



DECEMBER 17, 2018

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

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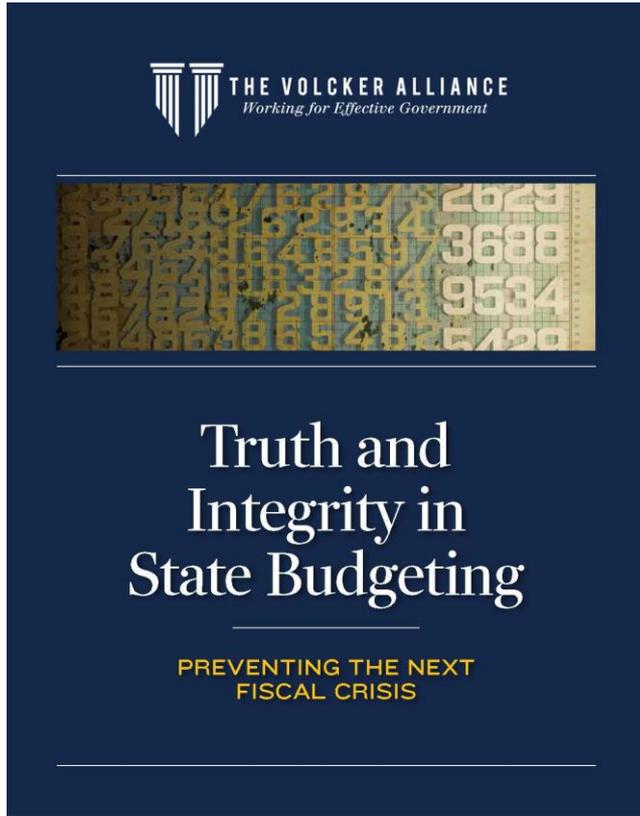
**Prepared for Citizens Budget Commission of New York  
December 17, 2018**

# About the Volcker Alliance

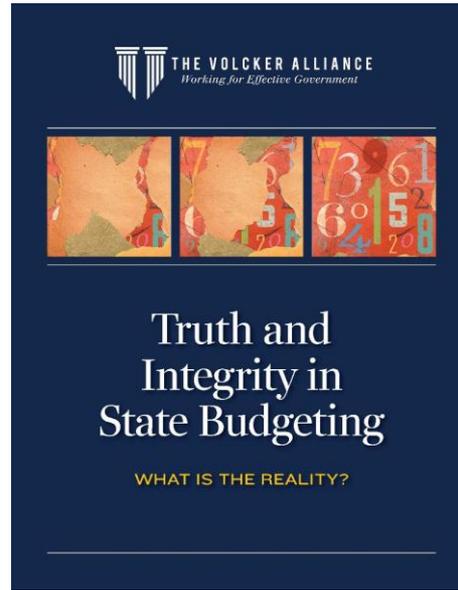


*The Volcker Alliance advances effective management of government to achieve results that matter to citizens.*

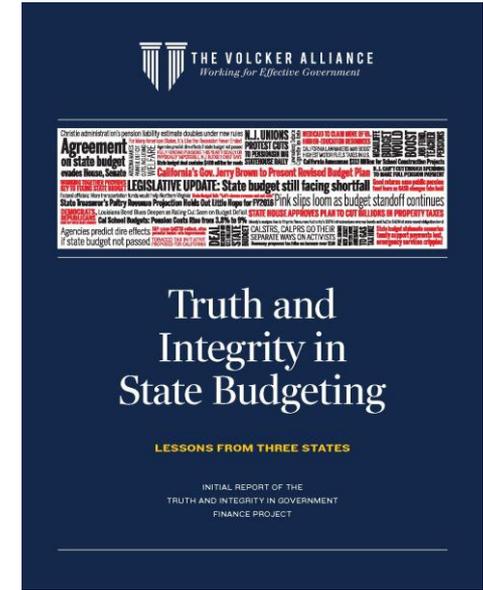
# The History of Truth and Integrity in State Budgeting



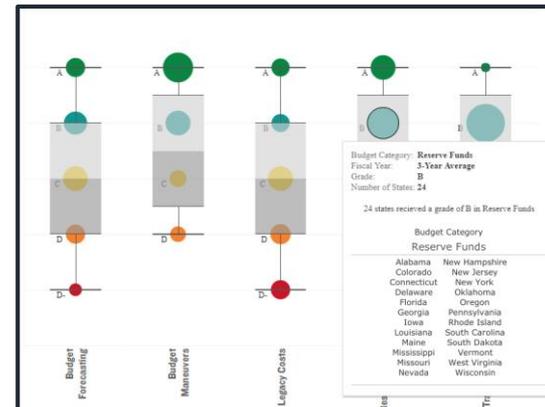
2018



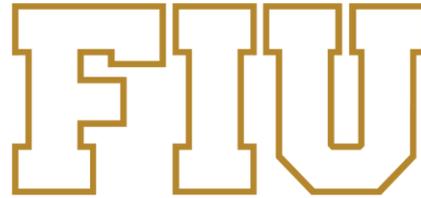
2017



2015



Data Lab



# 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*

## 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

10

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 an 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.

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.

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.

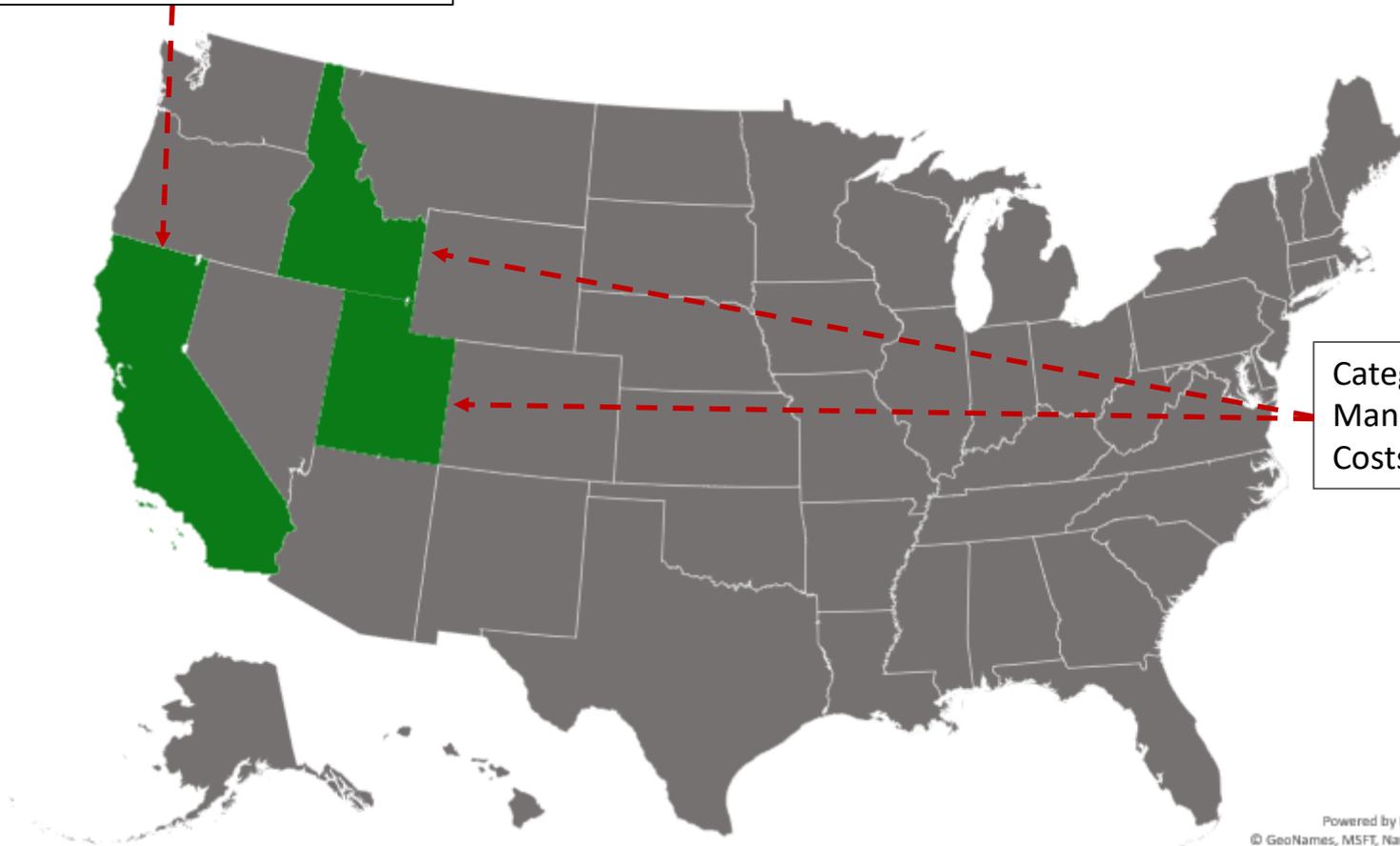
# Most Average A Grades, FY 2016-18

13

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

Categories: Budget Maneuvers,  
Reserve Funds, Transparency

Categories: Budget  
Maneuvers, Legacy  
Costs, Transparency



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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)
<b>IMPROVED</b>		
South Dakota	C	B
Texas	D	C

### Legacy Costs

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

### Budget Maneuvers

STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
<b>IMPROVED</b>		
Vermont	B	A
Virginia	D	C
West Virginia	C	B
<b>DECLINED</b>		
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)
<b>IMPROVED</b>		
Montana	D	C
North Carolina	C	B
Oklahoma	B	A
Wyoming	D	C
<b>DECLINED</b>		
Illinois	C	D
Pennsylvania	B	C

### Transparency

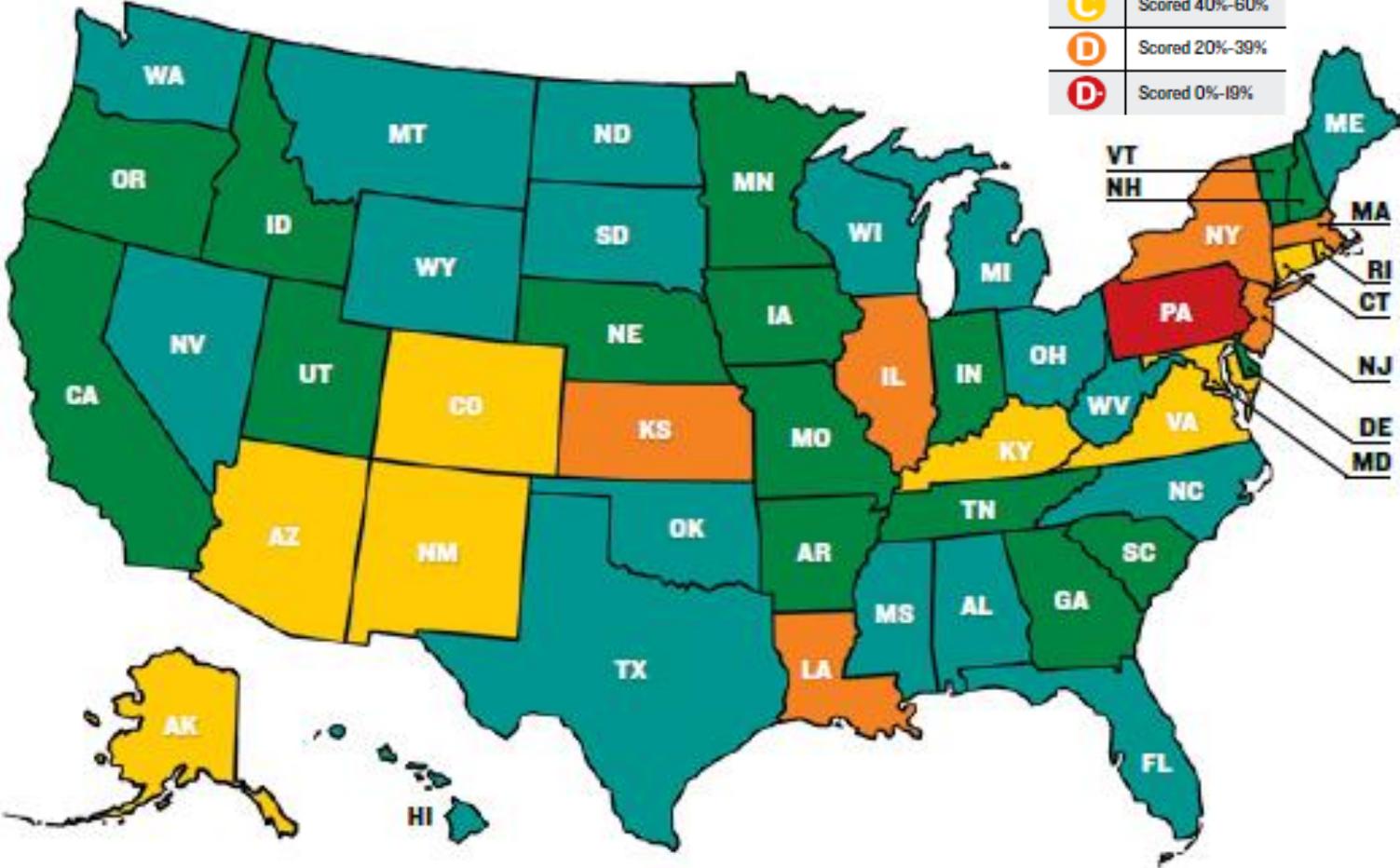
STATE	3-YEAR AVG (2015-17)	3-YEAR AVG (2016-18)
<b>IMPROVED</b>		
Alabama	C	B
Hawaii	C	B
Tennessee	B	A



# Budget Maneuvers Average Grades, FY 2016-18

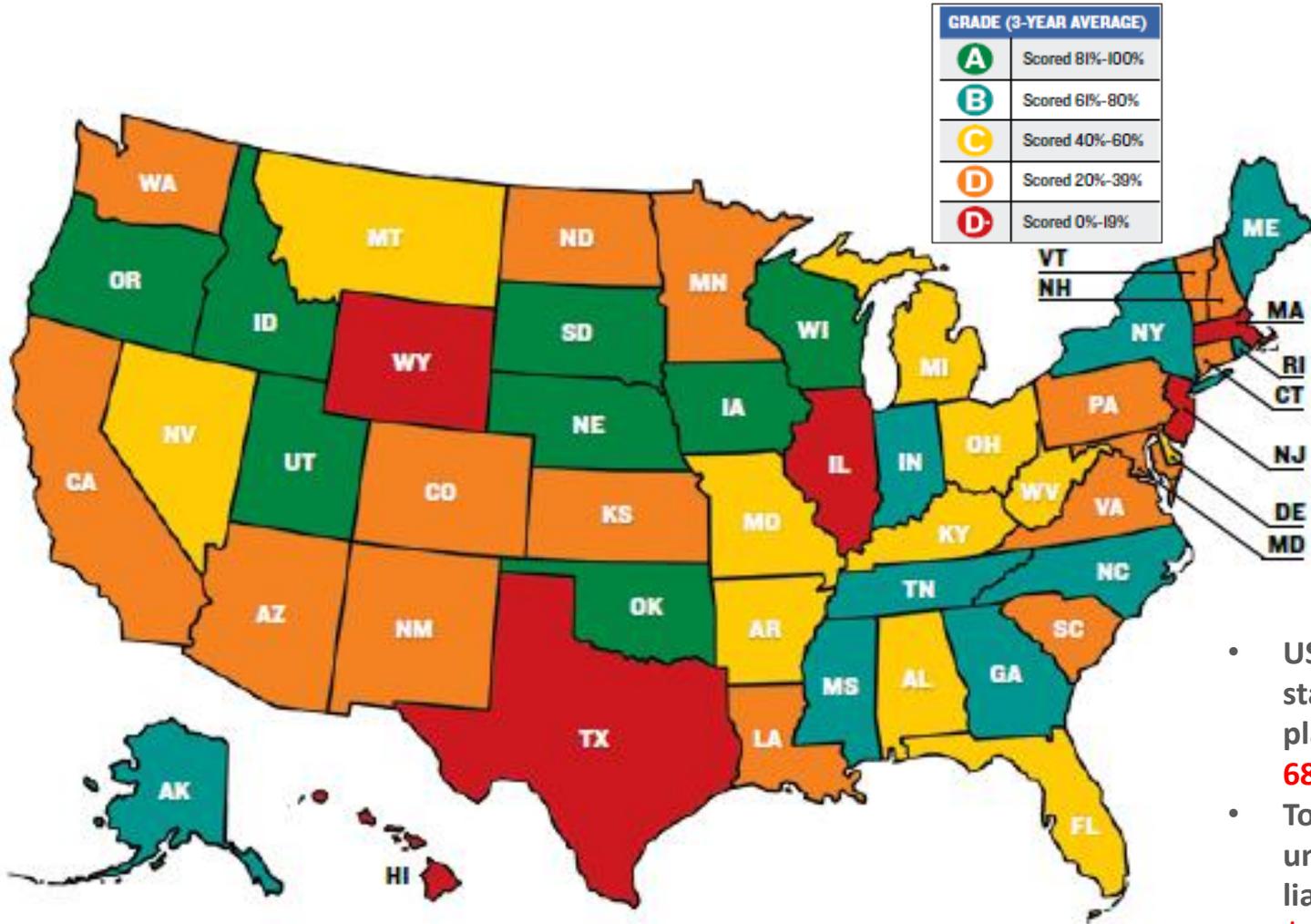
Trend ↘ : 16 get an A but 7 are D or D-

GRADE (3-YEAR AVERAGE)	
<b>A</b>	Scored 81%-100%
<b>B</b>	Scored 61%-80%
<b>C</b>	Scored 40%-60%
<b>D</b>	Scored 20%-39%
<b>D-</b>	Scored 0%-19%



# Legacy Cost Average Grades, FY 2016-18

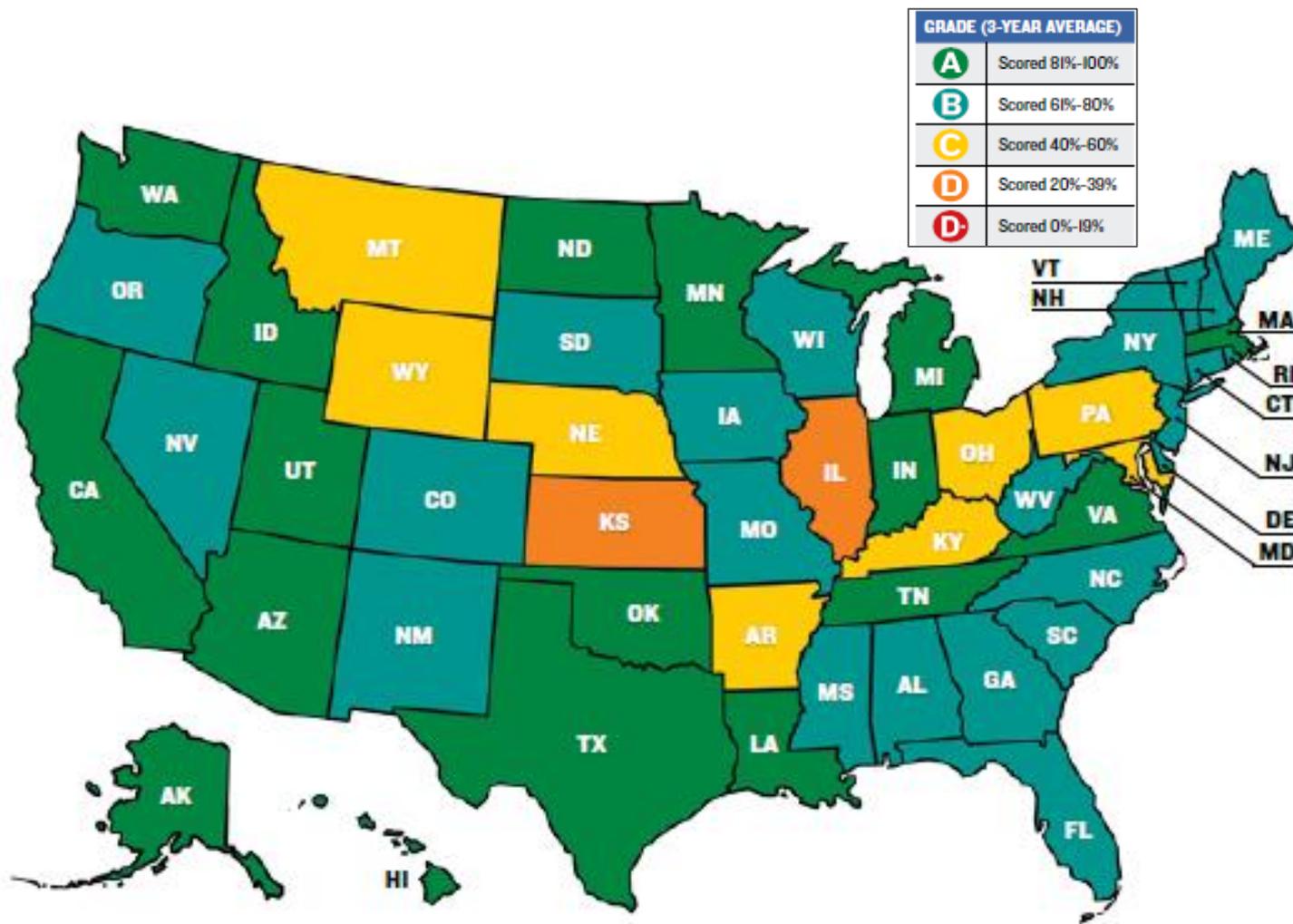
Trend ↗ : Only 8 get an A; 33 are C or Worse and 5 are D-



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

# Reserve Funds Average Grades, FY 2016-18

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





## Grades arranged by category and indicator

Follows best forecasting practices;  
Only 8 states get all As in this  
category

Much improvement needed in  
budget maneuvers

Full pension funding strategy;  
\$77.8 b OPEB gap a challenge

Solid reserves strategy, but revenue  
volatility should be considered,  
given high sensitivity to personal  
income changes

OK disclosure policy; deferred  
infrastructure maintenance cost  
should be included

### NEW YORK Budget Report Card

BUDGET FORECASTING			
	2016	2017	2018
 CATEGORY GRADE	A	A	A
Consensus Revenue Forecasts	✓	✓	✓
Multiyear Expenditure Forecasts	✓	✓	✓
Multiyear Revenue Forecasts	✓	✓	✓
Revenue Growth Projections	✓	✓	✓
3-YEAR AVERAGE		A	3-YEAR TREND —

BUDGET MANEUVERS			
	2016	2017	2018
 CATEGORY GRADE	D	D	D
Deferring Recurring Expenditures	✓	✓	X
Revenue and Cost Shifting	X	X	X
Funding Recurring Expenditures with Debt	X	X	X
Using Asset Sales and Up-Front Revenues	X	X	✓
3-YEAR AVERAGE		D	3-YEAR TREND —

LEGACY COSTS			
	2016	2017	2018
 CATEGORY GRADE	B	B	B
Public Employee OPEB Funding	X	X	X
Public Employee Pension Funding	✓	✓	✓
Public Employee Pension Funded Ratio*	91%	95%	95%
3-YEAR AVERAGE		B	3-YEAR TREND —

RESERVE FUNDS			
	2016	2017	2018
 CATEGORY GRADE	B	B	B
Positive Reserve or General Fund Balance	✓	✓	✓
Reserve Funds Disbursement Policy	✓	✓	✓
Reserve Funds Replenishment Policy	✓	✓	✓
Reserves Tied to Revenue Volatility	X	X	X
3-YEAR AVERAGE		B	3-YEAR TREND —

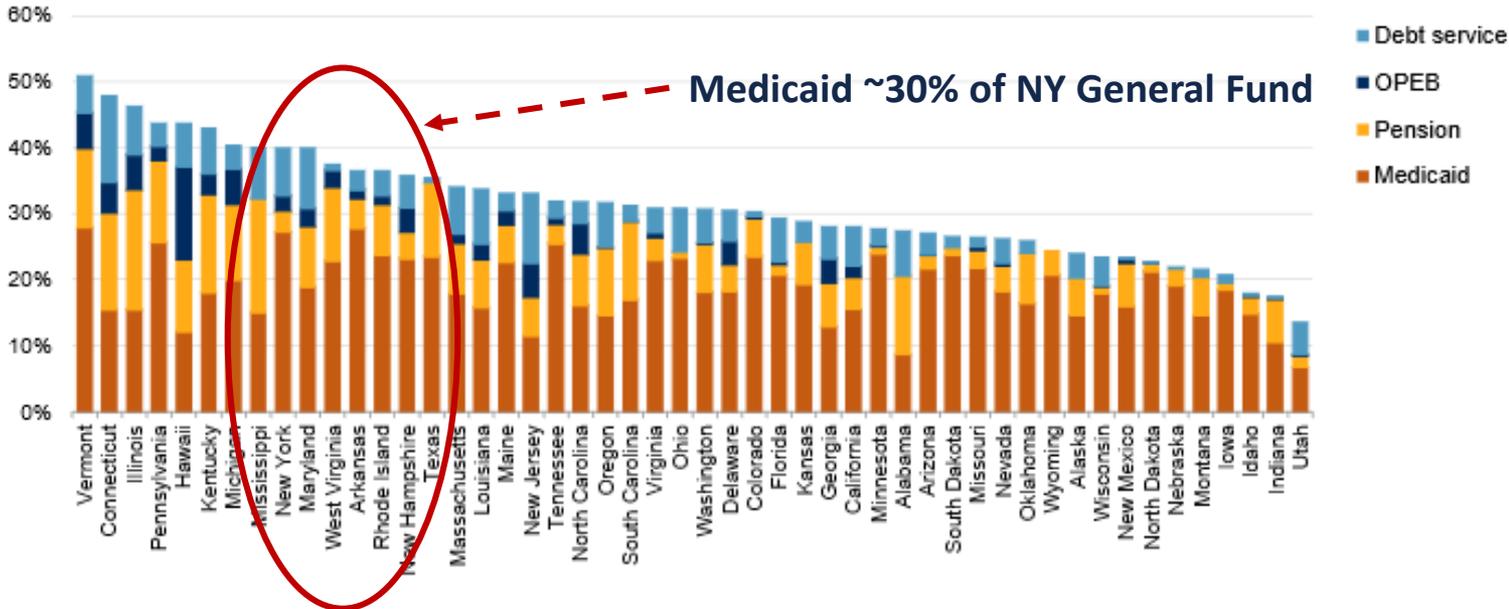
TRANSPARENCY			
	2016	2017	2018
 CATEGORY GRADE	B	B	B
Consolidated Budget Website	✓	✓	✓
Provides Debt Tables	✓	✓	✓
Discloses Deferred Infrastructure Replacement Costs	X	X	X
Discloses Tax Expenditures	✓	✓	✓
3-YEAR AVERAGE		B	3-YEAR TREND —

# Biggest Issue for New York?

## Medicaid leaves NY among states with highest fixed costs

### Combined Medicaid, Debt Service, Pension And OPEB Contributions Share Of General Fund Expenditures

Mandatory expenditures can reduce fiscal flexibility



Source: S&P Global Ratings' survey of state budgets, adjusted for biennial budgets where applicable. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

*“Absent any policy changes by state and local governments, revenues are likely to be insufficient to maintain the Sector’s capacity to provide services at levels consistent with current policies during the next 50 years.” – US Government Accountability Office, December 2018*

## 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 many 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 health 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.

# Questions?

# Contact Information

## The Volcker Alliance

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