

CBO TESTIMONY

Statement of
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on
How States Budget and Plan for Emergencies

before the
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Mr. Chairman, Congressman Cardin, and members of the Task Force, I am pleased to appear today to discuss how states budget and plan for emergencies, in particular, natural disasters. To support this testimony, the Congressional Budget Office (CBO) conducted a survey of states and collected data from the National Association of State Budget Officers (NASBO), the National Emergency Management Association (NEMA), and the Council of State Governments (CSG).

Based on that information, CBO concludes that the majority of states have procedures for funding disaster assistance programs that parallel current federal practices. Like the federal government, state legislatures typically appropriate small sums to emergency-response accounts annually. When a disaster occurs, governors declare a state of emergency and request a supplemental appropriation from the legislature. In that way, state legislatures tend to maintain control over the total amount spent for disasters, while governors are given the discretion to decide how and when that money is spent. In another approach, some governors declare an emergency and then "borrow" unobligated funds from other accounts without first getting legislative approval. Even when governors have that authority, they usually have access only to funds that have already been appropriated by the legislature.

Few states have a dedicated account or trust fund for emergencies that bypasses the legislative appropriation process, and even fewer provide funding in advance for those accounts at a level that would be sufficient to cover large-scale emergencies. Furthermore, most states count on the fact that the federal government

will step in with assistance when large-scale disasters occur. That assumption affects how states budget and plan for emergency-response activities.

The remainder of my statement will discuss:

- o What tools states generally use to plan for uncertainty, such as budget stabilization funds and other emergency accounts;
- o How emergency accounts are financed and operate;
- o Who has the authority to allocate money from emergency accounts; and,
- o The criteria for deciding what projects qualify for assistance.

BUDGETING FOR UNCERTAINTY: BUDGET STABILIZATION FUNDS AND OTHER EMERGENCY ACCOUNTS

States tend to plan for two types of fiscal emergencies: economic downturns and natural disasters. In the case of a weak economy, most states have created budget stabilization funds (usually referred to as rainy-day funds). Budget stabilization funds are closely tied to the state's general operating fund; consequently, they tend to be used for a wide variety of purposes, but only in times when revenues fall short

of expectations. To respond to emergencies, however, states establish a variety of contingency and emergency accounts (referred to in one state as the Stormy Day Fund) to prepare for unforeseen disasters, either natural or man-made, that can occur at any time.

Budget Stabilization Funds

When the economy is strong, most states deposit excess revenues into reserve accounts so that they can operate during an economic downturn without raising taxes or cutting spending. Those budget stabilization funds provide 44 of the states with a short-term fiscal cushion when faced with an unexpected decline in revenues or an increase in spending needs. Most states require a vote of the legislature to spend from rainy-day funds; such funds are almost never used to pay for natural disasters or other types of emergency needs.

State statutes or constitutions usually establish a target or cap for stabilization funds, which are funded using a formula based on a percentage of general fund revenues, balances, or spending.¹ When possible, states commit to the fund specific appropriations or all or a portion of general fund surpluses until the target is met. For

1. The general fund is essentially the operating portion of a state budget, which, although it accounts for only about half of total state spending, is the source of funding over which state lawmakers have the greatest control.

example, Maine's Rainy Day Fund is capped at 4 percent of general fund revenues received during the previous fiscal year. Connecticut's Budget Reserve Fund is required to maintain a balance equal to 5 percent of net general fund appropriations for the fiscal year in progress.

Balances in those funds accumulate (up to the constitutional or statutory cap or target) and in fiscal year 1996 totaled about \$9 billion nationwide. Current estimates by NASBO indicate that those balances will grow to over \$11 billion in fiscal year 1998. *The Wall Street Journal* reported that 1997 year-end balances of both rainy-day funds and general fund surpluses were at their highest level in over 20 years.

Emergency Funds

In addition to rainy-day funds, almost all states have some kind of contingency or emergency account. The purpose of those accounts is to earmark money for emergencies or other unanticipated or hard-to-estimate one-time expenditures that may occur within a given fiscal year. Often states have just one account that is available for either natural disasters or unanticipated expenditures. For example, West Virginia's general contingency fund is available for natural disasters, deficiencies, and other unexpected expenditures by state agencies.

Many states, however, have two types of funds: one for cost overruns by agencies and another for natural disasters. For example, Maryland has both a Contingent Fund and a Catastrophic Event Fund. The Contingent Fund, established by the state constitution, is available when an agency's annual appropriation is insufficient to cover salaries and operating expenses. The Catastrophic Event Fund, established by statute, accumulates funds for natural disasters and other emergency situations.

HOW EMERGENCY ACCOUNTS ARE FINANCED AND OPERATE

State legislatures build rainy day funds based on a percentage of annual revenues or spending; emergency accounts, however, usually receive a specific dollar appropriation from the legislature or occasionally a statutory allocation straight from the general fund each year. Sometimes those amounts are tied to specific events or projects. For the most part, the amounts received are relatively small, requiring the governor to go to the state legislature in the event of a large-scale emergency. In Arizona, the Governor's Contingency and Emergency Fund receives a small allocation annually from the general fund (\$4 million in 1997). The governor and the Emergency Council can obligate those funds without legislative approval but must go to the legislature to get more money.

Occasionally, a governor has the emergency authority to bypass the legislature entirely and borrow from almost any other state budget account. Idaho, Florida, and Virginia empower their governors to transfer all unobligated resources of all state agencies to the emergency account to address a disaster. Some states refer to that procedure as a "sums sufficient" appropriation.

Amount of State Money Committed to Emergencies

A recent survey of states conducted by NEMA and CSG indicates that states spent over \$1.1 billion in 1996 on predisaster programs (preparedness and mitigation) and almost \$1 billion on postdisaster programs (response and recovery). As disaster costs have skyrocketed, states have increased total spending and developed a number of innovative funding mechanisms, the majority of which, however, have focused on predisaster activities. In most states, none of the predisaster spending, and only some of the postdisaster spending, actually funnels through the emergency fund.

Most states recognize that the initial balances in their emergency funds are insufficient to cover the full cost of responding to emergencies. Maryland's Catastrophic Event Fund, which it established after Hurricane Hugo hit South Carolina, provides the state with the comfort of knowing that it has the resources to start the planning and recovery process immediately after a natural disaster or

emergency occurs. The fund is not designed to pay the full costs of disaster recovery and assistance.

The amount of money that states commit to emergency accounts varies greatly, ranging from a few hundred thousand dollars to several hundred million dollars. No state surveyed estimated total emergency needs based on a historical average of emergency spending (such as the federal government does with fire fighting). A number of states, however, pointed out that because the federal government most likely will step in during a large-scale emergency, their goal is to have enough money in the emergency account to provide the necessary match for federal disaster assistance. Arkansas and Illinois, for example, appropriate money to their emergency accounts based on a projection of the amount needed to match federal assistance.

Carryover and What Happens When There Is Not Enough Money

In about half of the states that have emergency accounts, unobligated money does not carry over to the next fiscal year or biennium unless it is specifically reappropriated in the next year's budget. Colorado, Kentucky, and Texas build up their emergency reserves by allowing unobligated amounts to carry over to the next year. In Illinois, where balances in the account must be appropriated by the legislature for specific

emergency projects, the balance in the emergency fund can accumulate, but specific appropriations expire at the end of the fiscal year if they are not obligated. In most states though, the governor must go to the legislature to get an appropriation if the emergency fund runs dry.

Other Approaches

A few states have emergency funds that are not directly tied to the annual appropriation process. Although emergency accounts in those states use funding mechanisms designed to provide significant budgetary resources in advance of an emergency, those funds are not always used when a large-scale emergency arises.

Kentucky has a General Fund Surplus Account that does not receive a specific legislative appropriation. Instead, the account receives all lapsed and unspent funds from the state's general fund at the end of each fiscal year, after contributions are made to the state's Budget Reserve Fund. Those funds are then available to the governor (without express legislative approval) to pay for legal judgments, court settlements, and emergencies caused by natural disasters.

The balance in Kentucky's surplus account has been accumulating and totaled over \$300 million at the beginning of this fiscal year. With balances at record levels,

the legislature chose to appropriate out of the surplus account for a variety of nonemergency purposes, including education and some infrastructure projects. That was the first time the account had been used solely for nonemergency purposes. Kentucky plans to rely on the Budget Reserve Fund (which currently has a balance of over \$300 million) in the event of an emergency.

Florida has one of the newest and most innovative funding mechanisms for disaster spending. In 1993, in response to Hurricane Hugo, Florida created an Emergency Management Preparedness and Assistance Trust Fund. That fund is financed with a surcharge on property insurance policies, totaling about \$16 million this year. It is designed to provide appropriations for emergency planning to state, county, local, and certain private concerns. It is not used for responding to state or federally declared emergencies. In those cases, the governor has the authority to borrow unused amounts from other state trust funds.

Colorado is one of the few states that finances its emergency fund using a formula, although that formula is not based on an estimate of emergency needs. In 1992, Colorado established the Emergency Reserve Fund as part of a citizen initiative known as the Taxpayer's Bill of Rights. That initiative required the state to maintain a balance in the reserve equal to at least 3 percent of the state's annual spending (excluding debt service). The formula yields amounts that are potentially large

enough (almost \$180 million in fiscal year 1998), on an ongoing basis, to address a large-scale emergency without requiring unbudgeted appropriations.

Despite the size of the reserve, however, and despite the fact that there have been a number of large-scale emergencies in the state over the past five years, Colorado has never dipped into the reserve. According to analysts in the Emergency Management department, the state is reluctant to use the reserve fund because it would have to be replenished from the next year's general revenues (in order to maintain the 3 percent balance). Instead, the state prefers to use the more common method of allowing the governor to declare an emergency and then shift priorities or use unobligated funds from other accounts. Those unobligated balances do not have to be replenished and would otherwise revert to the general fund. By relying on current-year funds that have already been appropriated but are unlikely to be used, the state can avoid creating a liability in the next year by using the reserve fund.

WHO HAS THE AUTHORITY TO USE EMERGENCY ACCOUNTS

In 36 states, the governor authorizes the use of emergency funds, often after declaring a state of emergency (or after a federal emergency is declared). South Carolina and Ohio have established emergency councils that make decisions about how to allocate appropriated funds for emergencies.

Oregon is an exception. It places authority for spending for emergencies solely with the legislature; an emergency board of legislators makes spending decisions when the legislature is not in session. Illinois has a hybrid of the two approaches: if the general assembly is not in session, the governor may transfer authority from one account to another to cover emergency expenses after notifying legislative leaders. If the legislature is in session, however, the governor must seek additional authority if existing appropriations for emergencies have been exhausted.

CRITERIA FOR DECIDING WHAT PROJECTS QUALIFY FOR ASSISTANCE

Most states have established statutory criteria for using emergency accounts that tend to be quite broad and leave ample room for interpretation. In most cases, assistance is available for both natural disasters and man-made catastrophes (such as the Oklahoma City bombing). In addition, assistance is often available only when a state of emergency has been declared and only for events that are unforeseen and unpredictable. Maryland specifies that its Catastrophic Event Fund is generally available "to enable the state to respond to a natural disaster or other catastrophic situation that cannot be taken care of within the resources of existing appropriations." Arizona statutes specifically state that loss of life or property must be involved.

CONCLUSION

Because catastrophic events are unpredictable, most states, like the federal government, have chosen to deal with such spending needs as they arise. Although governors tend to have the authority to designate emergencies and allocate funds, the legislatures in most states control emergency spending through the annual appropriation process.

A few of the states that CBO surveyed have created special reserve funds to set aside money for emergencies, but only rarely have those states attempted to provide sufficient budgetary resources up front to fully cover a large-scale disaster. They can underfund response activities in part because they rely on the federal government to step in and pay a significant portion of the cost of responding to a large-scale emergency. In addition, in many states emergency response tends to be a small portion of overall state spending, so handling those needs as they arise has been accommodated within normal budgetary constraints, and states have not needed to set aside large reserves.

In fact, even when states have emergency response funds with very large balances, those funds have not always been used for their originally intended purposes. Sometimes they have been diverted to nonemergency projects, and sometimes they have not been used at all. In cases in which the funds must be

replenished with general revenues, states have deliberately bypassed their emergency accounts and used other available state funds instead to avoid an out-year liability.