

## Note on Rainy Day Fund Proposals

PBO Note 3 of 2017

### Introduction

This Note briefly outlines the functions of a rainy day fund and provides examples of their use in other jurisdictions. It summarises the different potential uses of a rainy day fund. It also sets out the PBO's suggestions on various aspects of the structure and governance of such a fund in respect of the different potential uses.

### Context

A rainy day fund is a tool developed by Governments to act as a prudent buffer against fiscal shocks. In general, they are used to set aside money during good economic times to support the economy during downturns.

The form that rainy day funds take, and the type of fiscal shock they are designed to guard against, are shaped by the constraints and political circumstances of the different jurisdictions within which they operate. The Department of Finance's [Rainy Day Fund – Consultation Paper](#) outlines two possible uses for a rainy day fund:

- a counter-cyclical stabilisation policy tool, or
- a 'Once off' contingency fund.

In addition, it outlines a proposal for the adoption of a contingency reserve i.e. money set aside in the *annual* budget to account for unforeseen expenses.

### Governance Issues

Effective rules will determine the impact of the fund. The rules must balance making the rainy day fund difficult to access in good economic times without impeding its deployment when needed, maintain the

Government's accountability to the Oireachtas and support the long term operation of the fund. Unless the rainy day fund or contingency fund is put on a constitutional basis, a future Government (with the approval of the Houses of the Oireachtas) can change the deployment criteria and spend the fund as it wishes.

### Examples of Rainy Day Funds/Contingency Reserves

Rainy day funds are not common among European countries. Estonia operates a 'Stabilisation Reserve Fund'. This fund was established in 1997 to provide for financing in crises and for unexpected situations. In 2016 the fund had a value of €406 million (approx. 1.9% of GDP, 5% of Government expenditure). The use of the fund is controlled by the Estonian parliament based on a proposal by the Government.

A number of other EU countries, including the UK, France and Spain, maintain contingency reserves as part of their budgetary processes. These are funds set aside in the annual budget to cover unforeseen expenses. They can allow legislatures to approve budgets which are more in line with what is actually spent during a year.

Rainy day funds initially arose as a tool to allow U.S. State Governments to support current spending during economic downturns. U.S. States are generally restricted from borrowing to fund current spending. If they do not have money put aside, they are required to immediately cut spending if there is a revenue shortfall. Rainy day funds in the U.S. context are designed to 'smooth' changes in expenditure and reduce the volatility of State Government programmes. They have stringent restrictions on the ability to access the funds and often require the money to be repaid relatively quickly.



## Counter-cyclical policy tool

This is where a rainy day fund is used to smooth expenditure over the economic cycle. This would mean using the fund in order to support employment and capital expenditure during a downturn. In the longer term, the State would gain the benefit of the investments and the resulting boost to the potential of the economy.

However, a counter-cyclical rainy day fund's impact will be limited by Ireland's low fiscal multiplier. In addition, based on analysis of historical stimuli and downturns it is likely that the rainy day fund, as planned, is currently not large enough to deliver an effective stimulus.

If the rainy day fund is to be used as a counter-cyclical stabilisation policy tool then the PBO would suggest that:

- An automatic mechanism be set out in legislation with regard to resourcing the fund.
- Legislation should detail when and how the fund could be drawn down.
- The size of the fund should not be capped.
- The Government should also explore with the European Commission if changes could be made to the Stability and Growth Pact to accommodate the use of the fund.

## 'Once Off' Contingency Fund

A fund could also be maintained as a contingency to cover the cost of unexpected expenses, such as natural disasters. If the fund was structured in this manner it would offer the Government more flexibility in the immediate aftermath of an unexpected event and allow the quick deployment of aid.

The PBO considers the proposed level of the fund (€3 billion by end 2021) would probably be adequate to cover the short term costs of a severe natural disaster, a terrorist incident or a major pandemic. However, in the event of severe nuclear contamination or the realisation of certain contingent liabilities the fund may prove inadequate.

If the fund is to be used as a contingency fund for once off events then the PBO would suggest that:

- It should not be called the 'rainy day fund' as this term is more appropriate for a fund that is used as a counter-cyclical policy tool.
- The size of the fund be set at a suitable level in consultation with relevant stakeholders.
- The circumstances for drawing down the fund be clearly outlined in terms of the scale and nature of the demands on the fund.
- Restrictions should be placed on the fund in order to maintain compliance with the Stability and Growth Pact.

## In-year Expenditure Contingency Reserve

One suggestion in the consultation paper is to set up a contingency reserve and that monies left over in the contingency reserve at the end of the year would be transferred to the rainy day fund. This would help to ensure that unexpected expenditure could be accommodated within the Government Expenditure Ceilings. With respect to the contingency reserve, the PBO would suggest that:

- The contingency reserve be formally made a part of the Government Expenditure Ceilings and a Vote in the Estimates process.
- Expenditure from the contingency reserve be made by way of Supplementary Estimate, i.e. Dáil approval of monies disbursed from a new, dedicated Vote.
- There are clear guidelines as to what is considered to be unexpected expenditure within the year.

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Contact: [PBO@oireachtas.ie](mailto:PBO@oireachtas.ie)

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