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# Missouri Legislative Academy

## Missouri's Budget Reserve Fund

David C. Valentine

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### Introduction

The value of what has been called a “rainy day fund” was made obvious by several years of minimal revenue growth in the early 1980s. Without a reserve of this kind, the State had no sources of funds to help to cover shortfalls in fiscal years with less than anticipated revenues. In addition, the State did not have a way to meet uncontrollable increases in the cost of services such as Medicaid. The Budget Stabilization Fund and the Cash Operating Reserve Fund were both created in the 1980s to help the State maintain public programs in an era of fiscal stress.

### Origins of the Budget Reserve Fund

Missouri's Budget Reserve Fund, commonly called the Rainy Day Fund, was created by SJR 25, 1999 and sponsored by Senator Larry Rohrbach and by Representative Richard Franklin.<sup>2</sup> It was submitted to the voters at the 2000 general election and approved by 59% of those voting. As of June 30, 2004, the Fund had a balance of \$444 M.

The Budget Reserve Fund was preceded by two separate funds, both of which were created in response to the recession of the early 1980s. The first, the Budget Stabilization Fund, was created by statute in 1985 to enable the Governor to tap the Fund in those fiscal years when he had withheld appropriations due to revenue shortfalls.<sup>3</sup> The Governor could only act while the General Assembly was in session and the General Assembly could disapprove of the use of the Fund. The statutes assumed that the General Assembly would appropriate money to the Fund but there was no mechanism requiring

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<sup>1</sup> Dr. David Valentine is an Associate Research Professor at the Institute of Public Policy in the Truman School of Public Affairs, University of Missouri-Columbia. He can be reached at ValentineD@missouri.edu.

<sup>2</sup> See Article IV, Section 27(a), Missouri Constitution.

<sup>3</sup> Section 33.285, Revised Statutes of Missouri.

repayment of funds used when there was a budget shortfall. Moneys were placed in the Fund pursuant to SB 2, enacted in 1989.<sup>4</sup> The act provided that revenues collected but not used for refunds to federal retirees would be placed in the Budget Stabilization Fund.

The second fund, the Cash Operating Reserve Fund, was created in 1986 by constitutional amendment to allow the state to meet immediate short-term financial needs. The Fund could be used without specific legislative authorization but the moneys used, plus interest, had to be repaid by May 15 of the same fiscal year in which used (July 1 - June 30). The Cash Operating Reserve Fund has proven its worth. It was used regularly for cash flow purposes and was used in 1993 to finance reconstruction following a widespread flood.

### **Provisions and proposed use of the Budget Reserve Fund**

The revised Budget Reserve Fund combines several features drawn from the funds discussed above. Moneys are automatically transferred into the Fund in a manner similar to that used to build the Cash Operating Reserve Fund. The Fund can be used and is used regularly to make “cash operating transfers” to meet the immediate cash requirements of the state without legislative authorization. These transfers must be repaid by May 15<sup>th</sup> of the fiscal year in which made, with interest, and no transfer may occur after May 15.

The Fund may also be used in the event of a disaster or to meet budget shortfalls within the current fiscal year. In both cases, the Governor must declare an emergency and the General Assembly must appropriate the money by a two-thirds vote.<sup>5</sup> All other appropriations actions require only a majority vote. Only one-half of the balance of the Fund may be appropriated in any one year and moneys must be repaid, with interest, in equal payments made during each of the three following fiscal years. Moneys to repay the Fund “stand appropriated” without any legislative action required. If the fund balance drops below 7.5% of net general revenue collections the difference shall stand appropriated to the Fund but if the fund balance exceeds 7.5% of net general revenue collections, the amount in excess is transferred to general revenue. In both FY 03 (July 1, 2002-June 30, 2003) and FY 04, money was transferred from the Budget Reserve Fund to general revenue because the fund balance exceeded 7.5% of general revenue.

The Budget Reserve Fund has not been used to meet a budget or other emergency, although Governor Holden proposed its use for both the 2002 and the 2003 fiscal years.

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<sup>4</sup> See Hackman v. Director, Department of Revenue, 771 S.W. 2d 77 (Mo. 1989). The case, following an earlier U.S. Supreme Court decision, held that the state had improperly taxed federal retirees and ordered refunds. A special tax was subsequently enacted explicitly for to pay those refunds and revenues generated in excess of the amount required to refund the federal retiree’s tax payments were placed in the Budget Stabilization Fund.

<sup>5</sup> The language of the Article is ambiguous about whether the Governor must declare an emergency when there is a budget shortfall but that has been the interpretation. See Article IV, Section 27(a).5.

He proposed using \$135 M from the Fund for FY 03 in his State of the State and subsequently proposed using \$120 M from the Fund to meet FY 02 end of year shortfalls. Neither proposal was approved by the General Assembly.<sup>6</sup>

### **Issues in usage**

The Budget Reserve Fund is well designed to enable the State to meet transitory cash flow problems and appears well suited to enable the State to respond external emergencies such as those caused by an earthquake or flood. The two-thirds vote requirement makes it difficult, but not impossible, to reach an agreement about using the funds for these temporary revenue needs such as those created by natural disasters.

The “budget shortfall” provisions are of limited value in meeting a temporary shortfall that occurs within a single fiscal year because periods of “temporary revenue shortfalls” almost always last for several years. In the current budgetary environment, the use of the Budget Reserve Fund to meet a revenue shortfall constitutes just another “one-time” revenue source but with a cruel twist. When one-time moneys are used for on-going budgetary needs, the General Assembly must find replacement revenue in the following fiscal year, just to maintain a “steady state” budget. If the Budget Reserve Fund were used, the General Assembly would have to find money to replace the amount used, plus one-third of the principal with interest in the immediately following fiscal year. Automatic repayment to the Fund is essential if it is going to be sufficiently funded to respond to the next period of fiscal austerity but if the Fund is to be used for shortfalls, it will be necessary to devise a repayment “trigger” that is more sophisticated than simply using the beginning of the next fiscal year.

### **For Further Reading**

Annual Fiscal Report. Missouri Senate Appropriations Committee. Senator John Russell, Chairman, and Marty Drewel, Director of the Appropriations Committee Staff.

Budget Stabilization Fund, section 33.285, Revised Statutes of Missouri. This section is still on the books even though the fund has been superceded by the Budget Reserve Fund.

Cash Operating Reserve Fund, Article 27 (a) of the Missouri Constitution  
Article 27(a) of the Missouri Constitution as it existed before November 2000 (for the Cash Operating Reserve Fund) and as it now exists (for the Budget Reserve Fund).

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<sup>6</sup> The Senate approved using the Fund to meet FY 2002 budget shortfalls but the House did not. Neither approved using the Fund to cover a portion of the FY 03 projected shortfall. The discussion about the use of the Fund was widely covered in the press during the 2002 session. See for example, Josh Flory, “Holden’s budget strategy sparks partisan debate in legislature,” Columbia Daily Tribune, January 26, 2002 and Bob Watson, “Rainy Day Fund argument continue after session ends,” News Tribune, May 19, 2002.

Moody, James R. and Associates, Missouri's Budget Problem: Causes and Possible Solutions, January 2003.

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