



Municipal Building
New York, N.Y. 10007

August 19, 1987

Mr. Steven Weinstein, Executive Director
Municipal Assistance Corporation
One World Trade Center Suite 8901
New York, NY 10048

Dear Mr. Weinstein:

Since we last spoke I have joined OMB as Assistant Director of Tax Policy. An announcement is enclosed. In that capacity I have been closely involved in the development of a Rainy Day Fund for the City.

Paul Dickstein spoke to you the other day about some accounting complications tied to use of a Fund to avoid deficits during economic downturns. These complications could be relieved if the City's and MAC's bond covenants would accept the use of Rainy Day Fund monies as a legitimate method of currently funding expenditures. In other words, if current revenues plus Fund monies equal current expenditures, then the budget would be considered balanced as required by the bond covenants and related legislation.

As he discussed with you on the telephone the other day, Paul would appreciate your views on whether the Fund can be used to maintain budget balance while continuing to satisfy the City's obligations to bondholders.

At Paul's request, I enclose a package of materials related to our proposal:

1. A table showing how withdrawals under the proposal would have worked in FY 1982 - FY 1984;
2. A general description of the structure and operation of the Fund (5 pages);
3. A brief description of an expired Fund structure that did not work (1 page);

4. Draft legislation to establish the currently proposed Fund (10 pages).
5. An okay article by Michael Wolkoff on the use of such Funds by municipalities (12 pages).

If you have any questions, in addition to Paul you can talk with Mark Page (669-4328) or with me (669-4370). I will be out of town until September 8.

Sincerely yours,



Allen J. Proctor
Assistant Director

Enclosures



Municipal Building
New York, N.Y. 10007

Allen J. Proctor
Chief, Regional Economics Staff and Monetary Analysis Division
Federal Reserve Bank of New York

joined the Office of Management and Budget of
The City of New York on April 15, 1987.
He will serve as Assistant Director,
Tax Policy, Forecasting and Economic Analysis.

His new address is:

Allen J. Proctor, Assistant Director
Office of Management and Budget
Room 1350
Municipal Building
New York, New York 10007
(212) 669-4370

OPERATION OF PROPOSED REVENUE STABILIZATION RESERVE
OF NEW YORK CITY

Hypothetical estimates of how the mechanism for reserve payments out of the Authority might have worked. Hypothetical payments to the Authority cannot be derived ex post from audited books.

<u>Beginning of FY Quarter</u>	<u>Employment Test</u>	<u>Revenue Test</u>	<u>\$ Millions Paid Out of The Authority</u>
FY 1982 Q1	Met	Failed	0
Q2	Failed	Failed	0
Q3	Failed	Failed	0
Q4	Met	Met	\$45
FY 1983 Q1	Met	Met	\$136
Q2	Met	Met	\$173
Q3	Met	Met	\$59
Q4	Met	Met	\$71
FY 1984 Q1	Met	Failed	0
Q2	Met	Failed	0
Q3	Failed	Met	0
Q4	Failed	Failed	0

DRAFT
6/4/87

Revenue Stabilization Authority

PURPOSE: In order to provide for possible future periods of decreased revenues that may be caused by recessionary or other unanticipated economic events, monies should be set aside during periods of economic strength. During fiscal periods in which current tax revenues may be inadequate to provide appropriate levels of City services, these monies will be available to provide the additional revenue and avoid disruption or cessation of such services. This policy decision is intended to continue the City's sound financial management practices. Any excess moneys (as defined herein) held by the Authority should be transferred to the capital fund to support the City's ongoing capital program.

MECHANISM: A public authority (the "Authority") will be established under state law to accumulate, control, invest, and disburse these resources which shall be known as the Revenue Stabilization Reserve. The Authority would be governed by a board of directors. Money held by the Authority would be paid to the City in accordance with the criteria set forth below.

FUNCTION: Payments to the Authority

In any fiscal year when the City's audited General Fund statement of revenues and expenditures would otherwise show an excess of revenues over expenditures of more than \$5 million, a current expenditure would be recognized in an amount that would reduce the excess of revenues over expenditures to \$5 million. This amount would then be paid to the Authority.

Payments out of the Authority

When the City is in a period of budgetary stress, as determined by certain objective criteria, the moneys held by the Authority will become available to support current services. When on the publicly reported results of a given quarter the criteria for budgetary stress have been met, the moneys held by the Authority may be recognized as current revenue. Moneys shall be paid to the City's general fund in an amount defined by the Payment Amount Criteria defined below.

Tests for budgetary Stress

The criteria for budgetary stress shall have been

met, and therefore the moneys held by the Authority become available, whenever as of the end of any quarter (the three month periods ending September 30, December 31, March 31 and June 30) both of the following tests are met:

Test 1 Employment Slowdown

The test is met if the average of the federally published monthly non-agricultural employment numbers for New York City for the six months ending as of the end of the last quarter is less than one percent greater than the same average for the six month period immediately prior to that period.

Test 2 Revenue Slowdown

The test addresses the reported actual collections of economically sensitive taxes in New York City which shall be for this purpose the Personal Income Tax, the Sales Tax, the General Corporation Tax, the Unincorporated Business Tax, the Utility Tax and the Commercial Rent Tax. The total collections of all of these taxes is referred to below as the "Economic Tax Collections".

To apply the test:

1) Determine the Economic Tax Collections for the last three City fiscal years for which audited results are available and the average of the change in such collections between the third and second years back and the second and first years back. This average change will be known as the "Past Revenue Growth".

2) Compare the reported Economic Tax Collections for the last two quarters and for the comparable two quarters one year earlier and determine the percentage change in collections between the two periods. This change will be known as the "Current Collection Trend".

The test is met if the Current Collection Trend is less than the Past Revenue Growth.

Payment Amount Criteria

When, as of the end of a quarter, moneys held by the Authority become available they shall be paid into the City's general fund in an amount (up to the entire balance held) sufficient to bring actual Economic Tax Collections up to the Past Revenue Growth. The amount paid by the Authority to meet the Past Revenue Growth trend shall be the difference between actual Economic Tax Collections

in the last quarter and the amount such actual collections would have had to be for the Economic Tax Collections in the last two quarters to have achieved a percentage increase over the actual Economic Tax Collections in the comparable two calendar quarters in the previous year equal to the percentage increase of the Past Revenue Growth.

Excess Balance held by the Authority

If, as of December 1 in any year, the balance held by the Authority exceeds 2-1/2 percent of the City's total revenues for the fiscal year ending the previous June 30, as audited, the excess shall be paid over to the City's capital projects fund.

Tax Appropriation and General Fund Stabilization Reserve Fund

The Tax Appropriation and General Fund Stabilization Reserve Fund was established pursuant to Section 128 of the New York City Charter.

Local Law No. 66 which became effective on June 20, 1955 changed the name of this Fund to the Tax Appropriation and General Fund Stabilization Reserve Fund, and also its composition and purpose.

This Fund is to be credited with any balance remaining in the Tax and Appropriation Surplus and Deficiency Account, established pursuant to the Greater New York Charter, after providing in this latter account for the amounts of Outstanding Taxes prior to 1937 deemed to be uncollectible.

It is also to be credited with the Appropriations in the Expense Budget required by the New York City Charter, which Appropriation, together with the amount appropriated for the Tax Deficiency Account, shall not exceed two per cent of the Tax Levy of the current fiscal year. These appropriations are to continue until a sum is provided sufficient to bring the total accumulation of this Fund to an amount equal to thirty per cent of the Tax Levy of the current fiscal year.

Local Law 33 of 1959 defines the term "Tax Levy" as that part of the real estate tax levy which is included within the tax limitation prescribed by Section 10 of article 8 of the state constitution.

The Comptroller may from time to time borrow the Funds accumulated in the Tax Appropriation and General Fund Stabilization Reserve Fund for the purposes for which he is authorized to issue Tax Anticipation Notes or Revenue Anticipation Notes.

In addition to the above, Local Law No. 66 of 1955 provides:

If the total amount of receipts of the General Fund in any fiscal year is less than the anticipated receipts, the difference must be transferred from this fund to the General Fund. If the remaining cash balance is less than 10% of the tax levy for any fiscal year then the amount transferred must be repaid in equal appropriations in not less than three expense budgets during the following six years or until the cash in this fund again reaches 10% of the tax levy. If the cash exceeds 30% of the tax levy the excess may be used by the Board of Estimate for the reduction of taxes.

The cash in the Tax Appropriation and General Fund Stabilization Reserve Fund at June 30, 1976 amounted to \$6,379,974.49⁽¹⁾ and Receivable from Mortgages \$12,343,964.83.

Credit Balance July 1, 1975	\$22,841,851 07
Credits for Year:	
Amount Transferred from Tax and Appropriation Surplus and Deficiency Account
Credit Balance at June 30, 1976	<u>\$22,841,851 07</u>

Notes:

(1) Cash Tax Appropriation and General Fund Stabilization Reserve Fund Balance, July 1, 1975	\$848,021 83
Proceeds of Sale of Real Property Acquired by Virtue of Tax Enforcement Foreclosure Proceedings	1,977,412 35
Real Estate Tax Collections—Levies of 1969-1970 and Prior—Net After Adjustments for Redistribution and Overpayments	4,820,139 70
Proceeds from In Rem Mortgage Repayments	663,514 69
Total Credits	<u>\$3,027,234 49</u>
Less: Transfer of Cash to the General Fund for Mortgages on In Rem Sales as per Local Law 80 of 1960	3,352,740 00
Credit Balance at June 30, 1976	<u>\$6,379,974 49</u>

6/22/87

AN ACT to amend the public authorities law in relation to the establishment of a revenue stabilization fund for the city of New York, the creation of a public benefit corporation for the maintenance and administration of such fund, providing for the powers and duties of such corporation, and repealing the New York City Stabilization Reserve Corporation Act.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Title twenty-six of article eight of the public authorities law is REPEALED.

§ 2. Article eight of such law is amended by adding a new title twenty-six as follows:

TITLE 26

NEW YORK CITY REVENUE STABILIZATION CORPORATION

Section:

2530. Short title.

2531. Definitions.

2532. New York City revenue stabilization corporation.

2533. Legislative findings and declaration of purposes.

2534. Administration of the corporation.

2535. General powers of the corporation.

2536. Revenue stabilization fund.

2537. Payments to the city.

2538. Resources of the corporation.

2539. Exemption from taxation.

2540. Actions against the corporation.

2541. Assistance to the corporation.

2542. Corporation counsel to be attorney.

§ 2530. Short title

This title may be cited as the "New York City Revenue Stabilization Corporation Act."

§ 2531. Definitions

For the purposes of this title:

1. "City" means the city of New York.

2. "Director of management and budget" means the director of management and budget of the city.

3. "Corporation" means the New York City revenue stabilization corporation as created by this title.

4. "Mayor" means the mayor of the city.

5. "Comptroller" means the comptroller of the city.

6. "State" means the state of New York.

§ 2532. New York City revenue stabilization corporation.

(a) There is hereby created the New York City revenue stabilization corporation. The corporation shall be a corporate governmental agency constituting a public benefit corporation. It shall have the powers and privileges of a corporation and all of its business shall be transacted, all funds invested, all warrants for money drawn and payments made, and all cash and securities and other personal property held under its corporate name.

(b) The corporation shall continue until all its liabilities have been met or otherwise discharged and until its existence shall have been terminated by law. Upon the termination of the existence of the corporation, all of its rights and property shall pass to and be vested in the city.

§ 2533. Legislative findings and declaration of purposes.

The legislature hereby finds and declares that an independently managed revenue stabilization fund should be created for the city in order to enhance and preserve the sound financial management of the city. Such fund should be created and replenished from city resources during periods of strength in the economy and budget of the city, in order to provide for periods when the revenues of the city may be inadequate due to economic downturns. The stabilization of revenues provided by such a fund is intended to minimize disruption or diminution of essential services in the city and to further insure the city's continuing fiscal stability. Accordingly, the legislature hereby finds and declares that it is necessary for a corporation to be created to establish, maintain and administer such a fund.

§ 2534. Administration of the corporation.

(1) The corporation shall be administered by seven directors: the director of management and budget, the commissioner of finance of the city, the first deputy comptroller of the city; the chief accountant of the city, all of whom shall serve ex officio, and three public members to be appointed by the mayor, one of whom shall be appointed upon the recommendation of the comptroller, and one of whom shall be appointed upon the recommendation of other two public members. Two public members shall serve for a term of one year and the other public member shall serve for a term of two years from the January first next succeeding the date of their appointment. Their successors shall serve for terms of two years each. Members shall continue in office until their successors have been appointed. A public member may be removed by the mayor for cause, but not without an opportunity to be heard, upon not less than ten days' notice.

(2) The mayor shall designate a chairman and a vice-chairman from among the directors. The chairman shall preside over all meetings of the directors and shall have such other duties as the directors of the corporation may prescribe. The vice-chairman shall preside over all meetings of the directors in the absence of the chairman and shall have such other duties as the directors of the corporation may prescribe.

(3) Each director who is a public member shall be entitled to reimbursement for his actual and necessary expenses incurred in the performance of his official duties and a per diem allowance of one hundred fifty dollars when rendering service as such director, provided that the aggregate of such per diem allowance to any one director in any one fiscal year of the corporation shall not exceed the sum of five thousand dollars. Such public members may engage in private employment, or in a profession or business, subject to the limitations contained in sections twenty-six hundred four, twenty-six hundred five, twenty-six hundred six and twenty-six hundred seven of the city charter. The corporation shall, for the purposes of such sections be a "city agency" and such directors shall be "officers" of the corporation for the purposes of such sections.

(4) Notwithstanding any inconsistent provisions of law, general, special or local, no officer or employee of the state of New York, any city, county, town or village, any other political or civil division of the state, any municipality, any governmental entity operating any public school or college, any school district or any other public agency or instrumentality or unit of government which exercises governmental powers under the laws of the state shall forfeit his office or employment by reason of his acceptance of appointment as a director, officer or agent of the corporation, nor shall such service be deemed incompatible or in conflict with such office or employment.

(5) A majority of the whole number of directors then in office shall constitute a quorum for the transaction of any business or the exercise of any power of the corporation. Except as otherwise specified in this title, for the transaction of any business or the exercise of any power of the corporation, the corporation shall have power to act by a majority of the directors present at any meeting at which a quorum is in attendance. The corporation may delegate to one or more of its directors, or officers, agents and employees, such powers and duties as the directors may deem proper. The director of management and budget, the commissioner of finance of the city, the first deputy comptroller of the city and the chief accountant of the City may each, by written instrument filed with and approved as to form by the corporation, designate a deputy or assistant in their respective departments or offices, to perform in their absence their respective duties under this title. The term director as used in this subdivision shall include persons so designated. The designation of such persons shall not affect the civil service or retirement rights of any persons so designated.

(6) On or before December thirty-first of each year, the corporation shall submit a financial statement audited by an independent certified public accountant to the mayor, the comptroller, the city board of estimate, the city council, and the New York state financial control board for the city. The corporation's fiscal year shall commence on July first and end on June thirtieth.

§ 2535. General powers of the corporation.

The corporation shall have the following powers in addition to those specially conferred elsewhere in this title: (1) to sue and be sued; (2) to have a seal and alter the same at pleasure; (3) to make and alter by-laws for its organization and internal management and to make rules and regulations governing the use of its property and facilities; (4) to make and execute contracts, leases, subleases and all other instruments or agreements necessary or convenient for the exercise of its powers and functions under this title; (5) to purchase real or personal property necessary and convenient for its corporate purposes; to execute and deliver deeds for real property held in its own name; and to sell or otherwise to dispose of such real or personal property that, in the judgment of the corporation, is no longer necessary for its corporate purposes; (6) to appoint officers, agents and employees, prescribe their duties and qualifications and fix their compensation; (7) to commence any action to protect or enforce any right conferred upon it by any law, contract or other agreement; (8) to invest any funds not required for immediate use or disbursement, at the discretion of the corporation, in obligations of the city, state or federal government, obligations the principal of any interest on which are guaranteed by the city, state or federal government, or obligations of agencies of the federal government or in secured time deposits or other interest bearing accounts secured by such obligations; (9) to procure insurance against any loss in such amounts and from such insurers as it deems desirable; (10) to engage the services of consultants on a contract basis for rendering professional and technical assistance and advice; (11) to contract for and to accept any gifts or grants or loans of funds or property or financial or other aid in any form from the federal government or any agency or instrumentality thereof, or from any other source and to comply with the terms and conditions thereof; (12) to do any and all things necessary or convenient to carry out its purposes and exercise the powers expressly given and granted in this title.

§ 2536. Revenue stabilization fund.

1. The corporation shall create and establish a revenue stabilization fund on or before October thirty-first, nineteen hundred eighty-seven and shall pay into such fund any expense budget

surplus theretofore or thereafter received from the city. As used in this section, expense budget surplus shall mean the amount by which any excess of revenues (and transfers) over expenditures (and transfers) for a fiscal year of the city would exceed five million dollars.

2. The city shall pay to the corporation any expense budget surplus on or before October thirty-first, nineteen hundred eighty-seven and on or before October thirty-first of each succeeding year. The determination of the amount of an expense budget surplus shall be made so as to assure that the city's audited financial statements for city fiscal year ending on June thirtieth of the year in which payment to the corporation is to be made do not show an excess of revenues (and transfers) over expenditures (and transfers) in an amount greater than five million dollars. Any payment by the city to the corporation pursuant to this section shall be recognized as an expenditure against the budget which was determined to have an expense budget surplus, and the audited financial statements of the city for the fiscal year of such budget shall be adjusted to reflect this transaction.

§ 2537. Payments to the city.

1. The corporation shall make payments to the city from the revenue stabilization fund during periods of budgetary stress at such times and in such amounts as are determined in accordance with this section. As used in this section, budgetary stress shall exist when the director of management and budget determines and certifies to the corporation that, as of the end of any fiscal quarter of the city (fiscal quarters being the three-month periods ending September thirtieth, December thirty-first, March thirty-first and June thirtieth), each of the following conditions exist:

(a) The average non-agricultural employment of city residents (as published by the Bureau of Labor Statistics of the United States Department of Labor) for such fiscal quarter and the first preceding fiscal quarter of the city exceeds by less than one percent the comparable average employment (as published by the same source) for the second and third preceding fiscal quarters of the city; and

(b) The sum of collections of economically sensitive taxes for such quarter and the first preceding fiscal quarter of the city, when divided into the sum of collections of such taxes for the same two fiscal quarters of the preceding year, yields a percentage increase that is less than average past revenue growth. As used in this section, economically sensitive taxes shall only include the personal income tax, the sales tax, the general corporation tax, the unincorporated business income tax, the utility tax and the commercial rent or occupying tax, as each is imposed by the administrative code of the city. As used in this section, average past revenue growth as of the end of any fiscal quarter of the city shall be a percentage computed as follows: (i) determine the percentage by which collections of economically sensitive taxes for the first prior fiscal year for which audited financial statements are published exceeds (or lags) collections of such taxes for the second prior fiscal year; (ii) determine the percentage by which collections of economically sensitive taxes for the second prior fiscal year exceeds (or lags) collections of such taxes for the third prior fiscal year; (iii) add the two percentages determined pursuant to (i) and (ii) herein, and divide the result by two.

2. Upon a determination that the city is in a condition of budgetary stress, the corporation shall determine the amount of additional revenue that would cause the percentage increase in current collections of economically sensitive taxes (calculated in accordance with paragraph b of subdivision one of this section as of the end of the fiscal quarter for which such determination is made) to be equal to average past revenue growth. Upon making such determination, the corporation shall pay such amount to the city from the revenue stabilization fund. In the event that the amount in the revenue stabilization fund is insufficient to make the payment, the corporation shall certify to the director of management and budget the amount then on deposit in the revenue stabilization fund, and shall pay such amount to the city. All amounts paid to the city pursuant to this subdivision shall be treated as current period revenue of the city for budgetary purposes.

4. On December first of each year, the corporation shall determine whether the amount then on deposit in the revenue stabilization fund exceeds two and one-half percent of the city's total revenues for the fiscal year ending the preceding June thirtieth (based upon the city's audited financial statements for such fiscal year) and shall thereupon pay the amount of any such excess to the city. All amounts paid to the city pursuant to this subdivision shall be used for capital projects of the city.

§ 2538. Resources of the corporation.

(a) Subject to the provisions of this title, the directors of the corporation shall receive, accept, invest, administer, expend and disburse for its corporate purposes all monies for the corporation from whatever sources derived including (1) payments by the city pursuant to the provisions of section twenty-five hundred thirty-six of this title; and (2) any other payments, gifts, or appropriations to the fund from any other source.

(b) The monies of the corporation shall be paid to the comptroller as agent of the corporation.

(c) The monies in any of the corporation's accounts shall be paid out on checks signed by the comptroller on requisitions of the chairman of the directors of the corporation or of such other officer or employee as the directors shall authorize to make such requisition.

(d) The comptroller or his legally authorized representative, from time to time may examine the books and accounts of the corporation, including its receipts, disbursements, contracts, investments, and any other matters relating to its financial standing. Such an examination shall be conducted by the comptroller at least once every five years; in lieu of such an examination, the comptroller may accept from the corporation an external examination of the books and accounts made at the request of the directors of the corporation.

§ 2539. Exemption from taxation.

1. It is hereby determined that the creation of the corporation and the carrying out of its corporate purposes is in all respects a public governmental purpose for the benefit of the people of the state and the city and for the improvement of their health,

safety, welfare, comfort and security, and that said purposes are public purposes and that the corporation will be performing an essential governmental function in the exercise of the powers conferred upon it by this title.

2. The property of the corporation and its income and operations shall be exempt from taxation.

§ 2540. Actions against the corporation.

(a) An action against the corporation for death, personal injury or property damage or founded on tort shall not be commenced more than one year and ninety days after the cause of action thereof shall have accrued nor unless a notice of claim shall have been served on a director of the corporation or officer or employee thereof designated by the corporation for such purpose, within the time limited by, and in compliance with the requirements of section fifty-e of the general municipal law.

(b) The venue of every action, suit or special proceeding brought against the corporation shall be laid in the county of New York.

(c) Neither the members of the corporation nor any officer or employee of the corporation acting in behalf thereof, while acting within the scope of his authority, shall be subject to any liability resulting from the carrying out any of the powers expressly given in this title. A director, officer or employee of the corporation shall be deemed an "employee" for the purposes of section fifty-k of the general municipal law.

§ 2541. Assistance to the corporation.

1. Officers and employees of city agencies may be transferred to the corporation, and officers and employees of the corporation may be transferred to appropriate city agencies without examination and without loss of any civil service or retirement status or rights. No such transfer shall be made except with the approval of the head of the agency involved, the director of management and budget, and the chairman of the corporation.

§ 2542. Corporation counsel to be attorney.

The corporation counsel of the city shall be attorney and counsel for the corporation, except with the approval of the

corporation counsel the corporation may retain or employ such counsel
as are necessary to carry on its corporate purposes.

§3. This act shall take effect immediately.

MICHAEL WOLKOFF

An Evaluation of Municipal Rainy Day Funds

Over the past decade a number of state and local governments have created explicit budgetary funds to provide insurance from cyclical economic changes. Although these "rainy day funds" have gained wide acceptance at the state level of government, they remain a relatively unknown innovation for local governments. This paper examines the rationale for creating local governmental savings accounts, and reports on their use by a sample of municipal governments.

The rationale for establishing governmental savings funds is best examined in the context of the pressures created by the annual budget process. Most state constitutions require that local governments have annually balanced budgets. Each year public officials furiously work through the annual process of budget formulation to meet this requirement. But, despite significant advances in the capabilities of state and local officials to track expenditures, forecast revenues, and simulate alternative outcomes, budget making remains an imprecise science. Fortunately, sufficient flexibility is built into most public budgets so that minor changes in expenditure requirements or revenue yields are accommodated without much pain.

In a stable economic environment, budget officials are presented with the usual problem of balancing revenue and expenditure aggregates. However, when cyclical changes in national economic performance impact local economies, or when local economic conditions change, such as when an important industrial employer closes, the task of equating budgetary flows becomes more difficult. Under these conditions, the balanced budget requirement can cause significant disruptions in budgetary policy. The annual budgeting cycle is simply too short to allow officials to respond easily to unanticipated changes in revenue or expenditure patterns.

Rational officials will seek to minimize the occasions when constituents are harmed by budgetary changes. Budgetary officials will attempt to schedule unpopular decisions at times when voters have low issue salience.¹ Alternatively, officials may try to exercise budgetary control by issuing strategic expenditure and revenue estimates to create a budgetary cushion.² But cyclical economic performance, combined with state constitutional requirements, interferes with local officials' attempts to manipulate the timing of budgetary rewards. Fluctuating economic performance results in officials confronting painful budgetary actions more frequently than they would otherwise prefer.

Michael Wolkoff is assistant professor, Public Policy Analysis Program, University of Rochester.

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A potential solution to the annual budget problems created by cyclical and random economic changes is to create a budgetary mechanism for dampening such impacts. One way of doing this is to establish a special fund which would accumulate reserves when revenue and expenditure patterns yield a surplus, and use those reserves when changes in economic performance result in a deficit. These "rainy day funds" would enhance budgetary control by permitting decision makers to smooth the effects of economic fluctuations on local budgets.³

ARE LOCAL GOVERNMENT RAINY DAY FUNDS NEEDED?

Proponents of state rainy day funds argue that the sensitivity of state economies to economic cycles requires that state budget officials be able to smooth budgetary fluctuations.⁴ A similar case can be made for cyclical smoothing at the municipal level. In general, small urban economies are more likely to experience cyclical fluctuations than larger state economies, because of less diversified economic bases.⁵

The cyclical variability of public expenditures and revenues make local budgets vulnerable to economic changes. The cyclical sensitivity of the local public fisc will depend upon both the revenue and expenditure structure. Certain taxes and expenditures are far more cyclically sensitive than others.

Jurisdictions will differ in their cyclical vulnerability depending upon the composition of their revenue sources. For instance, income taxes are particularly responsive to changes in economic conditions. Income tax dependent jurisdictions are likely to face many more budget imbalances than jurisdictions that rely primarily upon property taxes. Revenue fluctuations are dampened in property tax dependent jurisdictions because changes in personal income do not immediately result in property value changes.⁶ Sales taxes, the third important local government revenue source, are more responsive to cyclical changes than property taxes, but less responsive than income taxes.

Although local economies are less diversified, the cyclical stability of property taxes diminishes the need for budget stabilization policies. Unavoidable cyclical shocks are less frequent when revenue flows are consistent. Table 1 contains data on the source of tax revenues for local governments. Nearly 50 percent of municipal own-source revenue is raised from non-property tax sources. School districts, on the other hand, depend almost exclusively on property taxes, the most stable of own-source revenues, and on state aid. It is clear that rainy day funds are potentially useful for municipal governments.

Public expenditures also change with the economic cycle. During recessions greater demands are placed upon all local governments.⁷ Public assistance programs expand; unemployment and job training related programs swell; expenditures on fire and crime control surge upward, and use of public facilities increases as formerly affordable private substitutes are discarded (i.e. parents send their children to the local recreation program rather than the sleep-away camp). The swing in expenditures will depend upon the current package of services offered, and the socio-economic mix of the jurisdiction's residents.

TABLE 1
Tax Revenue by Major Source (in percent)

Year	Total Taxes	Property Taxes	Sales Taxes	Income Taxes	Other
<i>Cities</i>					
1979	100	55.8	25.4	12.2	6.6
1981	100	53.6	26.3	13.3	6.8
1984	100	50.5	28.5	13.7	7.4
<i>Counties</i>					
1979	100	77.1	15.3	3.0	4.6
1981	100	76.4	16.5	2.9	4.2
1984	100	76.5	16.2	2.7	5.0
<i>School Districts</i>					
1979	100	96.7	1.2	0.8	1.3
1981	100	96.1	1.2	0.9	1.8
1984	100	96.9	1.1	0.8	1.2

Source: U.S. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1985-86 Edition*, (Washington, D.C.: 1986.)

Public welfare expenditures are especially sensitive to changes in economic activity. In most states the county government is responsible for public welfare services; so counties will be likely to suffer cyclically induced hardship. Municipalities are the primary providers of police, fire, sanitation, and health services. These are somewhat less subject to cyclical swings but still show some sensitivity. Education is probably the service least sensitive to cyclical effects. Looking at both revenues and expenditures, rainy day funds will be the most attractive to municipal governments.

THE USE OF RAINY DAY FUNDS

No published account of the use of municipal rainy day funds exists. In the fall of 1985 a mail survey of the chief financial officers of the fifty-five most populous American cities was conducted. Each official was sent a three page mail questionnaire concerning the use of rainy day funds within their locality. Approximately one-third of the sample responded to the first request. A subsequent letter was mailed to non-respondents and resulted in ten more responses. In all, officials from twenty-seven cities replied, nearly 50 percent of the original sample.

The sample was restricted to large municipalities where rainy day funds are most likely to be used. These cities are more dependent upon sensitive revenue sources than either small cities or counties, and are therefore more likely to look for ways to manage revenue changes. Further, budgetary innovations typically flow from localities with more sophisticated local governments to less sophisticated units. Large cities are widely acknowledged to run the most sophisticated local governmental operations. If any local governments were to use rainy day funds, large cities would be the most likely.

Table 2 contains the survey results for the sample. Clearly, municipal rainy day accounts are not widely used. Of the twenty-seven cities that responded to the survey,

City

Baltimore, Md.
Boston, Ma.
Buffalo, N.Y.
Cleveland, Oh.
Columbus, Oh.
El Paso, Tx.
Honolulu, Ha.
Houston, Tx.
Indianapolis, Ind.
Long Beach, Ca.
Los Angeles, Ca.
Milwaukee, Wi.
New York City, N.Y.
Norfolk, Va.
Oakland, Ca.
Oklahoma City, Ok.
Omaha, Neb.
Phoenix, Az.
Rochester, N.Y.
Sacramento, Ca.
St. Paul, Mn.
San Antonio, Tx.
San Diego, Ca.
Tampa, Fla.
Tucson, Az.
Va. Beach, Va.
Washington, D.C.

(A) Municipality levie
(B) Los Angeles reserv
(C) Sum of percent of
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TABLE 2
Selected Characteristics of Cities Responding to Survey

Other	City	Rainy Day Fund	Inception Date	State Rainy Day Fund	% Cyclic Revenue (C)	Bond Rating	Public Welfare \$
	Baltimore, Md.	No	—	No	7.6 (A)	A1	Yes
6.6	Boston, Ma.	No	—	No	.3	Baa	Yes
6.8	Buffalo, N.Y.	No	—	Yes	1.8	Baa	No
7.4	Cleveland, Oh.	No	—	Yes	32.8 (A)	Baa	Yes
	Columbus, Oh.	No	—	Yes	27.4 (A)	A1	No
	El Paso, Tx.	No	—	No	11.6	A1	No
4.6	Honolulu, Ha.	No	—	No	6.4	Aa	No
4.2	Houston, Tx.	Yes	1982-83	No	19.5	Aal	No
5.0	Indianapolis, Ind.	No	—	Yes	1.8	Aa	Yes
	Long Beach, Ca.	No	—	Yes	9.4	Aa	No
	Los Angeles, Ca.	(B)	—	Yes	10.7	Aaa	No
1.3	Milwaukee, Wi.	Yes	1969	No	.4	Aa	No
1.8	New York City, N.Y.	No	—	Yes	20.2 (A)	Baal	Yes
1.2	Norfolk, Va.	No	—	Yes	13.7	Aa	Yes
	Oakland, Ca.	No	—	Yes	12.7	A	No
	Oklahoma City, Ok.	No	—	No	36.3	Aa	No
	Omaha, Neb.	Yes	1984	Yes	23.1	Aaa	No
	Phoenix, Az.	No	—	No	16.7	Aal	Yes
	Rochester, N.Y.	No	—	Yes	.3	A1	No
	Sacramento, Ca.	No	—	Yes	17.7	Aal	No
	St. Paul, Mn.	Yes	1986	Yes	6.4	Aa	No
	San Antonio, Tx.	Yes	1983	No	4.8	Aa	Yes
	San Diego, Ca.	No	—	Yes	17.9	Aal	No
	Tampa, Fla.	No	—	Yes	15.4	Aaa	No
	Tucson, Az.	No	—	No	21.9	A1	Yes
	Va. Beach, Va.	Yes	1986	Yes	14.0	Aa	Yes
	Washington, D.C.	No	—	—	16.7	Baa	Yes

(A) Municipality levies income tax

(B) Los Angeles reserve fund functions similar to rainy day fund.

(C) Sum of percent of own source revenue from income and sales tax (1983).

Sources: *Moody's Municipal and Governmental Manual*, January 1986.

Author's own survey.

National Conference of State Legislatures, "The Fiscal Letter," September 1986.

U.S. Bureau of the Census, *Government Finances*, 1986.

only six cities report having established a rainy day fund. In addition, one city indicated that an existing reserve fund can operate as a rainy day fund. It is also apparent that rainy day funds are a relatively new phenomenon. Only the Milwaukee fund, established in 1969, has been in operation for over five years. Interestingly, the second municipal fund was not created until 1982.⁸

The geographic pattern of existing funds gives no clear indication of the forces behind their creation. One hypothesis is that policies diffuse from one level of government to another. Jurisdictions in states that have established rainy day funds would be more likely to establish their own funds, but there appears to be little evidence to support this hypothesis. Although thirty-one states report having state stabilization funds, municipal funds appear only in five different states, two of which have no state fund at all.⁹ To this point, urban policy makers do not seem to be getting these cues from the state level.

Policy diffusion can also occur across jurisdictions.¹⁰ This may explain the widespread use of rainy day funds by state governments, where policy diffusion has been encouraged by the endorsement of the rainy day fund concept by such groups as the National Conference of State Legislatures. The presence of rainy day funds in two Texas municipalities provides some evidence for this hypothesis at the municipal level. However, measuring diffusion is difficult, and there is too little evidence in this survey to suggest that municipal rainy day funds are spreading in any geographic pattern.

PROGRAM DETAILS OF EXISTING FUNDS

Operational details of most rainy day funds are scarce because of their recent origin. However, the program details in Milwaukee and Houston are likely to be informative for localities considering such a fund.

As currently constituted, the Milwaukee Tax Stabilization Fund, established in 1969, can contain up to five percent of the total common council budget. The fund's purpose is to "assist in stabilizing the common council controlled tax rate of the city of Milwaukee within reasonable limits from year to year."¹¹ Changes in non-property tax revenues or variations in property tax collections could create pressure on the stability of the local property tax rate and result in use of the fund.

The Milwaukee fund has been used primarily to prevent an increase in the property tax rate of more than three percent. The fund may also be used for further tax stabilization purposes if three-fourths of the common council approves and not more than 50 percent of the outstanding balance of the fund is withdrawn. The fund is specifically excluded from financing deficits due to shortfalls in estimated non-property tax revenues, although the fungibility of local revenue would presumably make this difficult to enforce.

The conception of the Milwaukee fund as an active buffer has resulted in a steady flow of funds into and out of the account. The average annual addition to the fund between 1969 and 1983 has been \$13.9 million. The fund has been drawn down annually, with an average withdrawal in this time period of \$13.6 million, or 44 percent of the annual fund balance. The minimum fund withdrawal during this period was \$6.8 million in 1971 and the maximum was \$27.2 million in 1976.

Unlike many of the newer funds whose details have yet to be worked out, the operation of the Milwaukee fund is specified in great detail in the City's Code of Ordinance. No apparent confusion or uncertainty surrounds the purposes or use of this fund, and it has been incorporated as a component part of the normal budget process.

The Houston fund was established in 1982. Ironically, it is the one fund whose use most closely matches the notion of *rainy day* funds. Although a major motivation for the fund's creation was to provide protection from cyclically-induced economic hardships, the fund was first used to clean up the damage of a particularly rainy set of days—Hurricane Alicia in 1983. The current fund balance (1985-86) is 4.2 percent of projected revenues. The fund balance is anticipated to reach five percent in the next fiscal year. The current balance of \$30 million would be sufficient to cover approximately a 10 percent shortfall in property tax collections. Appropriations from the Houston fund

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TABLE 3
Program Details of Rainy Day Funds

	Houston	Milwaukee	Omaha
Maximum balance (% of Budget)	No limit (aim for 5%)	5% revenues	4% revenues
Current balance	\$30 million	\$23.4 million (1984)	\$2.3 million
Deposit rules	Mayor-council agreement	Budget surplus Special tax levy	General fund surplus (to cap)
Withdrawals	Council appropriates	Budget approp. ¼ council vote	Mayor-council approval Interest above cap goes to general fund.
Purpose	Hurricane emergencies	Tax stabilization	Cyclical assistance
	San Antonio	St. Paul	Va. Beach
Maximum balance (% of budget)	5%	5%	75-100% of outstanding debt (approx. 8% of budget)
Current balance	\$10.4 million	\$4.2 million	\$28 million
Deposit rules	Council discretion	Mayor-council	no experience
Withdrawals	Council ordinance	Mayor-council	Council
Purpose	Meet revenue shortfalls	General cyclical	Recession Counter intergov. revenue fall.

Source: Author's mail and phone survey.

can be made by the city council at the beginning of each budget year. Additions to the fund originate with general fund surpluses.

Table 3 gives further details on the six funds in existence. With the exception of the Virginia Beach fund, a standard five percent balance seems to be the general rule, perhaps reflecting the guidelines published in the NCLC primer for state rainy day funds. While the funds aim at maintaining similar balances, they do rely upon different mechanisms to effect withdrawals and appropriations. The Milwaukee fund rigidly restricts the degree of tax rate stabilization that can be achieved by the fund and the conditions under which the fund can be used. Houston, on the other hand, leaves considerable discretion to the city council. Milwaukee and Omaha both require general fund surpluses to be transferred to the rainy day account. The remaining localities treat rainy day fund transactions similarly to the normal budget appropriation process.

Unfortunately, the limited data that exists on the functioning of rainy day funds provides only suggestive information about how a proposed fund might operate. A number of design questions can not be answered because, as of yet, there is too little

historical experience to make a judgement about the success of rainy day funds. However, localities considering establishing rainy day funds might observe one general principle. If the operating procedures for a fund are less flexible, i.e., the mechanisms for adding to the fund or for withdrawing from the fund are unspecified, rainy day fund policy will be more susceptible to the vagaries of existing political leadership. In particular, a shift in the composition of the city council can result in a very different conception of how the fund should be used.

SHOULD MORE CITIES ADOPT RAINY DAY FUND POLICIES?

During the past decade thirty-one states have created rainy day funds. Whether municipalities should also create funds will depend upon a number of considerations. The existence of economic fluctuations does not by itself require that a mechanism for municipal savings be created. The benefits and costs of such a strategy should be examined; the same objectives may be achieved, at less cost, in other ways. Finally, it is important to examine whether a constituency exists to support this budgetary innovation.

The Case for Rainy Day Funds

Rainy day funds can insulate municipal governments from changes in economic activity.¹² This protection provides potential benefits to both elected officials and constituents. The major advantage of budgetary stabilization is the smoothing of tax and expenditure policies. The carry-over of surpluses from one year to the next, in anticipation of budgetary deficits or the spreading of deficits over multiple years, permits a greater degree of consistency in budgetary policy. By dampening the impact of economic fluctuations, businesses and residents are sheltered from sudden twists and turns in expenditure and revenue flows. Reducing uncertainty about budgetary policy decisions is believed to be particularly advantageous for business firms whose investment and production decisions are made over multiple year time horizons.¹³

Rainy day funds create flexibility for dealing with economic changes. By extending the effective length of the accounting period, multiple year time considerations can be included in budgetary decision making.¹⁴ Capital budget planning explicitly recognizes the multiple year commitments of budget allocations. But many expense budget items, such as job training and education programs, also have multiple year time frames. Rainy day funds could prevent the premature termination of these programs due to transitory changes.

Rainy day funds could also reduce the cost of municipal government by changing the impressions of private investors who purchase municipal bonds. San Antonio's fund was established for just this purpose. The existence of a rainy day fund indicates the borrower's additional capacity to successfully negotiate unfavorable economic conditions. If bond rating agencies incorporate this information in their analyses and upgrade credit ratings, the cost of borrowing would decline. Recent evidence suggests that investors are willing to purchase state insured municipal bonds at lower interest rates.¹⁵

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Although debt costs are not generally a large portion of municipal expenditures, there is potential for rainy day insurance to reduce borrowing costs.¹⁶

Rainy day funds can also help assure greater local political autonomy by sheltering local units of government from federal and state governmental decisions. There are two explanations for this effect. First, local governments that establish rainy day funds have less need to rely on other levels of government for financial resources. Thus, local governments retain greater control over the expenditure choices they make. Second, in those rare instances when local governments have suffered severe fiscal stress, the provision of significant intergovernmental support has been at the expense of local autonomy.¹⁷ Although the root cause of these situations has been fiscal imprudence, rainy day accounts could help localities maintain decision sovereignty.

Finally, rainy day funds can protect taxpayers from the overzealous budgetary behavior of politicians. Unfortunately, once the goal of re-election disappears, budgetary policies can deviate substantially from voters' desires.¹⁸ Potentially, this problem can occur when elected officials have different time horizons from their constituencies, or when these officials become independent of their constituencies.¹⁹

As an example, consider the case of the lame-duck politician. Once the incentive to be responsive to the electorate is removed, political market discipline is destroyed. This is particularly a problem in those years when favorable economic conditions generate sizable surpluses. A rainy day fund prevents budget maximizing officials from spending this surplus. Maintaining the surplus in a general fund buffer does not provide the same protection as placing it in an explicit savings fund. In order for the fund to work, it is important that payments to the fund be triggered by a legislated rule. If fund payments and withdrawals are left to the discretion of budget officials, "Niskanen-type" incentives for spending surpluses will circumvent the intent of the fund. Non-discretionary rules will turn what was once an opportunity for the politician into a deposit in the rainy day fund account.

The Case Against Rainy Day Funds

Rainy day funds transfer part of the savings responsibility of individuals to the government. The public sector decides the appropriate cash reserve to maintain for stabilization purposes and how much current private consumption must be sacrificed.

The full cost of establishing a municipal rainy day fund will depend upon the trade-off between current consumption, either public or private, versus future consumption. In all savings decisions a comparison should be made between foregone consumption and future choices.²⁰ When funds are put away in a rainy day account, taxpayers lose the current value of the resources that would have been returned as tax reductions or new expenditure programs. Either result is likely to alienate one group of voters or another. Conservatives might complain about the potential tax reduction they lose; liberals will complain about the spending programs forgone.

The use of rainy day funds will create problems because it changes the time sequence of costs and benefits of budgetary policies. This reallocation of costs and benefits over time is particularly important for individuals who are mobile. Savings funds force these

residents to forgo current consumption without compensation if they migrate before the rainy day surplus is used. Similarly, future recipients of government services may be recent arrivals who did not contribute to the rainy day fund. The consequence of residential mobility is redistribution from one group of taxpayers to another. This is especially a problem in central cities where current residents may have short time horizons because of their age or family structure. The very old pass away, and those with school age children move to the suburbs.²¹

Rainy day funds alter the relationships between levels of government, and not all of these changes are useful to the locality that institutes a fund. In fact, the existence of a rainy day fund may actually hinder the ability of a locality to attract intergovernmental funds from higher levels of government. To the extent that intergovernmental assistance is tied to the fiscal health and capacity of recipients, jurisdictions might actually weaken their claim for assistance by self-insuring against cyclical changes.

Consider the provision of counter-cyclical assistance in the late 1970s. It is highly unlikely that any local government that had self-insured against cyclical changes would have been eligible for intergovernmental funds. A similar situation actually exists today. United States Treasury Department officials have argued for a reduction in intergovernmental assistance based on the existence of large national deficits and a state and local sector in surplus.²² The financial implications of this linkage are potentially important.

Finally, some may argue that the creation of rainy day funds are unnecessary because the stabilization fund objectives can be achieved in other ways. Many cities maintain excess general fund balances which can be used if budgeted projections are not achieved. The success of these conventions depends, in part, on the ability to keep these funds segregated from the general budget process.

CONCLUSIONS

Despite the widespread diffusion of rainy day funds at the state level, very few large municipalities have thus far elected to establish explicit savings accounts. Surprisingly, those cities that have established rainy day funds are not the ones that we would have expected on the basis of the fund's advantages and disadvantages.

First, we expected that cyclically sensitive cities would be more likely to institute a savings fund. Yet, we find in our sample that the cities most prone to economic cycles are no more likely to institute rainy day funds than other cities. In Table 2 we can see that the cities that have instituted rainy day funds are actually less dependent upon cyclical revenue sources than cities without funds. The unweighted average proportion of local revenue coming from sales and income taxes is 11.6 percent in "rainy day cities," and 14.5 percent in cities without funds. Further, none of the cities which rely upon the most cyclical of all revenue sources, the income tax, have rainy day funds.

Similarly, we expected cities that were providing cyclically sensitive services to be more likely to institute these funds. Although the evidence on service provision is not as reliable as for tax revenue, Table 2 indicates which cities make budget expenditures for the public welfare category (column 7). Once again we find that cities making expen-

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What then determines whether a municipality will establish a rainy day fund? How likely is it that these funds will become widespread? Although it may be premature to conclude that rainy day funds have a limited future in municipal governments, a number of conditions suggest that extensive use of these funds is unlikely.

A precondition for establishing a savings account is to have something to save. We must recognize that the past two decades have not been kind to most cities in this respect, and given the current prevailing mood in Washington, few view a better future.

Table 2 contains the Moody's ratings of general obligation bonds for the cities in our sample (column 6). If we use these ratings as proxies for fiscal capacity, we can see that the cities most often identified as fiscally distressed, New York City, Boston, Buffalo and Cleveland, have the lowest bond ratings. These same cities tend to have cyclically sensitive revenue sources and in a few instances are responsible for public welfare expenditures. Yet none of these cities has instituted rainy day funds. Although we have argued that these types of cities are most likely to enjoy the advantages of rainy day funds, their budgetary conditions have not been conducive to establishing savings accounts, and they are unlikely to generate the surpluses that would permit a fund to be established in the future. In contrast, those cities that have established rainy day funds enjoy excellent bond ratings.²³

On the face of it, establishing rainy day accounts seems to be a fiscally conservative strategy which increases the capability of officials to exercise budget control. However, a rainy day fund will only be established if significant actors push for its creation. Groups with a particular interest in fiscal responsibility may find this formulation attractive (i.e., city managers, citizen budget committees, bankers, good government watchdogs, etc.); but this does not imply that a sufficiently strong constituency will form to provide the political support for rainy day funds.²⁴ Both taxpayers and politicians have incentives to avoid forced savings. The problem is that both groups have time horizons that may differ from the benefits created by rainy day funds. Typically, reelection cycles do not coincide with cyclical changes. Further, mobile voters have little to gain from budgetary innovations that confer benefits on a future group of taxpayers.

Finally, the decision to institute a rainy day fund will in part hinge on the ability of municipal governments to achieve budgetary smoothing without an explicit savings fund. In fact, municipal officials are able to make budgetary decisions that have the same effect as savings. Budgetary priorities can be accelerated or forestalled depending upon economic conditions. As an example, consider such capital projects as road rebuilding, that can both exhaust current surpluses and diminish future maintenance obligations. Expenditures of this type will have consequences similar to the use of rainy day funds. A more common form of smoothing is achieved by maintaining general fund balances for emergencies. This is a practice in many states and municipalities, although the ability of budget makers to maintain these reserves is somewhat impaired by the greater accessibility of funds saved within the general budget.

In conclusion, even if the modestly sized rainy day accounts, so prevalent at the state level of government, were to diffuse widely to municipalities, they would have little

impact on municipal resource allocation decisions. Rainy day funds can be viewed as an alternative rather than a unique mechanism for local governments to deal with cyclical changes.

NOTES

The author would like to thank Jeffrey Straussman, Karen Altman and two anonymous referees for their helpful comments on an earlier draft of this paper. He would also like to thank Gigi Harrington for her excellent research assistance.

1. The political business cycle literature explores the timing of expenditure and taxing decisions in the pursuit of electoral success. For evidence of the timing of state tax decisions see: John Mikesell, "Election Periods and State Tax Policy Cycles," *Public Choice* 33 (1978): 100-105.
2. Pat Larkey and Richard Smith, "Bias in the Formulation of Local Government Budget Problems," Carnegie-Mellon University Working Paper (September 1985).
3. Explicit savings funds are only one strategy for dampening the impact of unanticipated cyclical changes. For a discussion of other strategies in the state context see: National Association of State Budget Officers, "Budgeting and Fiscal Uncertainty: Stabilization Funds and Other Strategies" (Washington D.C.: 1985), 13-17.
4. Steven Gold, "Preparing for the Next Recession: Rainy Day Funds and Other Tools for States" (Denver, Colorado: National Conference of State Legislatures, December 1983).
5. Evidence of cyclical movements in revenue and expenditure patterns has been discussed by: David Puryear, "Industrial Specialization Among Urban Areas," Occasional Paper #24, Metropolitan Studies Program, Syracuse University (November 1975); Roy Bahl, *Financing State and Local Government in the 1980's*. (New York: Oxford University Press, 1984), 35-47; and Stanley Engerman, "Regional Aspects of Stabilization Policy," in Richard Musgrave, ed., *Essays in Fiscal Federalism* (Washington, D.C.: Brookings Institution, 1965). These studies were primarily concerned with whether local policies were pro-cyclical or counter-cyclical, rather than the impact of the cycle on local governments.
6. Most estimates of the elasticity of income taxes are > 1.0 . Estimates of the elasticity of property tax revenues to changes in income are < 1.0 .
7. United States Advisory Commission on Intergovernmental Relations, *State and Local Finances in Recession and Inflation* (Washington D.C.: 1979).
8. More than half of the thirty-one state rainy day funds have been established since 1982.
9. National Conference of State Legislatures, "The Fiscal Letter" (September/October, 1986).
10. Jack Walker, "The Diffusion of Innovations Among the American States," *American Political Science Review*, 63 (March 1969): 880-899.
11. Section 259, Milwaukee Code of Ordinances.
12. If the fund's balance is not sufficient it may be totally depleted before the cycle reaches its trough. This was precisely the problem encountered with the Michigan Stabilization Fund which proved inadequate to counteract the effects of the 1980 decline in that state's auto industry. The 1979 fund balance of \$241 million was decimated by the 1980 payout of nearly \$264 million.
13. Surveys of firm location decisions reveal that predictable governmental policy is important to business firms. One criticism of discretionary incentives is that firms view these rewards as subject to the current political climate.
14. Multiple year budget plans are now common features of many municipal financial systems. More often than not, future plans are disbanded because of changing budgetary conditions.
15. Robert Bland, "The Interest Cost Savings from Municipal Bond Insurance: A Comparison of Public and Private Alternatives," *Journal of Policy Analysis and Management*, (forthcoming).
16. The unweighted average proportion of expenditures used for paying off debt for the fifty-five largest American cities is 5.8 percent. U.S. Bureau of the Census. *City Government Finances* (1982-83) (Washington, D.C.: GPO, 1983).

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23. We have argue: credit risk. He:
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17. The resolution of New York City's fiscal crisis provides an excellent example on this point. The federal and state governments tied the provision of intergovernmental assistance to the creation of a variety of financial control boards to oversee municipal budget decisions.
18. This is a prominent theme in the literature on why governments are so large. For the seminal work on the budget maximizing behavior of bureaucrats see: William Niskanen, *Bureaucracy and Representative Government* (Chicago: Aldine, 1971).
19. The time horizon issue can be most clearly seen in instances where program costs come due far in the future. Elected officials will be more likely to agree to settlements that involve costs passed on to other administrations, such as agreeing to more generous pension benefits for municipal workers.
20. More formally, the value of consumption today should equal the properly discounted present value of consumption tomorrow.
21. An analogous problem occurs when public expenditures are financed through borrowing. Because of mobility, taxpayers have incentives to borrow more than they otherwise might since the probability that they will have to pay back the loan is less than one. The existence of constitutional debt ceilings can be viewed as a mechanism for limiting this behavior. See: Richard Wagner, "Optimality in Local Debt Limitation," *National Tax Journal*, 23 (September 1970): 297-305.
22. Jonathon Rauch, "Treasury's Rosy State Financial Forecasts Set Off New Numbers Battle," *National Journal* (2 February 1985): 257-259. Most of the state and local surplus consists of pension fund accumulations which cannot be used for general governmental services. In 1985 the accumulated state and local surplus totaled nearly \$59 billion of which \$53 billion was for retirement funds. U.S. Department of Commerce. *Survey of Current Business* (Washington, D.C.: GPO, Feb. 1986).
23. We have argued earlier that rainy day funds might actually improve the perception of a locality as a credit risk. Here we find that strong bond ratings preceded the establishment of these funds.
24. In Virginia Beach, Va., the city manager's arguments for greater budget flexibility and control overcame citizen interest in more immediate gains. However, the chi-square test reveals that city managed cities in this sample are no more likely to have rainy day funds than mayor-run cities.

AN ACT to amend the public authorities law in relation to the establishment of a revenue stabilization fund for the city of New York, the creation of a public benefit corporation for the maintenance and administration of such fund, providing for the powers and duties of such corporation, and repealing the New York City Stabilization Reserve Corporation Act.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Title twenty-six of article eight of the public authorities law is REPEALED.

§ 2. Article eight of such law is amended by adding a new title twenty-six as follows:

TITLE 26

NEW YORK CITY REVENUE STABILIZATION CORPORATION

Section:

2530. Short title.

2531. Definitions.

2532. New York City revenue stabilization corporation.

2533. Legislative findings and declaration of purposes.

2534. Administration of the corporation.

2535. General powers of the corporation.

2536. Revenue stabilization fund.

2537. Payments to the city.

2538. Resources of the corporation.

2539. Exemption from taxation.

2540. Actions against the corporation.

2541. Assistance to the corporation.

2542. Corporation counsel to be attorney.

§ 2530. Short title

This title may be cited as the "New York City Revenue Stabilization Corporation Act."

§ 2531. Definitions

For the purposes of this title:

1. "City" means the city of New York.
2. "Director of management and budget" means the director of management and budget of the city.

3. "Corporation" means the New York City revenue stabilization corporation as created by this title.

4. "Mayor" means the mayor of the city.

5. "Comptroller" means the comptroller of the city.

6. "State" means the state of New York.

§ 2532. New York City revenue stabilization corporation.

(a) There is hereby created the New York City revenue stabilization corporation. The corporation shall be a corporate governmental agency constituting a public benefit corporation. It shall have the powers and privileges of a corporation and all of its business shall be transacted, all funds invested, all warrants for money drawn and payments made, and all cash and securities and other personal property held under its corporate name.

(b) The corporation shall continue until all its liabilities have been met or otherwise discharged and until its existence shall have been terminated by law. Upon the termination of the existence of the corporation, all of its rights and property shall pass to and be vested in the city.

§ 2533. Legislative findings and declaration of purposes.

The legislature hereby finds and declares that an independently managed revenue stabilization fund should be created for the city in order to enhance and preserve the sound financial management of the city. Such fund should be created and replenished from city resources during periods of strength in the economy and budget of the city, in order to provide for periods when the revenues of the city may be inadequate due to economic downturns. The stabilization of revenues provided by such a fund is intended to minimize disruption or diminution of essential services in the city and to further insure the city's continuing fiscal stability. Accordingly, the legislature hereby finds and declares that it is necessary for a corporation to be created to establish, maintain and administer such a fund.

§ 2534. Administration of the corporation.

(1) The corporation shall be administered by seven directors: the director of management and budget, the commissioner of finance of the city, the first deputy comptroller of the city; the chief accountant of the city, all of whom shall serve ex officio, and three public members to be appointed by the mayor, one of whom shall be appointed upon the recommendation of the comptroller, and one of whom shall be appointed upon the recommendation of other two public members. Two public members shall serve for a term of one year and the other public member shall serve for a term of two years from the January first next succeeding the date of their appointment. Their successors shall serve for terms of two years each. Members shall continue in office until their successors have been appointed. A public member may be removed by the mayor for cause, but not without an opportunity to be heard, upon not less than ten days' notice.

(2) The mayor shall designate a chairman and a vice-chairman from among the directors. The chairman shall preside over all meetings of the directors and shall have such other duties as the directors of the corporation may prescribe. The vice-chairman shall preside over all meetings of the directors in the absence of the chairman and shall have such other duties as the directors of the corporation may prescribe.

(3) Each director who is a public member shall be entitled to reimbursement for his actual and necessary expenses incurred in the performance of his official duties and a per diem allowance of one hundred fifty dollars when rendering service as such director, provided that the aggregate of such per diem allowance to any one director in any one fiscal year of the corporation shall not exceed the sum of five thousand dollars. Such public members may engage in private employment, or in a profession or business, subject to the limitations contained in sections twenty-six hundred four, twenty-six hundred five, twenty-six hundred six and twenty-six hundred seven of the city charter. The corporation shall, for the purposes of such sections be a "city agency" and such directors shall be "officers" of the corporation for the purposes of such sections.

(4) Notwithstanding any inconsistent provisions of law, general, special or local, no officer or employee of the state of New York, any city, county, town or village, any other political or civil division of the state, any municipality, any governmental entity operating any public school or college, any school district or any other public agency or instrumentality or unit of government which exercises governmental powers under the laws of the state shall forfeit his office or employment by reason of his acceptance of appointment as a director, officer or agent of the corporation, nor shall such service be deemed incompatible or in conflict with such office or employment.

(5) A majority of the whole number of directors then in office shall constitute a quorum for the transaction of any business or the exercise of any power of the corporation. Except as otherwise specified in this title, for the transaction of any business or the exercise of any power of the corporation, the corporation shall have power to act by a majority of the directors present at any meeting at which a quorum is in attendance. The corporation may delegate to one or more of its directors, or officers, agents and employees, such powers and duties as the directors may deem proper. The director of management and budget, the commissioner of finance of the city, the first deputy comptroller of the city and the chief accountant of the City may each, by written instrument filed with and approved as to form by the corporation, designate a deputy or assistant in their respective departments or offices, to perform in their absence their respective duties under this title. The term director as used in this subdivision shall include persons so designated. The designation of such persons shall not affect the civil service or retirement rights of any persons so designated.

(6) On or before December thirty-first of each year, the corporation shall submit a financial statement audited by an independent certified public accountant to the mayor, the comptroller, the city board of estimate, the city council, and the New York state financial control board for the city. The corporation's fiscal year shall commence on July first and end on June thirtieth.

§ 2535. General powers of the corporation.

The corporation shall have the following powers in addition to those specially conferred elsewhere in this title: (1) to sue and be sued; (2) to have a seal and alter the same at pleasure; (3) to make and alter by-laws for its organization and internal management and to make rules and regulations governing the use of its property and facilities; (4) to make and execute contracts, leases, subleases and all other instruments or agreements necessary or convenient for the exercise of its powers and functions under this title; (5) to purchase real or personal property necessary and convenient for its corporate purposes; to execute and deliver deeds for real property held in its own name; and to sell or otherwise to dispose of such real or personal property that, in the judgment of the corporation, is no longer necessary for its corporate purposes; (6) to appoint officers, agents and employees, prescribe their duties and qualifications and fix their compensation; (7) to commence any action to protect or enforce any right conferred upon it by any law, contract or other agreement; (8) to invest any funds not required for immediate use or disbursement, at the discretion of the corporation, in obligations of the city, state or federal government, obligations the principal of any interest on which are guaranteed by the city, state or federal government, or obligations of agencies of the federal government or in secured time deposits or other interest bearing accounts secured by such obligations; (9) to procure insurance against any loss in such amounts and from such insurers as it deems desirable; (10) to engage the services of consultants on a contract basis for rendering professional and technical assistance and advice; (11) to contract for and to accept any gifts or grants or loans of funds or property or financial or other aid in any form from the federal government or any agency or instrumentality thereof, or from any other source and to comply with the terms and conditions thereof; (12) to do any and all things necessary or convenient to carry out its purposes and exercise the powers expressly given and granted in this title.

§ 2536. Revenue stabilization fund.

1. The corporation shall create and establish a revenue stabilization fund on or before October thirty-first, nineteen hundred eighty-seven and shall pay into such fund any expense budget

surplus theretofore or thereafter received from the city. As used in this section, expense budget surplus shall mean the amount by which any excess of revenues (and transfers) over expenditures (and transfers) for a fiscal year of the city would exceed five million dollars.

2. The city shall pay to the corporation any expense budget surplus on or before October thirty-first, nineteen hundred eighty-seven and on or before October thirty-first of each succeeding year. The determination of the amount of an expense budget surplus shall be made so as to assure that the city's audited financial statements for city fiscal year ending on June thirtieth of the year in which payment to the corporation is to be made do not show an excess of revenues (and transfers) over expenditures (and transfers) in an amount greater than five million dollars. Any payment by the city to the corporation pursuant to this section shall be recognized as an expenditure against the budget which was determined to have an expense budget surplus, and the audited financial statements of the city for the fiscal year of such budget shall be adjusted to reflect this transaction.

§ 2537. Payments to the city.

1. The corporation shall make payments to the city from the revenue stabilization fund during periods of budgetary stress at such times and in such amounts as are determined in accordance with this section. As used in this section, budgetary stress shall exist when the director of management and budget determines and certifies to the corporation that, as of the end of any fiscal quarter of the city (fiscal quarters being the three-month periods ending September thirtieth, December thirty-first, March thirty-first and June thirtieth), each of the following conditions exist:

(a) The average non-agricultural employment of city residents (as published by the Bureau of Labor Statistics of the United States Department of Labor) for such fiscal quarter and the first preceding fiscal quarter of the city exceeds by less than one percent the comparable average employment (as published by the same source) for the second and third preceding fiscal quarters of the city; and

(b) The sum of collections of economically sensitive taxes for such quarter and the first preceding fiscal quarter of the city, when divided into the sum of collections of such taxes for the same two fiscal quarters of the preceding year, yields a percentage increase that is less than average past revenue growth. As used in this section, economically sensitive taxes shall only include the personal income tax, the sales tax, the general corporation tax, the unincorporated business income tax, the utility tax and the commercial rent or occupying tax, as each is imposed by the administrative code of the city. As used in this section, average past revenue growth as of the end of any fiscal quarter of the city shall be a percentage computed as follows: (i) determine the percentage by which collections of economically sensitive taxes for the first prior fiscal year for which audited financial statements are published exceeds (or lags) collections of such taxes for the second prior fiscal year; (ii) determine the percentage by which collections of economically sensitive taxes for the second prior fiscal year exceeds (or lags) collections of such taxes for the third prior fiscal year; (iii) add the two percentages determined pursuant to (i) and (ii) herein, and divide the result by two.

2. Upon a determination that the city is in a condition of budgetary stress, the corporation shall determine the amount of additional revenue that would cause the percentage increase in current collections of economically sensitive taxes (calculated in accordance with paragraph b of subdivision one of this section as of the end of the fiscal quarter for which such determination is made) to be equal to average past revenue growth. Upon making such determination, the corporation shall pay such amount to the city from the revenue stabilization fund. In the event that the amount in the revenue stabilization fund is insufficient to make the payment, the corporation shall certify to the director of management and budget the amount then on deposit in the revenue stabilization fund, and shall pay such amount to the city. All amounts paid to the city pursuant to this subdivision shall be treated as current period revenue of the city for budgetary purposes.

4. On December first of each year, the corporation shall determine whether the amount then on deposit in the revenue stabilization fund exceeds two and one-half percent of the city's total revenues for the fiscal year ending the preceding June thirtieth (based upon the city's audited financial statements for such fiscal year) and shall thereupon pay the amount of any such excess to the city. All amounts paid to the city pursuant to this subdivision shall be used for capital projects of the city.

§ 2538. Resources of the corporation.

(a) Subject to the provisions of this title, the directors of the corporation shall receive, accept, invest, administer, expend and disburse for its corporate purposes all monies for the corporation from whatever sources derived including (1) payments by the city pursuant to the provisions of section twenty-five hundred thirty-six of this title; and (2) any other payments, gifts, or appropriations to the fund from any other source.

(b) The monies of the corporation shall be paid to the comptroller as agent of the corporation.

(c) The monies in any of the corporation's accounts shall be paid out on checks signed by the comptroller on requisitions of the chairman of the directors of the corporation or of such other officer or employee as the directors shall authorize to make such requisition.

(d) The comptroller or his legally authorized representative, from time to time may examine the books and accounts of the corporation, including its receipts, disbursements, contracts, investments, and any other matters relating to its financial standing. Such an examination shall be conducted by the comptroller at least once every five years; in lieu of such an examination, the comptroller may accept from the corporation an external examination of the books and accounts made at the request of the directors of the corporation.

§ 2539. Exemption from taxation.

1. It is hereby determined that the creation of the corporation and the carrying out of its corporate purposes is in all respects a public governmental purpose for the benefit of the people of the state and the city and for the improvement of their health.

safety, welfare, comfort and security, and that said purposes are public purposes and that the corporation will be performing an essential governmental function in the exercise of the powers conferred upon it by this title.

2. The property of the corporation and its income and operations shall be exempt from taxation.

§ 2540. Actions against the corporation.

(a) An action against the corporation for death, personal injury or property damage or founded on tort shall not be commenced more than one year and ninety days after the cause of action thereof shall have accrued nor unless a notice of claim shall have been served on a director of the corporation or officer or employee thereof designated by the corporation for such purpose, within the time limited by, and in compliance with the requirements of section fifty-e of the general municipal law.

(b) The venue of every action, suit or special proceeding brought against the corporation shall be laid in the county of New York.

(c) Neither the members of the corporation nor any officer or employee of the corporation acting in behalf thereof, while acting within the scope of his authority, shall be subject to any liability resulting from the carrying out any of the powers expressly given in this title. A director, officer or employee of the corporation shall be deemed an "employee" for the purposes of section fifty-k of the general municipal law.

§ 2541. Assistance to the corporation.

1. Officers and employees of city agencies may be transferred to the corporation, and officers and employees of the corporation may be transferred to appropriate city agencies without examination and without loss of any civil service or retirement status or rights. No such transfer shall be made except with the approval of the head of the agency involved, the director of management and budget, and the chairman of the corporation.

§ 2542. Corporation counsel to be attorney.

The corporation counsel of the city shall be attorney and counsel for the corporation, except with the approval of the

corporation counsel the corporation may retain or employ such counsel as are necessary to carry on its corporate purposes.

§3. This act shall take effect immediately.