

Preparing for economic downturns

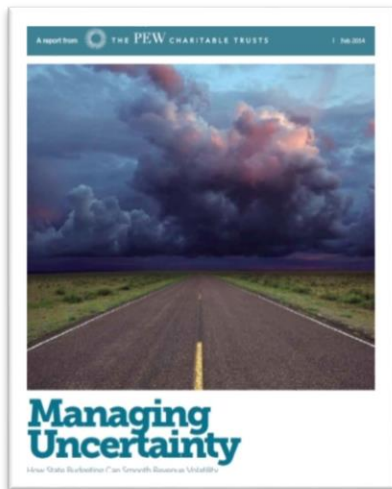
Best practices for managing the business cycle

Presentation by Stephen Bailey, Manager, State Fiscal Health
August 22, 2019

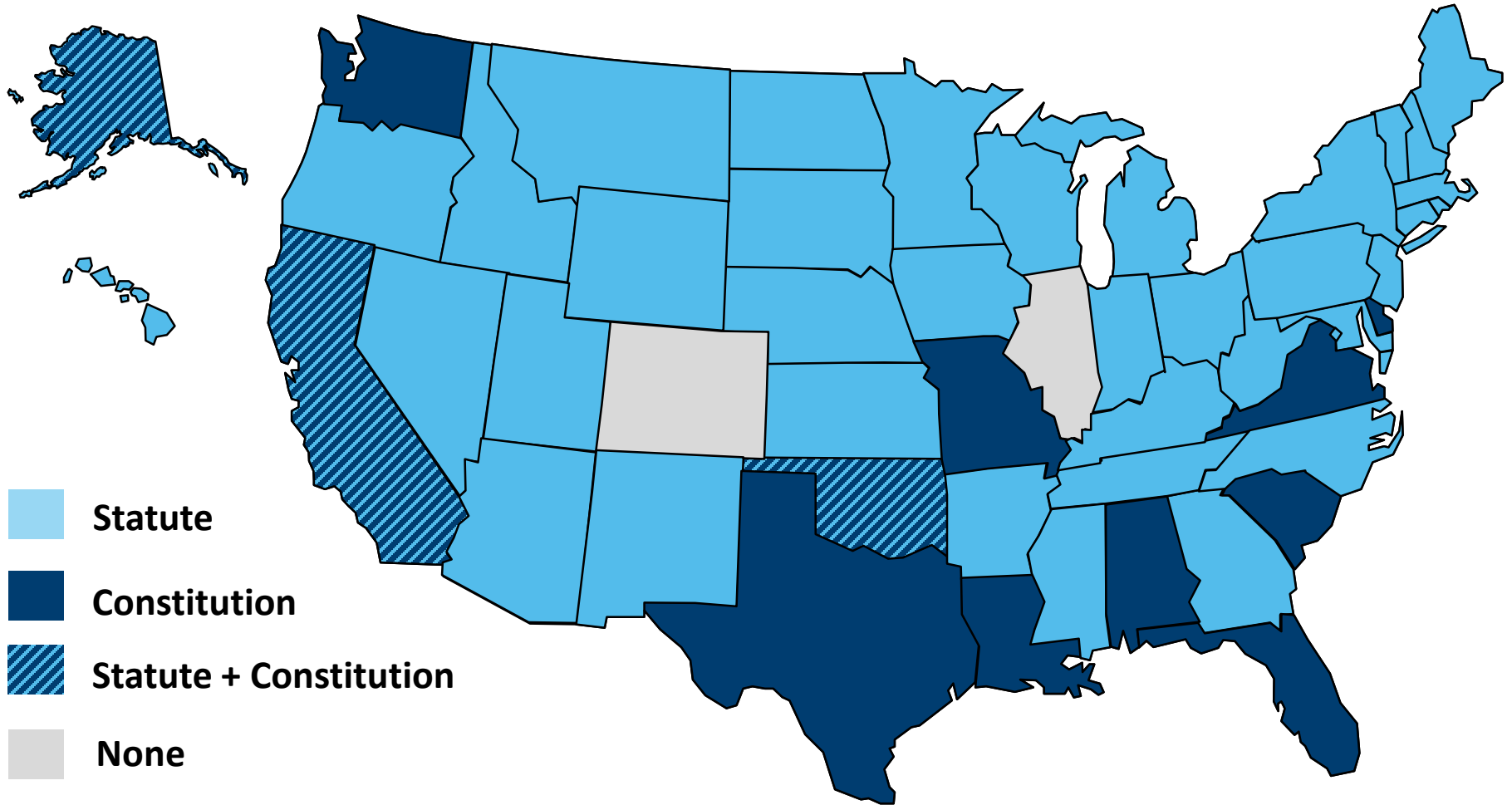
About The Pew Charitable Trusts

- Conducts research and analysis to improve policy, inform the public, and invigorate civic life.
- Established expertise on fiscal management of states, supported by research and experience providing hands-on assistance.
- Committed to identifying fiscal best practices and focused on non-partisan, data-driven solutions.

Pew's research on rainy day funds



48 States Have Formal Rainy Day Funds in Law

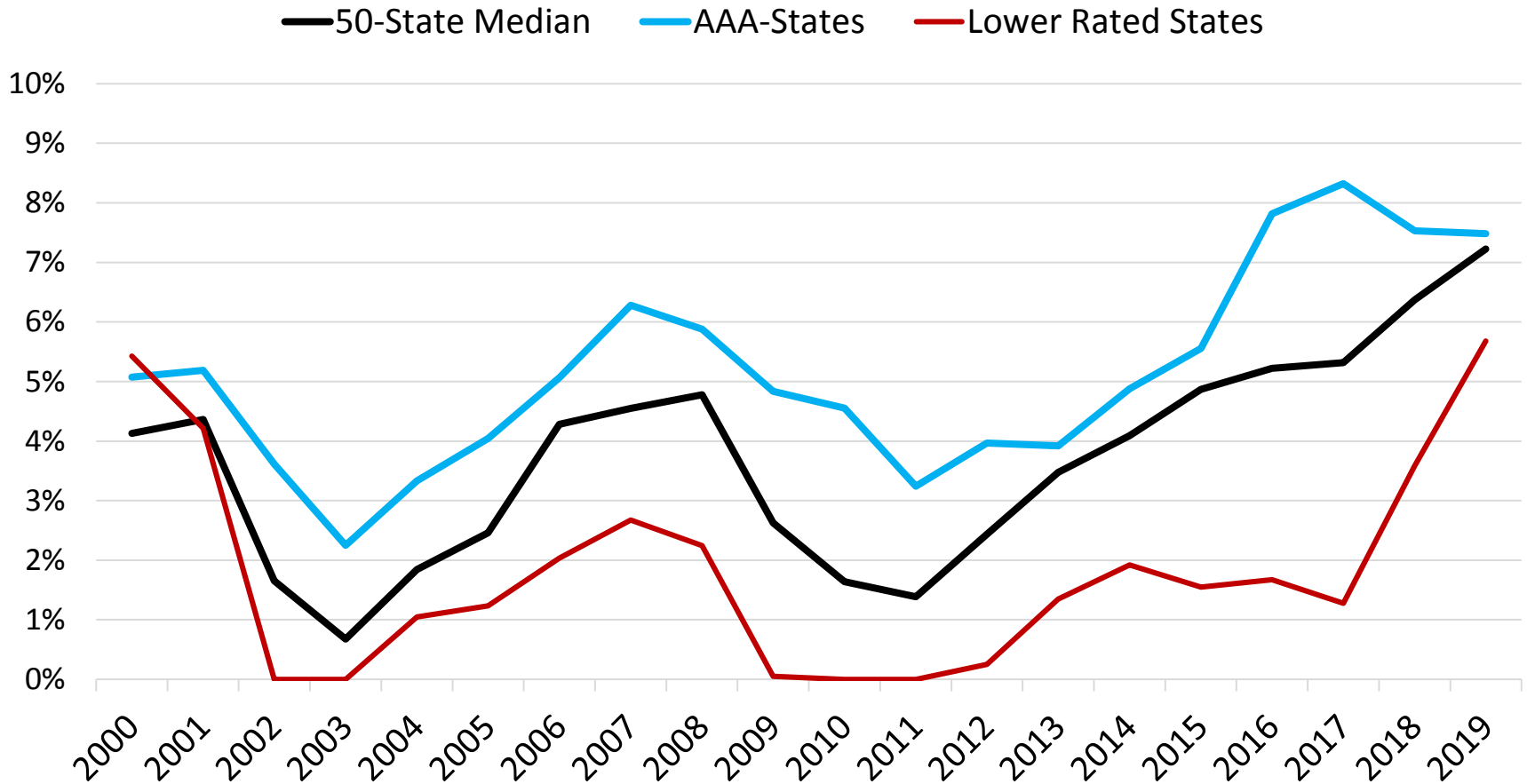


Benefits of a sound rainy day fund policy

- Prevents unsustainable budget practices
- Lessens the need for program cuts and/or tax increases
- Creates predictable levels of available revenue each year
- Allows state to focus on important one-time priorities when appropriate
- Enhances state credit ratings

Link between rainy day funds and credit rating

Rainy day fund size as a percentage of spending



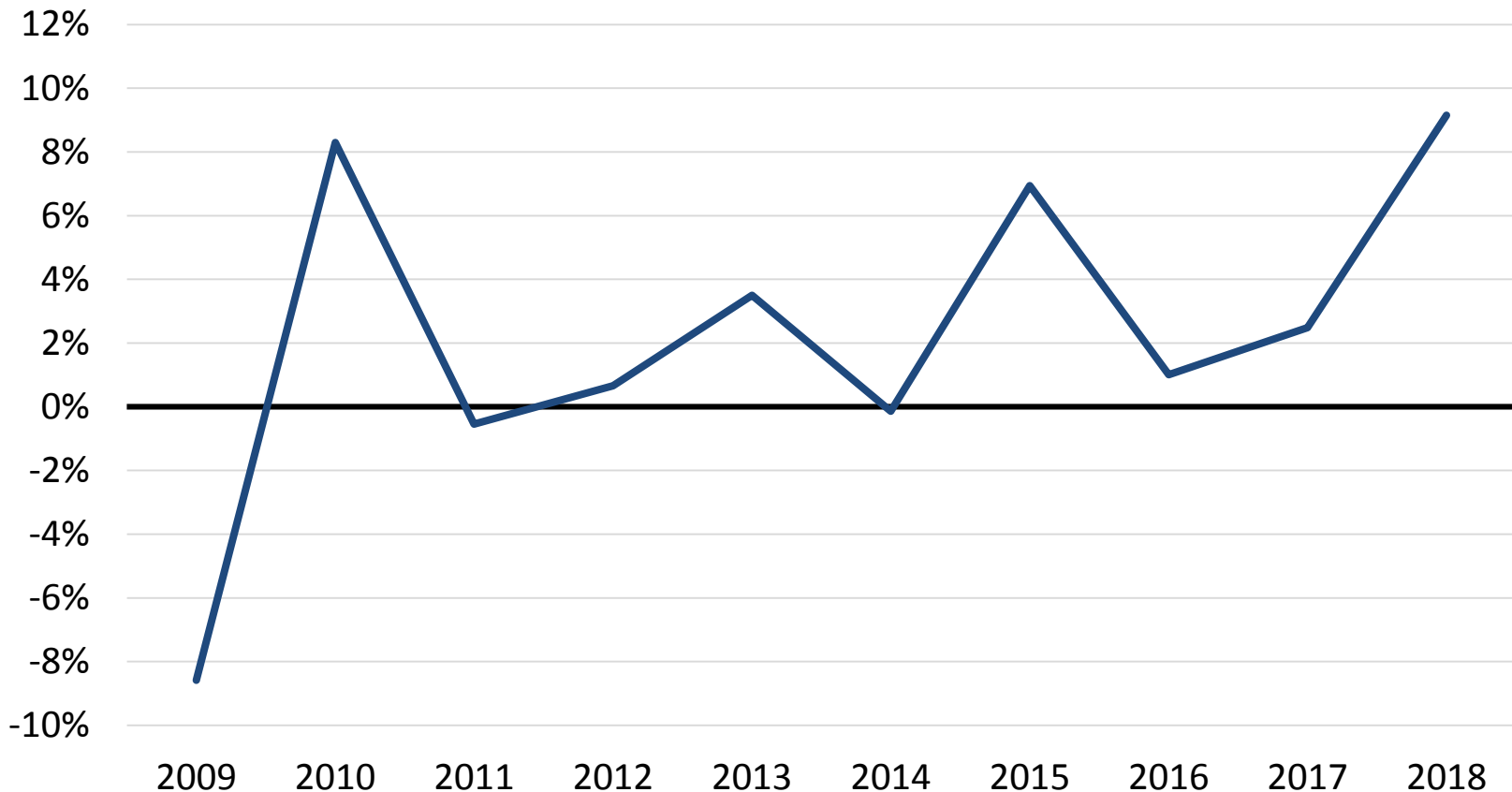
Source: Pew analysis of data from National Association of State Budget Officers

State rules for depositing into rainy day funds

- **Surplus rule:** a certain percentage of the end of fiscal year surplus is deposited to the rainy day fund
- **Forecast error rule:** a certain percentage of revenue that exceeds the certified forecast is set aside to the rainy day fund
- **Static rule:** the rainy day fund balance must maintain a certain percentage each year or be repaid within a specified window
- **Volatility rule (best practice):** a certain percentage of revenue growth above a threshold is set aside to the rainy day fund

Rainy day funds are designed to offset volatility

Annual percentage change of Pennsylvania's general fund revenue

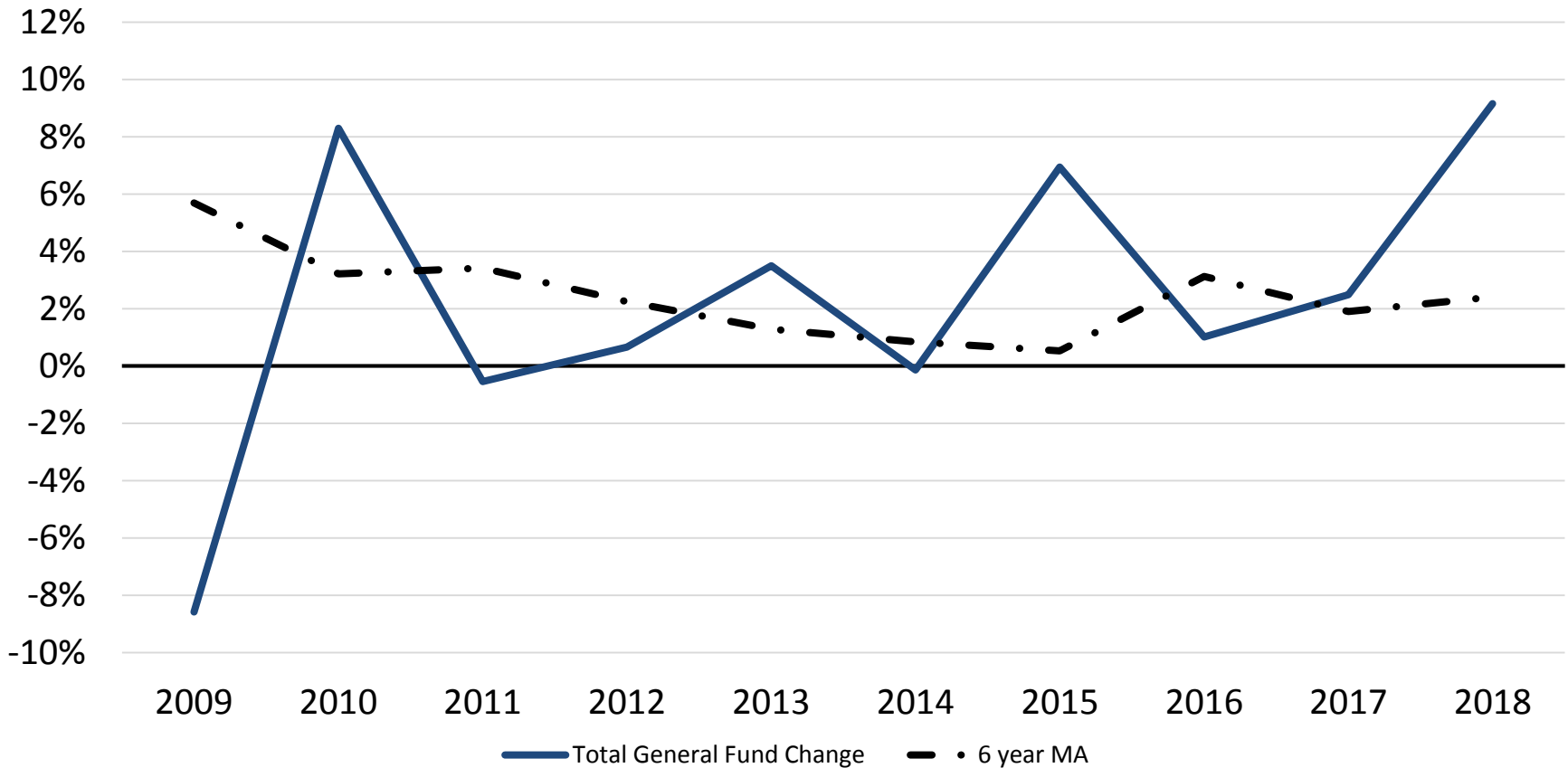


Source: Pew analysis of data from PA Department of Revenue

Rainy day funds are designed to offset volatility

Annual percentage change of Pennsylvania's general fund revenue

6-year moving average rule modeled

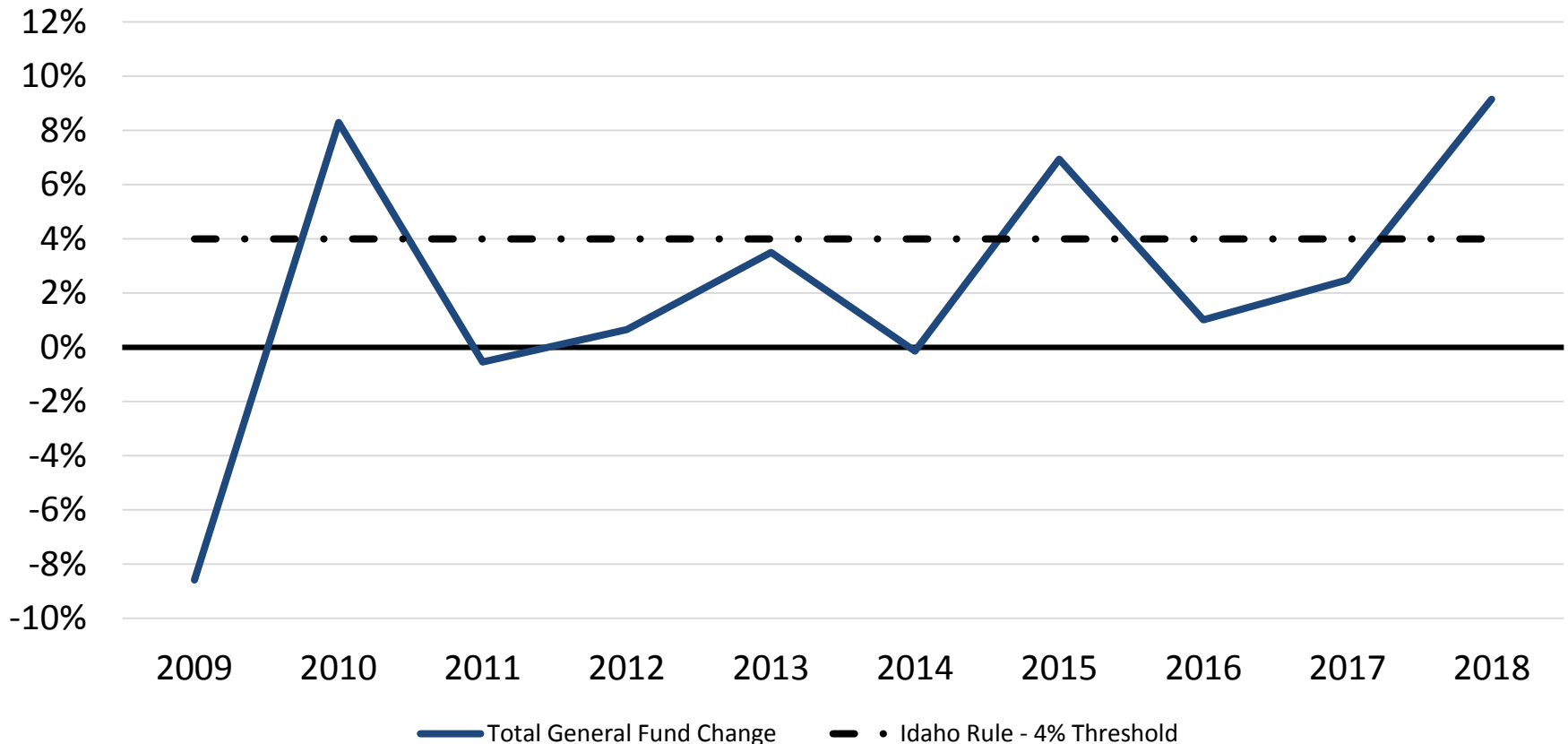


Source: Pew analysis of data from PA Department of Revenue

Rainy day funds are designed to offset volatility

Annual percentage change of Pennsylvania's general fund revenue

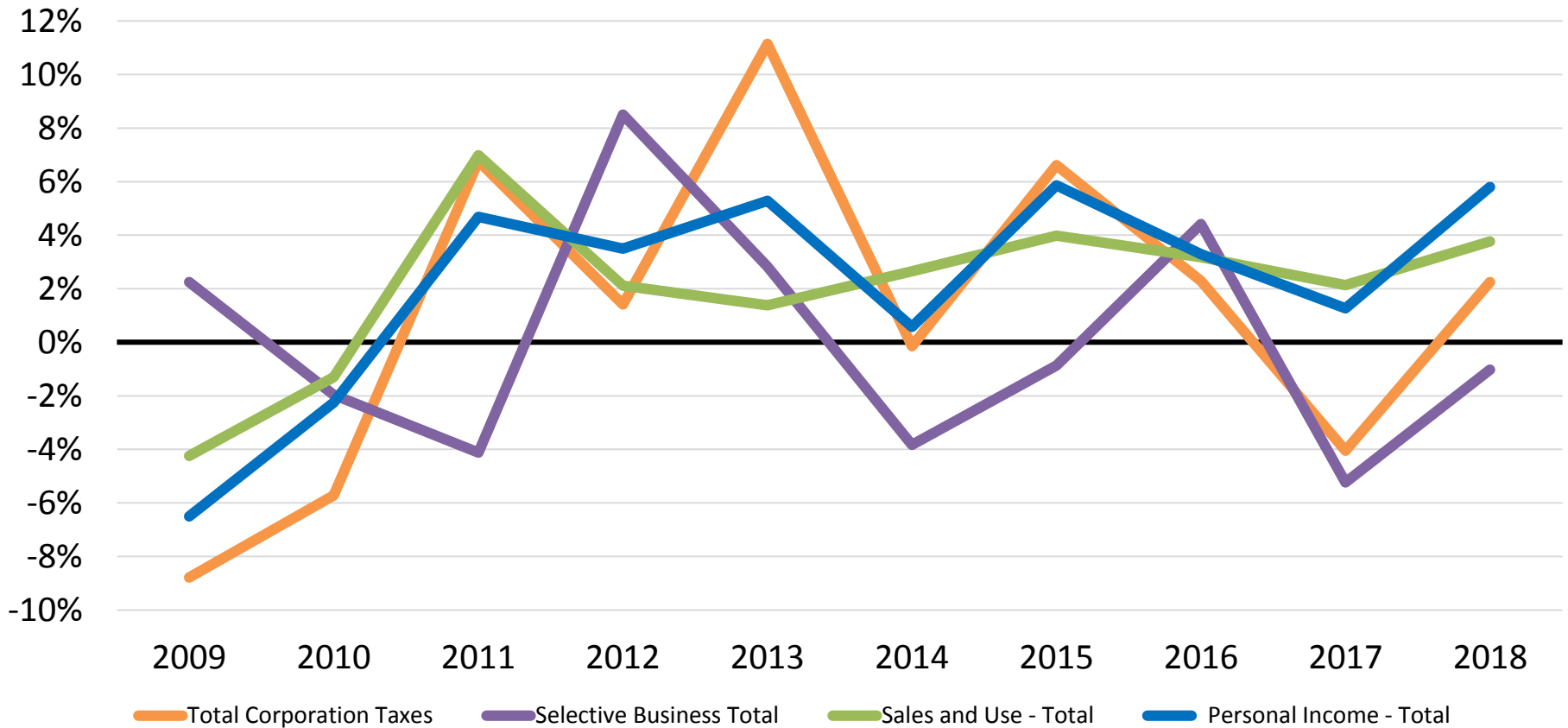
4% growth threshold modeled



Source: Pew analysis of data from PA Department of Revenue

Each revenue source has its own volatility

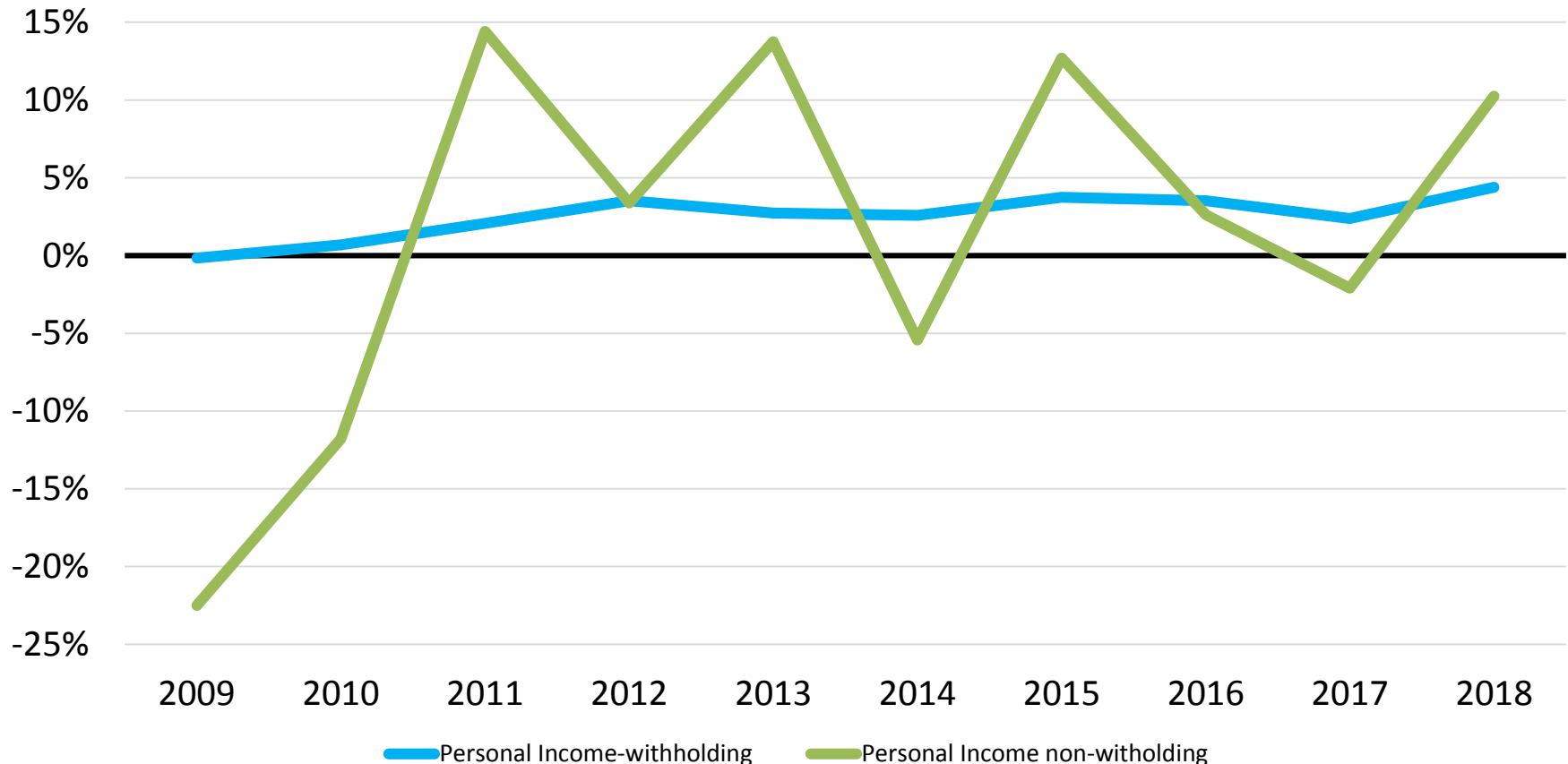
Percentage change in select general fund tax sources



Source: Pew analysis of data from PA Department of Revenue

There are volatile components within sources

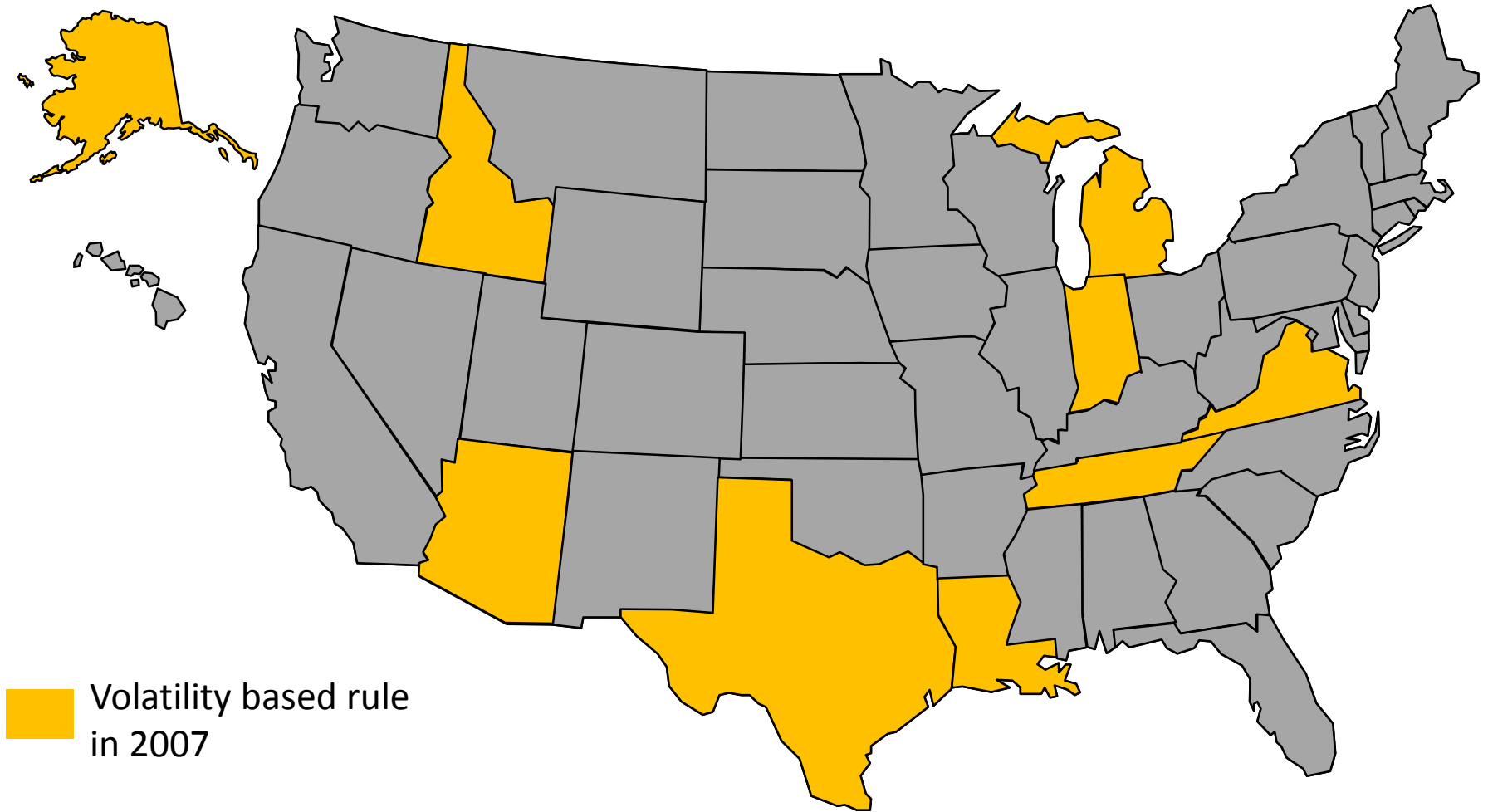
Percentage change in withholding and non-withholding taxes, personal income tax components



Source: Pew analysis of data from PA Department of Revenue

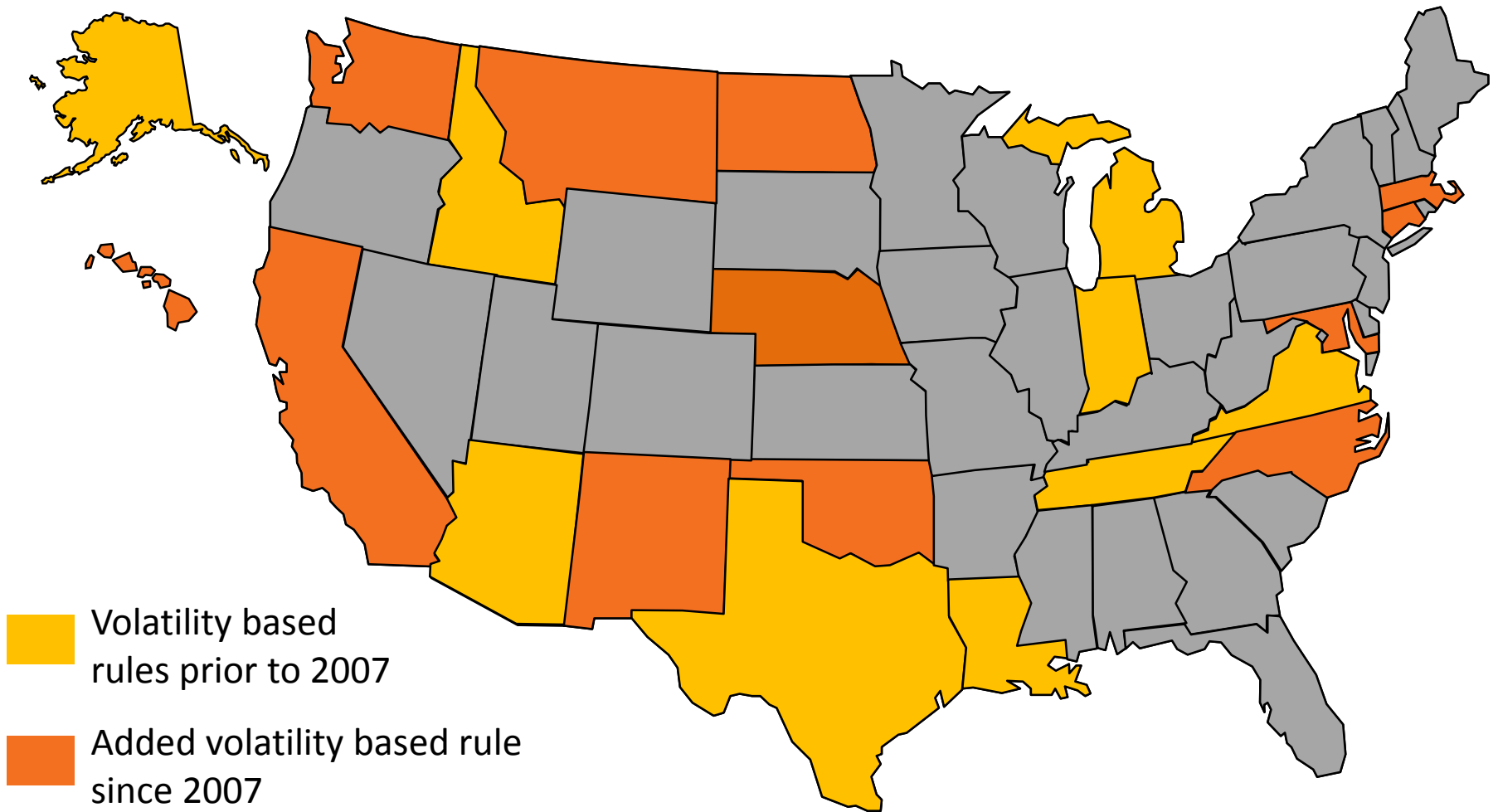
Savings tied to volatility

9 states saved based on revenue growth prior to Great Recession



Savings tied to volatility

21 states now save based on revenue volatility

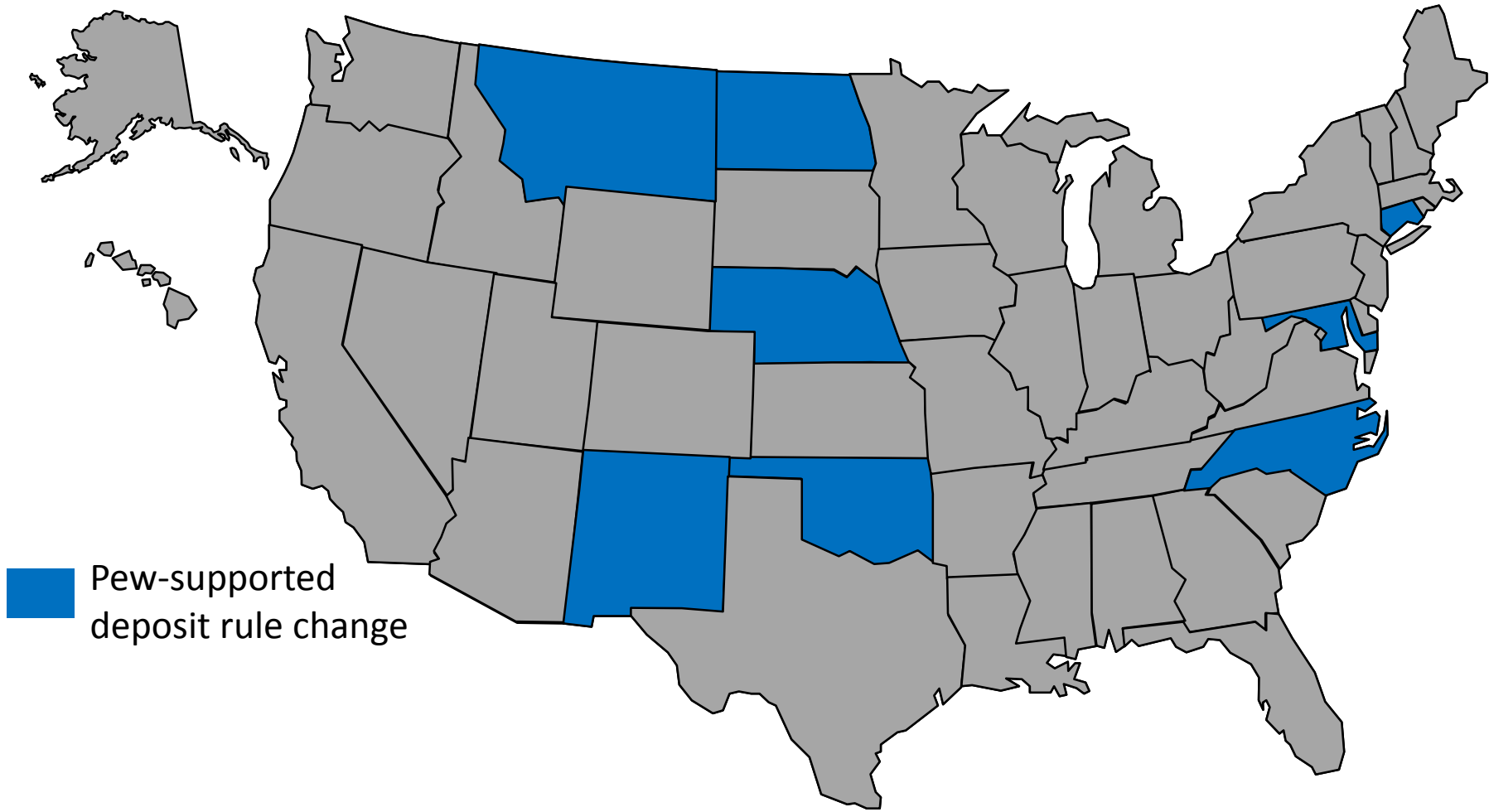


Using volatility rules for more than saving

- Creating a framework for identifying non-recurring/one-time revenue is important first step
- Vital to deposit some non-recurring revenue into rainy day fund in order to properly manage business cycle
- Once reserves are adequate – best practice to place non-recurring revenue toward one-time spending
 - ✓ *Capital projects/infrastructure costs*
 - ✓ *Pay down unfunded liability of pension system*
 - ✓ *Reduce or refinance state debt*
 - ✓ *Temporary tax reduction measures or program enhancements*

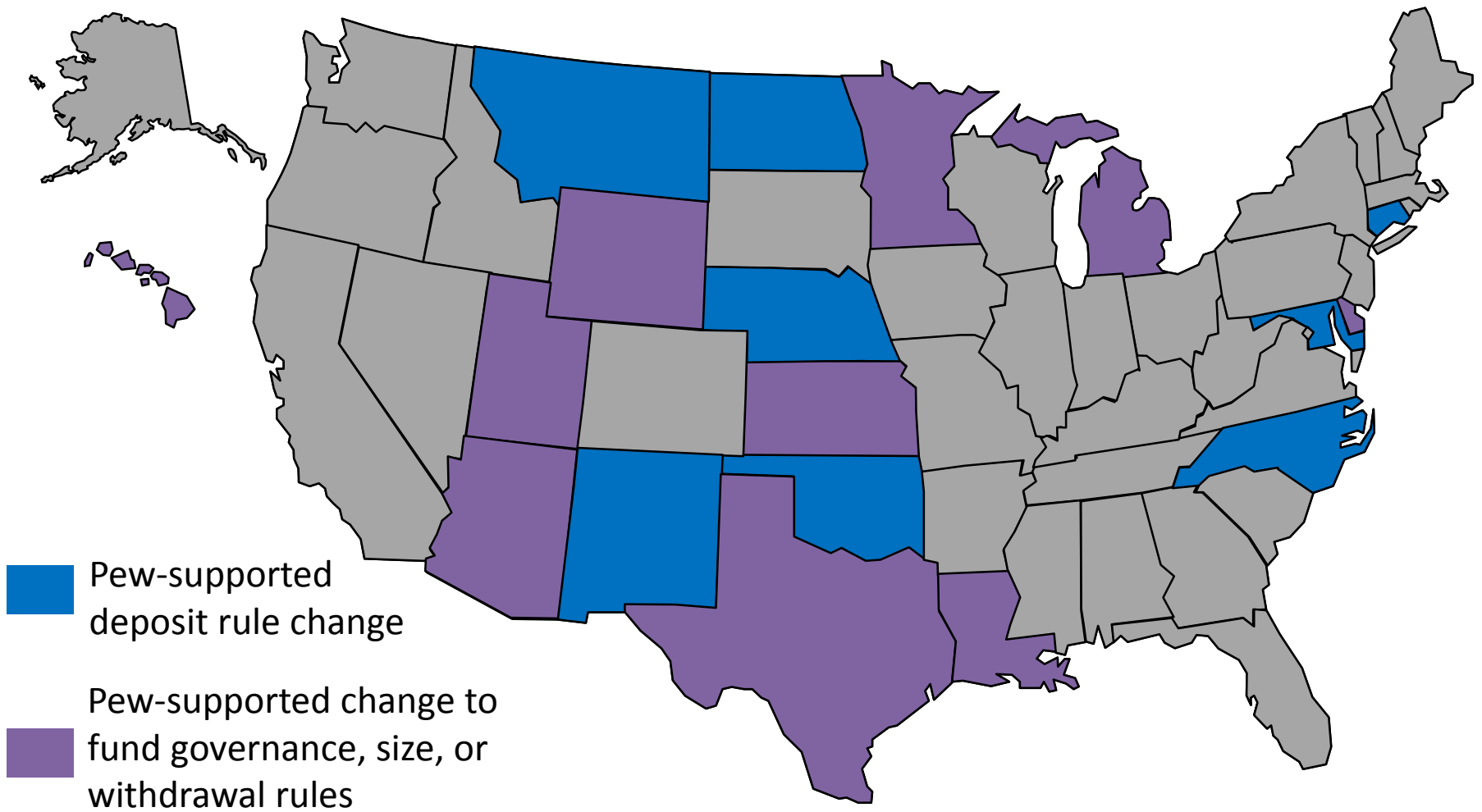
Pew's technical assistance in states

Helping inform rainy day fund policy since Great Recession



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