of the importance of moving forward with the creation of an RDF. It is imperative that changes to the FEA are not hastily or lightly enacted; any amendments should supplement the strong fiscal framework and existing legislative proposals should be amended to restrict use of an RDF to periods of economic contraction or severe emergency.

By Ana Champany

Footnotes

1. For more detailed discussion, see: Charles Brecher, Thad Calabrese, and Ana Champeny, *To Weather A Storm: Create a NYC Rainy Day Fund* (Citizens Budget Commission, April 18, 2019), https://cbcny.org/research/weather-storm.
2. New York Consolidated Laws, State Finance Law, *Section 92-cc. Rainy day reserve fund* (accessed March 6, 2020), https://codes.findlaw.com/ny/state-finance-law/stf-sect-92-cc.html.
3. S.06804/A.08737 (New York State, January 8, 2020), https://www.nysenate.gov/legislation/bills/2019/s6804; and A.09789 (New York State, February 11, 2020), https://nyassembly.gov/leg/?default_fld=%0D%0A&leg_video=&bn=A09789&term=2019&Summary=Y&Actions=Y&Text=Y.
4. The Government Accounting Standards Board (GASB), which provides directives to governments on financial reporting has requirements for reporting stabilization funds as restricted fund balance that include use in "events that are not generally expected to occur." See: Governmental Accounting Standards Board, *Statement No. 54 of the Governmental Accounting Standards Board: Fund Balance Reporting and Governmental Fund Type Definitions* (No. 287-B, February 2009), https://gasb.org/resources/ccurl/313/494/GASBS%2054.pdf.
5. The Pew Charitable Trusts, *Fact Sheet: State Rainy Day Funds in 2017: How states are improving the way they prepare for the next recession* (July 18, 2017), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2017/07/state-rainy-day-funds-in-2017; and Katherine Barrett and Richard Greene, *Rainy Day Fund Strategies: A Call to Action* (prepared for the Volcker Alliance, July 2019), https://www.volckeralliance.org/rainy-day-fund-strategies.
6. Tax revenue growth would be measured on a common rate and base basis and exclude the impact of changes to the base and the rate. If year over year growth in common rate and base tax revenue was below 3 percent, no deposit would be required. Once growth reached 3 percent, 75 percent of the revenue above that threshold would be deposited. If such deposit rules had been in place from fiscal year 2010 through fiscal year 2019, NYC would have an RDF with $9.0 billion. Charles Brecher, Thad Calabrese, and Ana Champeny, *To Weather A Storm: Create a NYC Rainy Day Fund* (Citizens Budget Commission, April 18, 2019), https://cbcny.org/research/weather-storm.
7. Charles Brecher, Thad Calabrese, and Ana Champeny, *To Weather A Storm: Create a NYC Rainy Day Fund* (Citizens Budget Commission, April 18, 2019), https://cbcny.org/research/weather-storm.