Truth and Integrity in State Budgeting: What is the Reality?

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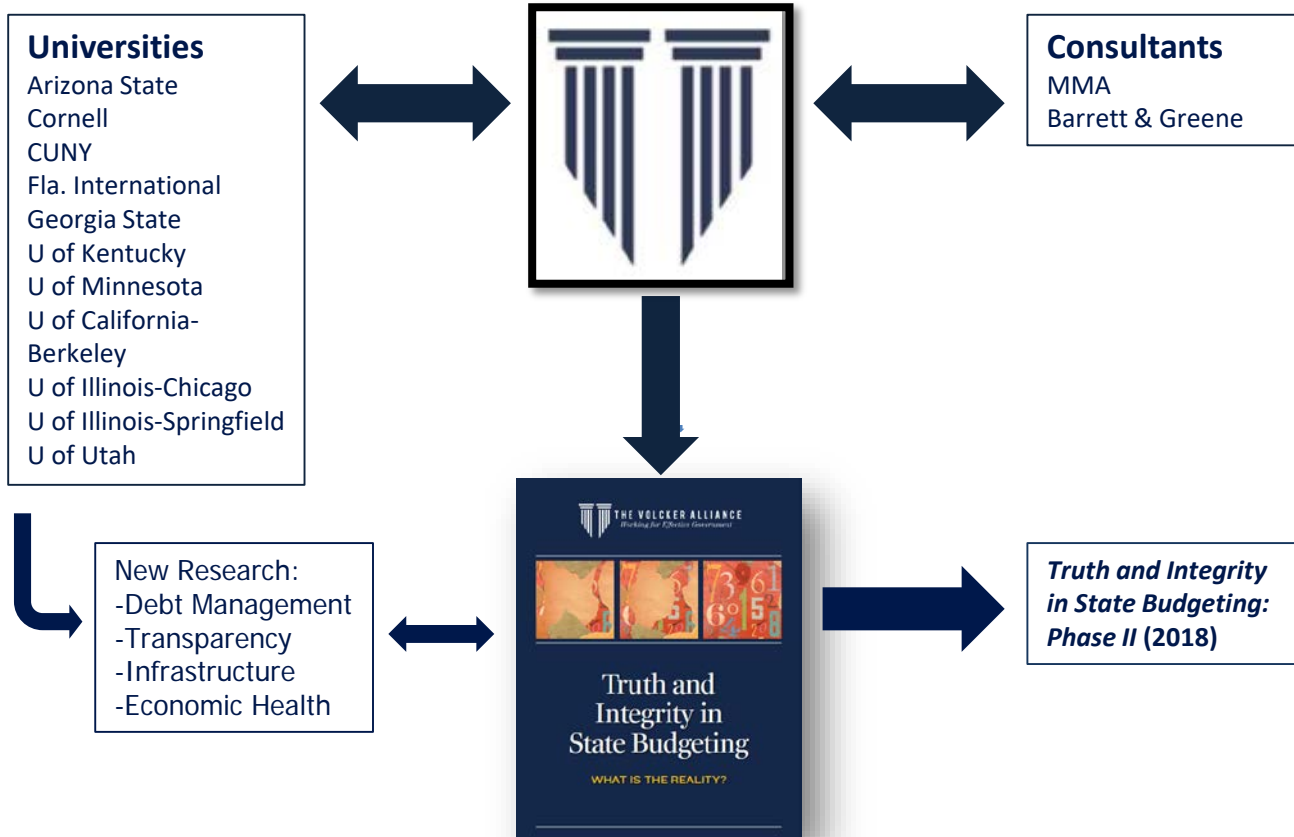New York

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Truth and Integrity in State Budgeting: Objectives

- Identify five key budgeting and financial reporting procedures
- Grade all states' performance in each area
- Propose best practices for states to follow
- Continue evaluations annually in cooperation with university partners
- Help bolster university teaching of public budgeting and finance
- Encourage further university-based research based on Volcker Alliance research and findings
- Download the full report, state report cards, and more: *https://www.volckeralliance.org/publications/truth-and-integrity-state-budgeting-what-is-the-reality*

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Research Network

Universities
Arizona State
Cornell
CUNY
Fla. International
Georgia State
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Berkeley
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New Research:
-Debt Management
-Transparency
-Infrastructure
-Economic Health

Truth and Integrity in State Budgeting: Phase II (2018)

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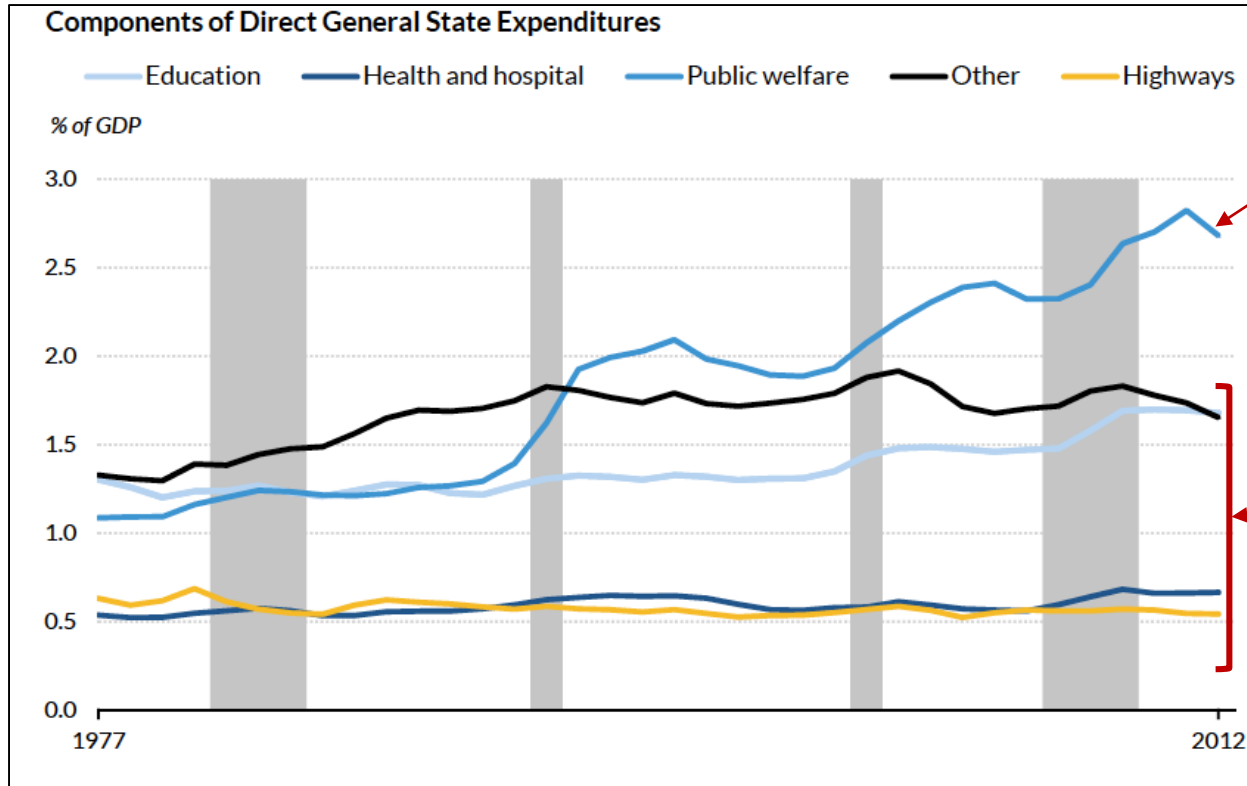*Working for Effective Government*

State Budget Challenges

- When the Volcker Alliance first began examining state fiscal and financial reporting practices in 2014, we were driven by one question: *What makes up a balanced budget?* That led us in 2015 to report on California, New Jersey, and Virginia, and now, all 50 states.
- Even the nation 's third-longest recovery since 1858 has not warded off fiscal crises for some states. Weak revenue growth challenges states' ability to pay bills for infrastructure, Medicaid, education, and public worker pensions and retiree health care. Unpaid obligations in these areas probably exceed the $2.2 trillion in annual state revenue.
- Cash-based budgeting allows states to push costs to future generations to keep budgets balanced in accordance with constitutions, statutes, or traditions.
- Best practices for state budgeting cannot successfully bolster fiscal stability and informed policymaking without political will to adopt and apply them for the long term. Establishing and maintaining strong and transparent budget processes and practices is a concern not only for the states themselves but for the entire economy.

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The State Fiscal Framework

- Record US recovery; modest, steady growth (GDP +~2.2%/yr)

- Low inflation (CPI +~2.1%/yr)

- Low unemployment (~4%)

- Slowly rising interest rates (10-year Treasuries @ 2.5% '17, 3.1% '18). Means muni rates may stay low, but tax reform may diminish demand

- Slow revenue growth (~3-3.5%); revenues/GDP ~2005 level of 10%. ==VT state tax revenue +1.4% in FY17 vs. +2.1% US avg. FY2018 1st quarter gap widened: +1.4% vs. US avg. +4.5%==

- Modest spending growth, still < historical 5.5% avg. State infrastructure spending lowest since mid-1990s.

- Budget pressure points: Federal tax bill (limits on SALT), Pensions/OPEB, Medicaid, Infrastructure, K-12, growth of tax expenditures

- Slower muni debt issuance (~ $315b in '18 vs. $405b in '17?)

Sources: Volcker Alliance, Bloomberg, Rockefeller Institute of Government, MMA, NASBO, Urban Institute, PNC

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State Fiscal Stresses

Components of Direct General State Expenditures

Education — Health and hospital — Public welfare — Other — Highways

% of GDP

3.0
2.5
2.0
1.5
1.0
0.5
0.0

1977   2012

*Medicaid's share of state spending is exploding**

Rising % of total spending is for legacy costs

*Figure includes Medicaid, SSI, TANF
Sources: Urban Institute, from US Census data

Areas of Inquiry & Best Practice Recommendations

❶ **Budget Forecasting**
Use a consensus approach to establishing single, binding numbers for revenues and expenditures. Provide long-term estimates. (Example: Washington)

❷ **Budget Accounting**
Pay for expenditures in the same year they are accrued; avoid deferring them. Shift from cash-based accounting to modified accrual accounting techniques used in state/local CAFRs. (Example: NYC)

❸ **Legacy Costs (Pensions & OPEB)**
Consistently make contributions actuaries determine to be necessary. (Example: Wisconsin). While some states may find it a crippling burden to fully cover costs of future benefits and past underfunding, they should consider committing to move toward full funding in the future. OPEB plans should be adequately funded to ensure benefits can be paid when bills come due (Example: Utah)

❹ **Fiscal Reserve Funds**
Enact clear policies for withdrawals from rainy day and other fiscal reserves, as well as rules for replenishing spent funds and tying the size of fund balances to revenue volatility. (Example: Indiana)

❺ **Transparency**
Construct a consolidated budget website (Colorado). Include full disclosure of cost to replace depreciated infrastructure (Examples: Alaska, California).

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Best-Graded States

- **Forecasting:** 9 states graded **A**

- **Maneuvers:** 22 states graded **A**

- **Legacy Costs:** 8 states graded **A**

- **Reserve Funds:** 15 states graded **A**

- **Transparency:** 2 states graded **A**

VT is one of 21 states with an A in Budget Maneuvers

2015-17 Average

BUDGET FORECASTING

STATE	GRADE
Connecticut	A
Florida	A
Hawaii	A
Maryland	A
New York	A
Rhode Island	A
South Carolina	A
Virginia	A
Washington	A

BUDGET MANEUVERS

STATE	GRADE
California	A
Delaware	A
Georgia	A
Hawaii	A
Idaho	A
Indiana	A
Iowa	A
Minnesota	A
Mississippi	A
Missouri	A
Montana	A
Nebraska	A
New Hampshire	A
North Dakota	A
Oregon	A
South Carolina	A
South Dakota	A
Tennessee	A
Texas	A
Utah	A
Vermont	A

LEGACY COSTS

STATE	GRADE
Idaho	A
Iowa	A
Nebraska	A
Oklahoma	A
Oregon	A
South Dakota	A
Utah	A
Wisconsin	A

RESERVE FUNDS

STATE	GRADE
Alaska	A
Arizona	A
California	A
Hawaii	A
Idaho	A
Indiana	A
Massachusetts	A
Michigan	A
Minnesota	A
North Dakota	A
Tennessee	A
Texas	A
Utah	A
Virginia	A
Washington	A

TRANSPARENCY

STATE	GRADE
Alaska	A
California	A

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Worst-Graded States

- **Forecasting:** 4 states graded **D**

- **Maneuvers:** 6 states graded **D**

- **Legacy Costs:** 9 states graded **D-**

- **Reserve Funds:** 3 states graded **D**

- **Transparency:** 3 states graded **D**

2015-17 Average

BUDGET FORECASTING

STATE	GRADE
Alabama	D-
Illinois	D-
Kansas	D-
North Dakota	D-

BUDGET MANEUVERS

STATE	GRADE
Illinois	D
Kansas	D
New Jersey	D
New York	D
Pennsylvania	D
Virginia	D

LEGACY COSTS

STATE	GRADE
Hawaii	D-
Illinois	D-
Kansas	D-
Massachusetts	D-
New Jersey	D-
Pennsylvania	D-
Texas	D-
Virginia	D-
Wyoming	D-

RESERVE FUNDS

STATE	GRADE
Kansas	D
Montana	D
New Mexico	D

TRANSPARENCY

STATE	GRADE
Alabama	D
Arkansas	D
New Mexico	D

Vermont Grades vs. New England States

	BUDGET FORECASTING	BUDGET MANEUVERS	LEGACY COSTS	RESERVE FUNDS	TRANSPARENCY
Connecticut	A	C	D	B	B
Maine	B	B	C	B	B
Massachusetts	C	C	D-	A	B
New Hampshire	D	A	D	B	B
Rhode Island	A	B	B	B	B
Vermont	C	A	D	B	B
US AVERAGE	B	B	C	B	B

Vermont Category Indicators & Grades

BUDGET FORECASTING			
	2015	2016	2017
CATEGORY GRADE	D	C	C
Consensus Revenue Forecasts	✓	✓	✓
Midyear Budget Adjustments	✗	✗	✗
Multiyear Expenditure Forecasts	✗	✗	✗
Multiyear Revenue Forecasts	✗	✓	✓
Revenue Growth Projections	✓	✓	✓
	3-YEAR AVERAGE C		3-YEAR TREND ↗

BUDGET MANEUVERS			
	2015	2016	2017
CATEGORY GRADE	B	A	A
Deferring Recurring Expenditures	✗	✓	✓
Revenue and Cost Shifting	✓	✓	✓
Funding Recurring Expenditures with Debt	✓	✓	✓
Using Asset Sales and Up-Front Revenues	✓	✓	✓
	3-YEAR AVERAGE A		3-YEAR TREND ↗

LEGACY COSTS			
	2015	2016	2017
CATEGORY GRADE	D	D	D
Public Employee OPEB Funding	✗	✗	✗
Public Employee Pension Funding	✓	✓	✓
Public Employee Pension Funded Ratio*		68%	
	3-YEAR AVERAGE D		3-YEAR TREND —

RESERVE FUNDS			
	2015	2016	2017
CATEGORY GRADE	B	B	B
Positive Reserve or General Fund Balance	✓	✓	✓
Reserve Funds Disbursement Policy	✓	✓	✓
Reserve Funds Replenishment Policy	✓	✓	✓
Reserves Tied to Revenue Volatility	✗	✗	✗
	3-YEAR AVERAGE B		3-YEAR TREND —

TRANSPARENCY			
	2015	2016	2017
CATEGORY GRADE	B	B	B
Consolidated Budget Website	✓	✓	✓
Provides Debt Tables	✓	✓	✓
Discloses Deferred Infrastructure Replacement Costs	✗	✗	✗
Discloses Tax Expenditures	✓	✓	✓
	3-YEAR AVERAGE B		3-YEAR TREND —

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Vermont's Budget Grades in Detail

- *Vermont received a three-year average grade of A for a near-absence of budget-balancing maneuvers.* It improved over the three years in this category measuring one-time actions to achieve balance, earning a B in 2015 (because it deferred health expenditures) but A's in 2016 and 2017

- *Vermont won a B, on average, for Transparency of budgetary information.* We noted the state's consolidated website that provides all budget and supplemental data, going back several years; its extensive disclosures on debt, including the treasurer's annual Debt Affordability Reports; and its excellent biennial tax expenditure reports. The overall grade was diminished by an absence of disclosure of replacement costs for depreciated infrastructure, something only Alaska and California do.

- *Vermont earned a B, on average, for Reserve Funds.* This reflected general adherence to best practices. But while the state has separate budget stabilization accounts for the general, transportation, and education funds, it doesn't link the account levels or contributions to historical revenue volatility. This is important in a state with a highly progressive tax structure and relatively few high-income residents, which may create revenue risks if markets tumble.

- *Vermont was given a C, on average. in Budget Forecasting*, with an improvement noted over the three-year period. While the state began using multiyear revenue estimates, it doesn't do the same for expenditures. It also made negative midyear budget adjustments in all three years studied.

- *Vermont got a D, on average, for legacy costs.* This reflected a lack of actuarially recommended OPEB funding and a below-average pension funding ratio of 68 percent (Pew, 2015), versus an average of 72 percent for all states.

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Tax Expenditure Transparency

VT publishes an exemplary biennial report

VERMONT
Tax Expenditures
2017 Biennial Report

January 15, 2017
Pursuant to 32 V.S.A § 312.

- Tax breaks may cost states & localities $80-300 billion or more/year but 11 states did not disclose tax expenditures in FY 2017 as part of budget (AL, AR, IN, IA, MO, MS, NM, ND, OH, SC, WY)
- Utah, Virginia made partial disclosures
- Illinois tax expenditures disclosed by Comptroller (not since 2015); in Texas disclosure by Comptroller in report to governor, lt. governor, and legislature
- Breadth, depth of disclosure varies widely (GA, NJ post exemplary reports)
- No reconciliation, in general, with GASB #77 yet

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State Grades, Forecasting, & Credit Ratings

BUDGET FORECASTING

STATE	GRADE	
Connecticut	A	A1
Florida	A	Aa1
Hawaii	A	Aa1
Maryland	A	Aaa
New York	A	Aa1
Rhode Island	A	Aa2
South Carolina	A	Aaa
Virginia	A	Aaa
Washington	A	Aa1

BUDGET FORECASTING

STATE	GRADE	
Alabama	D-	Aa1
Illinois	D-	Baa3
Kansas	D-	NR
North Dakota	D-	NR

Sources: Volcker Alliance, Moody's Investors Service, Bloomberg

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State Grades, Budget Maneuvers, & Credit Ratings

BUDGET MANEUVERS

STATE	GRADE	
California	A	Aa3
Delaware	A	Aaa
Georgia	A	Aaa
Hawaii	A	Aa1
Idaho	A	NR
Indiana	A	NR
Iowa	A	NR
Minnesota	A	Aa1
Mississippi	A	Aa2
Missouri	A	Aaa
Montana	A	Aa1
Nebraska	A	NR
New Hampshire	A	Aa1
North Dakota	A	NR
Oregon	A	Aa1
South Carolina	A	Aaa
South Dakota	A	NR
Tennessee	A	Aaa
Texas	A	Aaa
Utah	A	Aaa
Vermont	A	Aaa

BUDGET MANEUVERS

STATE	GRADE	
Illinois	D	Baa3
Kansas	D	NR
New Jersey	D	A3
New York	D	Aa1
Pennsylvania	D	Aa3
Virginia	D	Aaa

Sources: Volcker Alliance, Moody's Investors Service, Bloomberg

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State Grades, Legacy Costs, & Credit Ratings

LEGACY COSTS

STATE	GRADE	
Idaho	A	NR
Iowa	A	NR
Nebraska	A	NR
Oklahoma	A	Aa2
Oregon	A	Aa1
South Dakota	A	NR
Utah	A	Aaa
Wisconsin	A	Aa1

LEGACY COSTS

STATE	GRADE	
Hawaii	D-	Aa1
Illinois	D-	Baa3
Kansas	D-	NR
Massachusetts	D-	Aa1
New Jersey	D-	A3
Pennsylvania	D-	Aa3
Texas	D-	Aaa
Virginia	D-	Aaa
Wyoming	D-	NR

Sources: Volcker Alliance, Moody's Investors Service, Bloomberg

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State Grades, Reserve Funds, & Credit Ratings

RESERVE FUNDS

STATE	GRADE	
Alaska	A	Aa3
Arizona	A	NR
California	A	Aa3
Hawaii	A	Aa1
Idaho	A	NR
Indiana	A	NR
Massachusetts	A	Aa1
Michigan	A	Aa1
Minnesota	A	Aa1
North Dakota	A	NR
Tennessee	A	Aaa
Texas	A	Aaa
Utah	A	Aaa
Virginia	A	Aaa
Washington	A	Aa1

RESERVE FUNDS

STATE	GRADE	
Kansas	D	NR
Montana	D	Aa1
New Mexico	D	Aa1

Sources: Volcker Alliance, Moody's Investors Service, Bloomberg

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Notes on Research Methodology

The Volcker Alliance joined with professors and students in public finance and budgeting programs at eleven US universities who answered a standardized set of research questions on budget procedures. University research network gathered data from a variety of sources, interviewed current and former state budget and financial officials, and examined budget documents and financial disclosure filings. Responses to questions were reviewed by faculty advisers at the universities and Alliance consultants and revised, if necessary. Responses were then reviewed and normalized to account for any discrepancies among researchers' findings. The focus on states' adherence to best practices, combined with the normalization process, resulted in a relatively high level of comparability among the fifty states' budgetary performance.

States received a grade ranging from A to D-minus for each of the five budget categories for fiscal 2015, 2016, and 2017. Every state's average category score over the period was used to determine a three-year average grade. Sustained improvement or decline in a state's score over the three fiscal years was used to identify trends in budgetary performance in each category:

Budget Forecasting was graded on five indicators, each representing 20% of the category score. We asked if a state used a consensus revenue forecast; employed a reasonable rationale for revenue growth projections (based on historical revenue and economic growth trends); successfully avoided having to make a negative midyear budget adjustment; and produced multiyear revenue and expenditure forecasts.

Budget Maneuvers was graded on a state's use of one-time actions to create short-term budget fixes. States received 25% of the category grade for each type of one-time budget maneuver they successfully avoided. They included funding recurring expenses with debt; funding recurring expenses with the proceeds of asset sales or by tapping future revenues; deferring a current year's recurring expenditures; and covering general fund expenditures with transfers from other funds.

Legacy Costs was graded on a state's willingness to meet public employee pension and OPEB obligations. Thirty percent of a grade was determined by a state's making its OPEB actuarially required or determined contribution. Seventy percent of the category grade was scored on whether the state made its pension ADC or ARC contribution and on its pension funding ratio as of 2015, which represents the amount of assets available to cover promised benefits.

Reserve Funds was graded on a state's performance on four equally weighted budget indicators: If a state had a reserve fund disbursement policy; existence of a reserve fund replenishment policy; if reserves were tied to historic trends in revenue volatility; whether there was a positive reserve or general fund balance at the beginning of each fiscal year.

Transparency was graded on the extensiveness and usefulness of a state's fiscal disclosure practices. States received 25% of their grade for each of four transparency measures: providing the public with a consolidated budget website; disclosing outstanding debt and debt-service cost tables; providing information on deferred infrastructure maintenance costs; and providing cost estimates for tax expenditures.

Questions?