

# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Study of Emergency and Budget Stabilization Funds

### Summary

Forty-four states have established emergency and budget stabilization funds, sometimes called rainy day funds. These funds are intended to reduce a state's vulnerability to economic fluctuations. The funds accumulate revenues during periods of strong economic growth to use during periods of economic difficulty.

We found that the characteristics of rainy day funds vary widely. Deposits, withdrawals, and limitations on fund size are achieved in many different ways. There is debate over the usefulness of rainy day funds and little empirical evidence as to the effectiveness of various fund structures. Balances in rainy day funds have generally fallen. No ideal model was found.

However, some evidence exists that rainy day funds can work, and we found that a rainy day fund may be useful for Hawaii. We note that the State's expenditure pattern has not shown a steady predictable trend. Furthermore, revenues in excess of expenditures could have been deposited into a rainy day fund instead of disappearing into an informal rainy day fund or into insignificant tax rebates.

A rainy day fund is one of Hawaii's options for budget stabilization. Others are contingent taxation, contingent spending, delegation of authority, and tax stabilization.

With surpluses disappearing in Hawaii, it would be difficult to finance a rainy day fund at this time. However, the Legislature could establish the fund now with a mechanism to trigger deposits later when revenues are more ample. Or the Legislature could establish the fund later when revenues actually increase.

### Recommendations and Response

If the Legislature decides to establish a rainy day fund, we recommend that it consider clearly stating the fund's purpose and establishing requirements for deposits and withdrawals that protect the purpose. In doing so, the Legislature should determine (a) whether the fund is designed to meet short-term revenue shortfalls, unexpected emergencies, or both; and (b) whether either the Legislature or the executive would maintain control over the fund—or share control.

We recommend that the Legislature also consider other means of budget stabilization. A promising approach is contingent spending, accomplished by enacting a multi-part appropriations act designed to address unexpected revenue shortfalls and help ensure continuous funding of programs which the Legislature considers most important.

In its response, the Department of Budget and Finance said that in establishing the fund, its purpose should be limited to accommodating only non-recurring situations such as unanticipated short-term revenue shortfalls and unexpected emergencies. The department also commented that the stabilization fund will need to be compatible with constitutional and statutory requirements pertaining to the triggering of tax rebates, general fund expenditure ceilings, three-year limitations on general fund appropriations, and expenditure controls.

Concerning our recommendation that the Legislature consider other means of budget stabilization, the department notes that one alternative is maintaining a sufficiently large unencumbered balance in the general fund which can serve as an implicit rainy day fund to meet budget contingencies. The department says that our suggestion of contingent spending has been informally applied because the execution of a budget authorized by the Legislature must be sensitive to revenue conditions.

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**Marion M. Higa**  
State Auditor  
State of Hawaii

Office of the Auditor  
465 South King Street, Room 500  
Honolulu, Hawaii 96813  
(808) 587-0800  
FAX (808) 587-0830