Budget Surpluses Push States' Financial Reserves to All-Time Highs

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By: Justin Theal & Joe Fleming

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The Pew Charitable Trusts

After an early pandemic decline, states had collectively amassed their largest fiscal cushion on record by the start of the current budget year. Higher-than-expected tax revenue—among other temporary factors—drove the total held in savings and leftover budget dollars to new highs. As states approach the close of fiscal year 2022, most expect to spend down at least a portion of their surplus funds.

Despite fallout from the coronavirus and a two-month recession, the 50-state total of rainy day funds dipped only temporarily in fiscal year 2020, followed by a historic increase by the end of the first full budget year of the pandemic.

During fiscal 2021 alone, states grew their collective rainy day funds by $37.7 billion, or an increase of roughly 50% from a year earlier—driving the total held among all states to a record high of $114.6 billion. Moreover, amid widespread budget surpluses, states reported the largest annual increase in leftover general fund budget dollars (known as ending balances) in at least the past 21 years.

Among the 14 states that withdrew a combined total of $8.2 billion from their rainy day funds in fiscal 2020, all had made progress in replenishing their savings in part or in full by the start of this budget year. Nevada, for example, emptied its rainy day fund of $332 million by the end of fiscal 2020, but has since deposited nearly a third of that amount. And North Carolina withdrew roughly $680 million in fiscal 2020, but fully replenished those funds by the end of fiscal 2021.

Rainy day funds, also known as budget stabilization funds, grew in more than two-thirds of states—35—during fiscal 2021, according to figures reported to the National Association of State Budget Officers (NASBO). A slightly greater number of states—36—posted increases in the number of days they could run government operations using rainy day funds alone compared with the previous year. Because the size of state budgets varies widely, it is fairer to compare the strength of rainy day funds by measuring how many days' worth of spending each state's savings could cover rather than by ranking funds by dollar amounts. Days' worth of spending can increase either because states save more money or because they reduce their budgets.

In addition to state policymaker actions, those with deposit rules tied to volatility could direct at least some of last year's above-normal revenue growth or one-time influxes of dollars into their rainy day funds. For instance, Tennessee set aside 10% of its year-over-year additional revenue and Maryland dedicated at least a portion of its nonwitholding income tax revenue that exceeded the 10-year average.

Budget surpluses and related gains in states' total financial cushions during fiscal 2021 are not expected to continue at the same degree this budget year because multiple one-time and temporary factors, which helped prop up overall state fiscal conditions, have either ended or are diminishing. As states close out the current budget year, annual increases to rainy day fund balances are projected to slow compared with the previous year, and most states plan to spend down some of their larger-than-expected ending balances, according to enacted budget figures reported to NASBO.

Rainy day funds

With $114.6 billion in savings by the end of fiscal 2021, states could run government operations on rainy day funds alone for a median of 34.4 days, equal to 9.4% of spending—all record highs. Last year's historic increase, amid widespread budget surpluses, resulted from a combination of state policymaker actions and mandatory deposit rules. Still, the strength of states' rainy day funds ranged widely—from 301 days' worth of spending in Wyoming to a negative balance in Washington.

Most states have avoided tapping their rainy day funds since the outset of the pandemic-driven recession in early 2020. In general, states were cautious about using their dedicated savings accounts initially because of uncertainty about how the pandemic and resulting recession would unfold, as well as about the availability and extent of federal aid. Instead of first drawing down savings, most states managed fiscal 2020 budget gaps through a combination of spending cuts, early federal aid to state governments, and a historically high cache of ending balances that had built up over two previous years of widespread revenue surpluses.

Overall, states learned a valuable lesson from the 2007-09 downturn, when tax revenue losses far outstripped savings, and nine states nearly or completely emptied their rainy day funds by the end of fiscal 2008. States had pumped up total savings enough before the pandemic to run government operations for a median of 28.9 days, equivalent to 7.9% of spending, compared with 17.3 days, or 4.7% of spending, just before the Great Recession. At least 36 states could have covered a greater amount of government spending as they entered the pandemic than they could have prior to the Great Recession.

Download the data.

Rainy day fund highlights

At the close of fiscal 2021, the first full budget year affected by the pandemic:

- Wyoming recorded the nation's largest rainy day reserves as a share of operating costs (301 days). North Dakota (115.7), Alaska (111.7), and New Mexico (101) were the only other states with more than 100 days' worth of operating costs set aside.
- Thirty-six states had increases in days' worth of operating costs compared with the year before, and nearly half of states—23—hit record highs.
- Kentucky had the greatest increase in days (+51.2 days), followed by California (+40), Colorado (+34.4), New Hampshire (+34), and Connecticut (+27.6).
- Kansas (4.1 days) was the only state to report less than a week's worth of operating costs in reserve in fiscal 2021. Washington was the only state to end the budget year with a negative rainy day fund balance after draining its savings of $1.7 billion; however, the state is projected to at least partially replenish its savings over the next several fiscal years.
- At least three states—Connecticut, Iowa, and Georgia—filled their rainy day funds to their maximum balances, meaning that additional dollars that would ordinarily be directed to those fund balances were instead redirected to other sources.

Total balances

States' total balances—the combination of rainy day fund balances and leftover budget dollars known as ending balances—hit a record $217.1 billion, nearly $100 billion greater than the previous high of $121.6 billion in fiscal 2019. Total balances is a fuller measure of states' fiscal cushion against unexpected spending needs or revenue downturns. Together, these funds were enough to run state government operations at the end of fiscal 2021 for a median of 85.1 days, equivalent to 23.3% of spending—both record highs. By the end of fiscal 2021, total balances in 46 states could cover more days' worth of general fund spending than a year earlier.

Although both rainy day fund levels and ending balances reached record levels in fiscal 2021, states' leftover budget dollars were especially high due to higher-than-expected tax collections, among other temporary factors, which helped explain widespread budget surpluses. But ending balances fluctuate from year to year, so policymakers cannot count on them as cushions against future budget uncertainty to the degree that they can with rainy day funds, which are saved until policymakers decide to draw them down.

In the first budget year affected by the pandemic, states relied more on ending balances than on rainy day funds to make ends meet. In net dollars, which accounts for the fact that totals fell in some states while rising in others, ending balances fell by nearly $10 billion to $33 billion in fiscal 2020, while rainy day funds declined by $2.1 billion to $76.9 billion. Conversely, both types of funds increased in fiscal 2021. By the start of this budget year, states' collective ending balances more than tripled, from $33 billion by the end of fiscal 2020 to $102 billion by the end of fiscal 2021.

As with rainy day fund balances, states' collective total balances could have covered more days' worth of government operations before the start of the pandemic—a median of 50.8 days, equivalent to 13.9% of spending—than they could before the Great Recession—a median of 41.3 days, or 11.3% of spending. At least 30 states could have covered a greater share of government spending in fiscal 2019 than in fiscal 2007.

Total balance highlights

States' results for fiscal 2021 show:

- The highest-ranked state for total balances was the same as for rainy day funds: Wyoming (301 days). Eighteen other states had total balances that could cover more than 100 days, a record high count compared with prior years when only a handful of states surpassed this benchmark.
- No state had less than a week's worth of operating costs in total balances, for the first time in at least 20 years.
- North Dakota had the greatest increase in days (+132.9 days), followed by Oregon (+122.9), North Carolina (+100.2), Texas (+100), and Oklahoma (+92.1).
- The four states whose total fiscal cushions decreased were Wyoming (-53 days), New Mexico (-19), Louisiana (-10), and Michigan (-6.9).

Why reserves matter

States use reserves and balances to manage budgetary uncertainty, including revenue forecasting errors, budget gaps during economic downturns, and other unforeseen emergencies, such as natural disasters. This financial cushion can soften the need for spending cuts or tax increases when states need to balance their budgets.

Because reserves and balances are vital to managing unexpected changes and maintaining fiscal stability, their levels are tracked closely by bond rating agencies. For example, Fitch Ratings upgraded Idaho's credit rating in November 2021, citing the state's buildup of reserve levels as part of its rationale.

There is no one-size-fits-all rule on when, how, and how much to save. States with a history of significant economic or revenue volatility may desire larger cushions. According to a report by The Pew Charitable Trusts, the optimal savings target of state rainy day funds depends on three factors: the defined purpose of funds, the volatility of a state's tax revenue, and the level of coverage—similar to an insurance policy—that the state seeks to provide for its budget.

Similarly, two forward-looking fiscal management tools—long-term budget projections, which help states identify challenges that can build over time, and budget stress tests, which help determine a state's risk from adverse events—can help states better understand and prepare for fiscal challenges, such as by refining a savings target.

Reserves and balances represent funds available to states to fill budget gaps, although there may be varied levels of restriction on their use, such as under what fiscal or economic conditions they can be used. In addition, limits are often set on how much states may deposit into rainy day accounts in a given year when seeking to replenish their reserves.

General fund reserves and balances may not reflect a state's complete fiscal cushion. States may have additional resources to soften downturns, such as dedicated reserves outside of their general funds or rainy day accounts. In addition, the scope of each state's general fund expenditures can differ, so comparisons across states should be made with caution. For example, some states—such as Michigan—spend considerable amounts outside of their general fund, and Ohio is unusual because its general fund includes spending from federal Medicaid dollars. One way to standardize the size of reserves and balances is to calculate how many days a state could run solely on those funds, even though the scenario is highly unlikely.

Colorado and Illinois do not have a rainy day fund as defined by The Pew Charitable Trusts, despite balances reported within NASBO's surveys. Colorado maintains mandatory general fund balances, but these reserves do not respond in any way to changing economic or fiscal conditions. Illinois' Budget Stabilization Fund has a stringent repayment provision that requires all withdrawals from the fund to be repaid in full within the fiscal year, making it, in effect, a working-cash fund rather than a rainy day fund.

Download the data to see individual state trends. Visit Pew's interactive resource, Fiscal 50: State Trends and Analysis, to sort and analyze data for other indicators of state fiscal health.

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Experts: Melissa Maynard

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AUTHORS

Justin Theal
Officer
State Fiscal Health

Joe Fleming
Senior Associate
State Fiscal Health

MEDIA CONTACT

Catherine An

Officer, Communications

202.552.2088