THE VOLCKER ALLIANCE

Working for Effective Government

Truth and Integrity in State Budgeting: Preventing the Next Fiscal Crisis

DECEMBER 12, 2018

Agenda

1. Welcome
2. About the Volcker Alliance
3. The History of Truth and Integrity in State Budgeting
4. The Results
5. Case Study: Distressed States – Is Illinois typical or atypical?
6. Q & A

Welcome

Presenters

Thomas Ross

President - The Volcker Alliance

William Glasgall

Senior Vice President and Director, State and Local Initiatives - The Volcker Alliance

Beverly Bunch

Professor - University of Illinois Springfield

Moderator

Melissa Austin

Associate Director - The Volcker Alliance

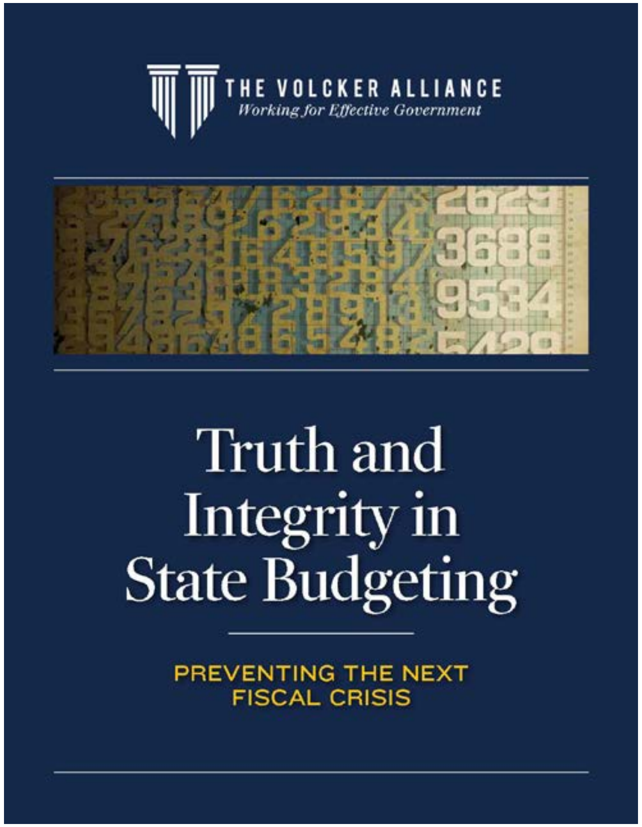
About the Alliance

About the Volcker Alliance

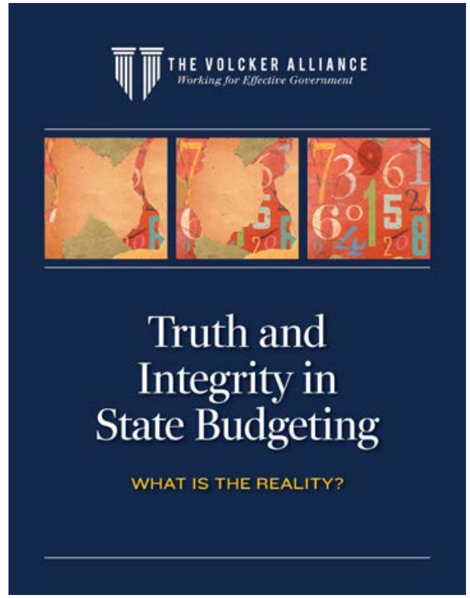
The Volcker Alliance advances effective management of government to achieve results that matter to citizens.

The History of Truth and Integrity in State Budgeting

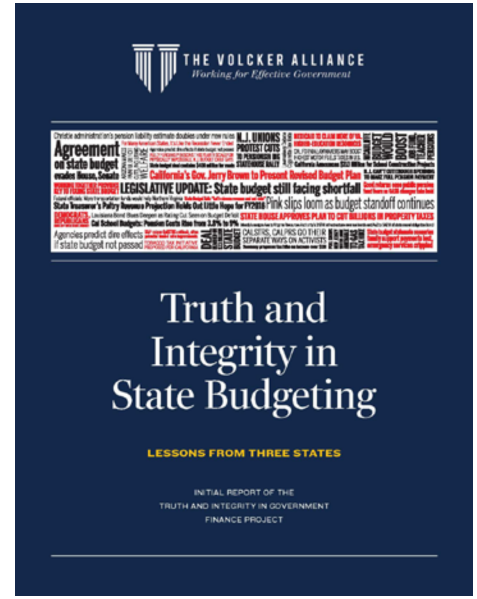
Truth and Integrity in State Budgeting



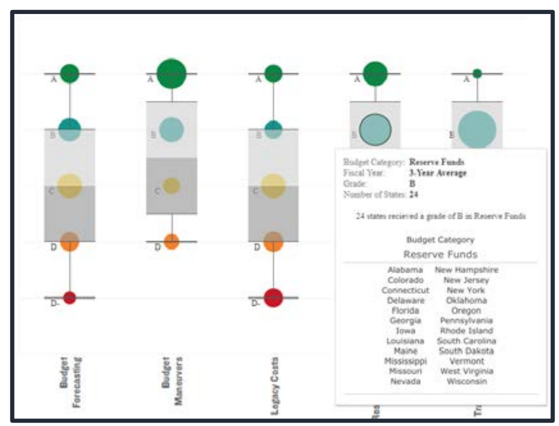
2018



2017



2015



Data Lab

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State Budget Research Network

CUNY THE CITY UNIVERSITY OF NEW YORK

FIU

Georgia State University

Berkeley UNIVERSITY OF CALIFORNIA

UK

UIC

UIS

THE UNIVERSITY OF UTAH

MMA Independent & Data Driven

BG Barrett&Greene

The Results

The Results

2019 Fiscal Framework for States

- **Second-longest GDP expansion since 1858.** Economy may slow, but only 15% probability of recession seen. Inflation ~2.3%, unemployment <4%.
  Source: Bloomberg

- **Fatter budgets for states.** FY '19 state budget spending +3.2% but well below historical +5.5%.
  Source: NASBO

- **More money for rainy day funds.** 3-year average reserve trend pointing up for 2nd year. State rainy day fund balances projected at 6.2% of general fund spending, highest share in at least 18 years and triple 2011 low.
  Sources: Volcker Alliance, NASBO

The Results

2019 Fiscal Framework for States

- **Federal budget uncertainty:** Budget gap >4% of GDP risks Congress making discretionary spending cuts affecting states.
  Sources: Volcker Alliance, Bloomberg

- **State budget pressure points.** Volcker Alliance 3-year legacy cost trend rising for 2nd year but 2/3 of states still experiencing stress. Pensions & OPEB battling debt service, Medicaid, infrastructure, K-12 for resources.
  Source: Volcker Alliance

- **Muni bond market recovering slowly.** 2019 muni sales @ $350b vs. $325b in ’18, $410 b in ‘17. New money issuance may be best in 8 years, yet state & local governments still wary of cost of borrowing for new projects, preferring to add to fiscal reserves, bolster existing programs.
  Source: Volcker Alliance, Municipal Market Analytics issuance estimates

How the Volcker Alliance Grades the States

States received average FY 2016-18 grades of A to D-minus, plus annual grades for each year, in five areas:

1. **Budget forecasting**–how and whether states estimate revenues and expenditures for the coming fiscal year and the long term;
2. **Budget maneuvers**—dependence on one-time revenues to offset recurring expenditures;
3. **Legacy costs**—how well states fund promises made to public employees for pensions and retiree health care;
4. **Reserve funds**—the condition of general fund reserves and rainy day funds and rules governing their use and replenishment;
5. **Budget transparency**—disclosure of budget information, including debt, tax expenditures, estimated cost of deferred infrastructure maintenance.

Five State Budget Principles

Our evaluation of state budgets is guided by these best practices

- **Budget forecasting**–States should use a consensus approach to establish single, binding estimates for revenues and expenditures. States should also make predictions about revenues and expenditures for more than one following fiscal year.

- **Budget maneuvers**—States should pay for expenditures with recurring revenue earned in the same year.

- **Legacy costs**—States should consistently make the contributions for pension and retiree health care plans that actuaries determine to be necessary.

Five State Budget Principles

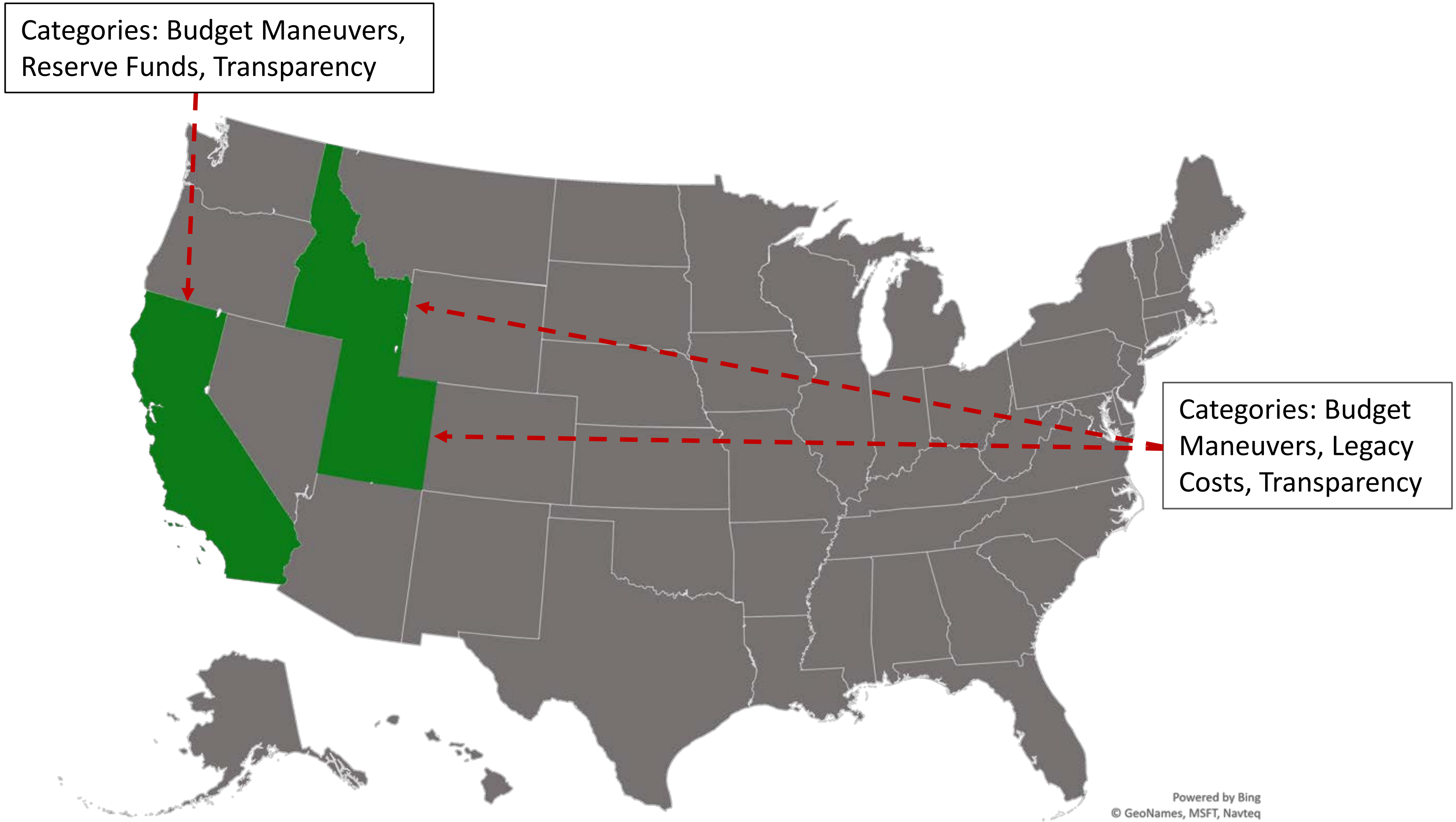
Our evaluation of state budgets is guided by these best practices

- **Reserve funds**—States should enact clear policies for deposits into and withdrawals from rainy day and other reserves.

- **Budget transparency**—States should provide the data that public officials, advocacy groups, and citizens need to thoroughly understand budgets. These budgetary disclosures should include the costs of debt, deferred infrastructure maintenance, and tax expenditures.

Most Average A Grades, FY 2016-18

California, Idaho, Utah Are the Only States With Three A Grades Each



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Changes in 3-Year Average Grades, FY 2016-18

Grades arranged by category

Budget Forecasting

STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
IMPROVED		
South Dakota	C	B
Texas	D	C

Legacy Costs

STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
IMPROVED		
Oregon	B	A
Pennsylvania	D-	D
Virginia	D-	D
DECLINED		
Arizona	C	D
California	C	D
New Mexico	C	D

Budget Maneuvers

STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
IMPROVED		
Vermont	B	A
Virginia	D	C
West Virginia	C	B
DECLINED		
Hawaii	A	B
Pennsylvania	D	D-
South Dakota	A	B

Changes in 3-Year Average Grades, FY 2016-18

Grades arranged by category

Reserve Funds

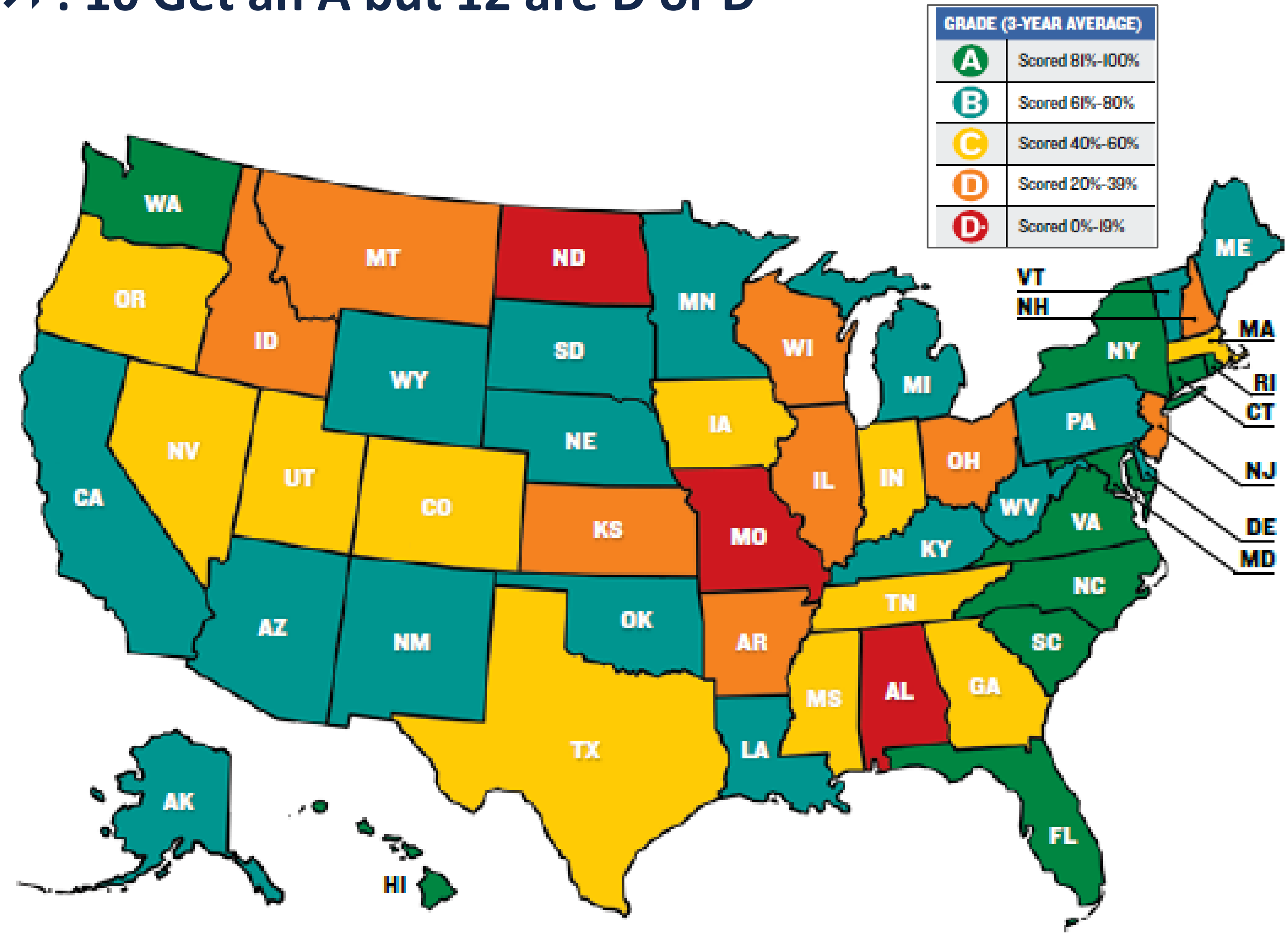
STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
IMPROVED		
Montana	D	C
North Carolina	C	B
Oklahoma	B	A
Wyoming	D	C
DECLINED		
Illinois	C	D
Pennsylvania	B	C

Transparency

STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
IMPROVED		
Alabama	C	B
Hawaii	C	B
Tennessee	B	A

Budget Forecasting Average Grades, FY 2016-18

Trend ↗ : 10 Get an A but 12 are D or D-



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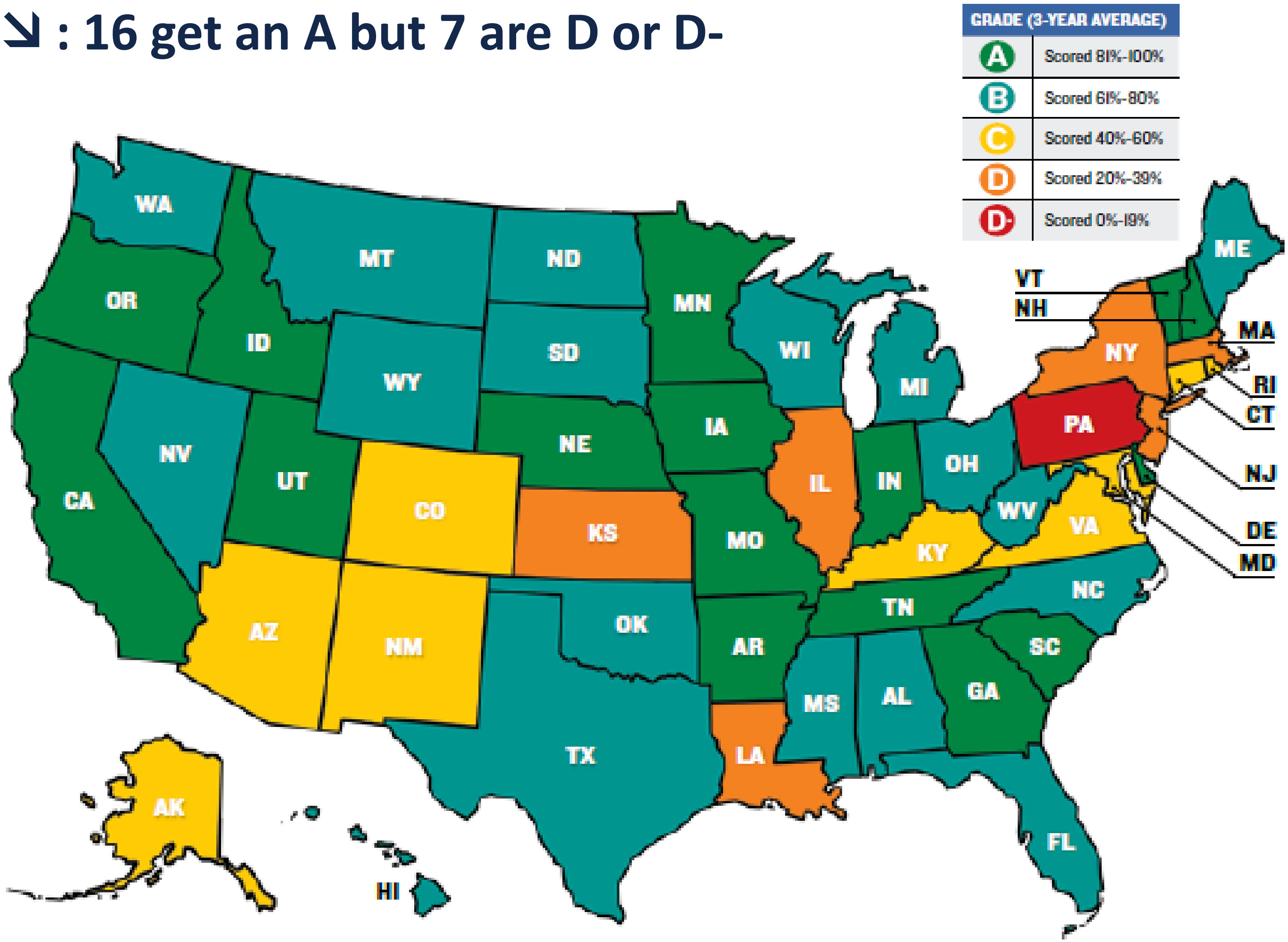
Budget Maneuvers Average Grades, FY 2016-18

Trend ↘ : 16 get an A but 7 are D or D-



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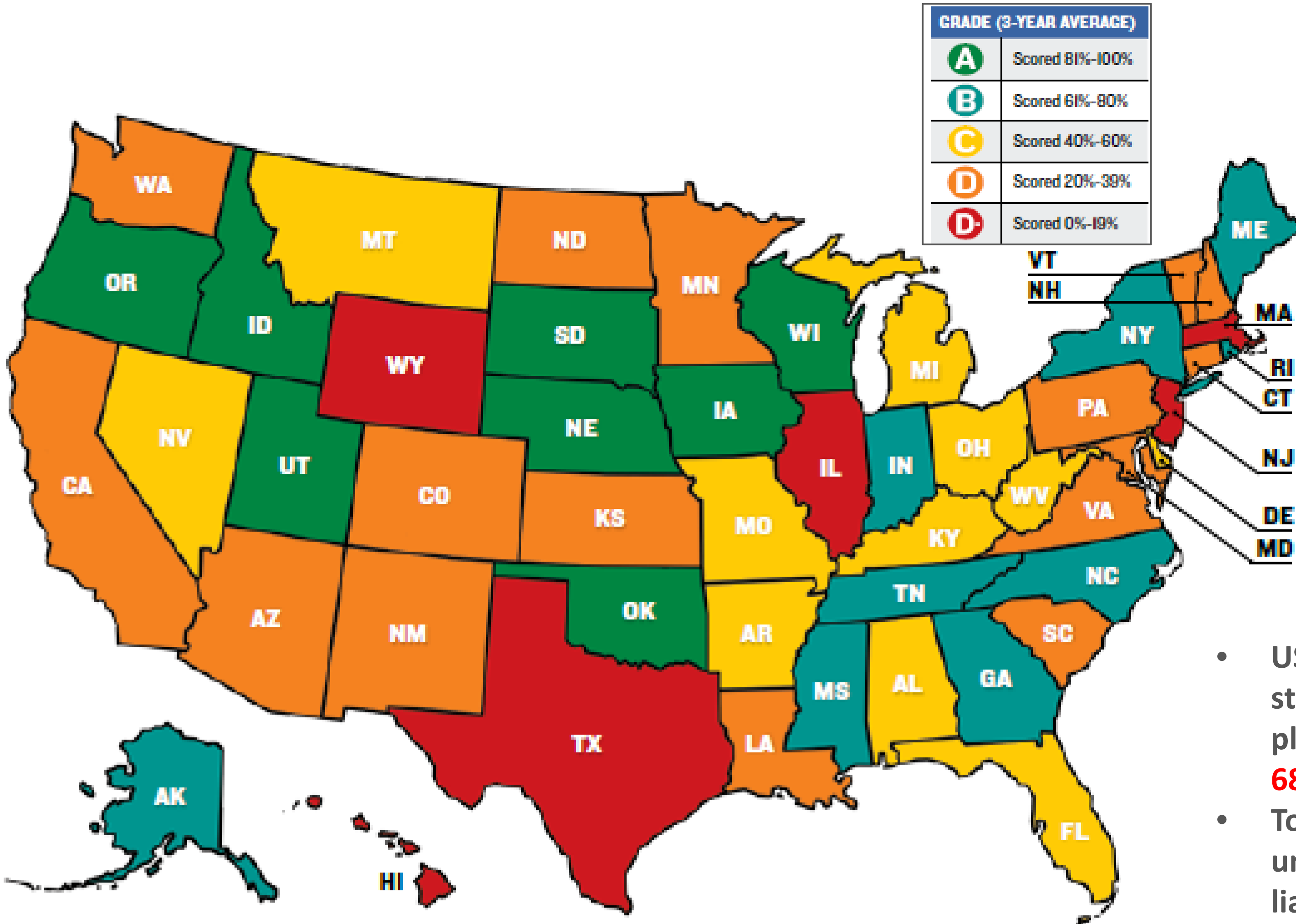
Legacy Cost Average Grades, FY 2016-18

Trend ↗ : Only 8 get an A; 33 are C or Worse and 5 are D-



- US average state pension plan funding: **68.6%**
- Total unfunded liability: **$1.35 trillion**

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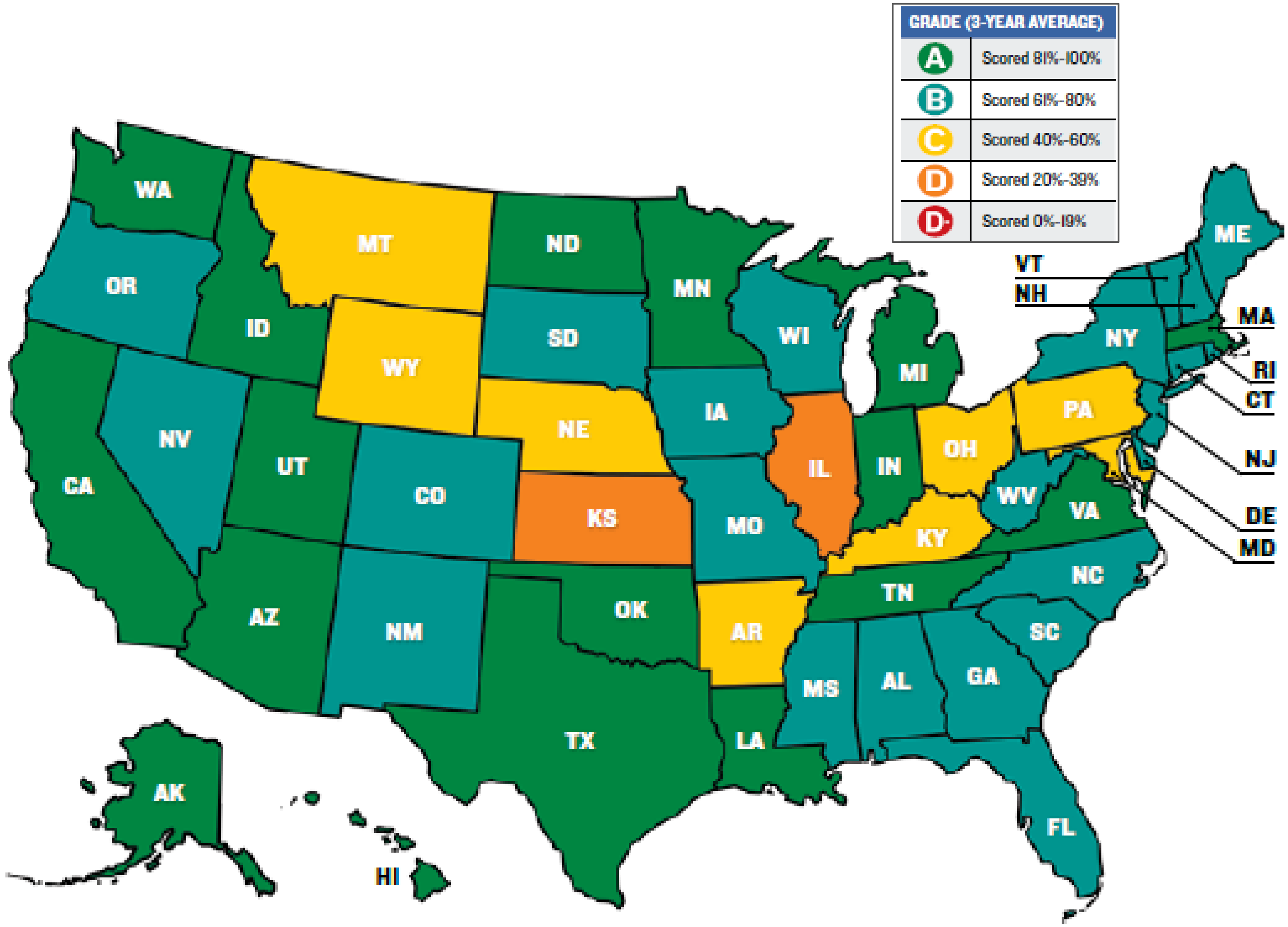
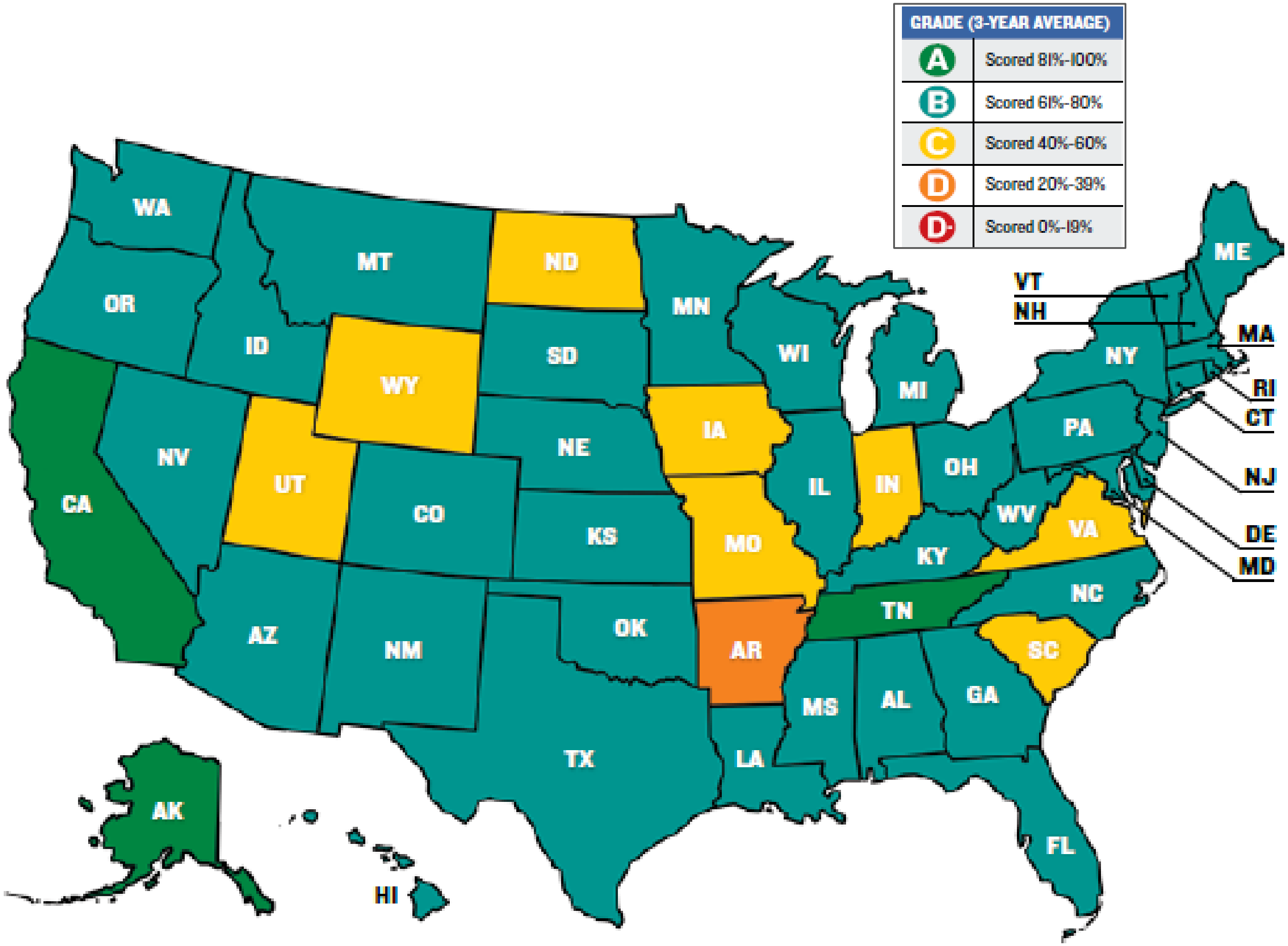
Reserve Funds Average Grades, FY 2016-18

Trend ↗ : 17 get an A, only 10 graded C or worse



Transparency Average Grades, FY 2016-18

Trend ↗ : 3 get an A, only 9 graded C or worse



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Five Takeaways

What the findings mean for policymakers, citizens, and investors

- **Budget forecasting**–With a US average grade of C, many states should improve how they estimate revenues and expenditures. Investors and taxpayers should prepare for surprises if the economy cools.
- **Budget maneuvers**–Average B grade reflects economic recovery, but one-time actions to balance budgets remain ubiquitous across the country. If economy slows, use of maneuvers may increase, threatening fiscal sustainability.
- **Legacy costs**—Average C grade indicates almost two-thirds of states are struggling to meet obligations for public worker pension and retirement health care. These costs, along with Medicaid and debt service, will continue to squeeze spending on education, infrastructure, public safety.
- **Reserve funds—**Average B grades show rainy day funds and budgetary reserves on the mend. But reserves need to be adjusted for revenue volatility. States with healthy reserves may withstand future commodity price swings or recessions better than those with little cushion.
- **Budget transparency**—Average US grade is B, but 47 states fail to provide budgetary data on deferred infrastructure maintenance costs. These are unmet obligations that threaten state economies and are being passed to future generations to meet.

Case Study

Case Study

Distressed States – Is Illinois typical or atypical?

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Questions?

Contact Information

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Thank You