THE PEW CHARITABLE TRUSTS

2005 Market Street, Suite 2800
Philadelphia, PA 19103-7077
P 215.575.9050
F 215.575.4939

901 E Street NW, 10th Floor
Washington, DC 20004
pewtrusts.org
P 202.552.2000
F 202.552.2299

Testimony of Brenna Erford
Manager, State Fiscal Health and Economic Growth
The Pew Charitable Trusts
September 11, 2015

Chairman Madden, Chairman Peterson, and members of the Joint Revenue Committee, thank you for inviting us to speak about our work identifying a savings target for Wyoming's budget reserves this morning. My name is Brenna Erford, and I oversee a research portfolio on state budget policy issues at The Pew Charitable Trusts.

First and foremost, let me explain a little about Pew. The Pew Charitable Trusts is a global nongovernmental organization that seeks to improve public policy, inform the public, and stimulate civic life. We accomplish this through research, partnerships, technical assistance, and nonpartisan advocacy. An independent nonprofit, Pew is the sole beneficiary of seven individual charitable funds established between 1948 and 1979 by the two sons and two daughters of Sun Oil Company founder Joseph N. Pew and his wife, Mary Anderson Pew. Pew has evolved in recent years from a grant-making organization to a public charity. Pew has maintained deep roots in Philadelphia and has a Washington, DC base of operations that focuses on a wide range of public policy issues including state fiscal policy, public health and national economic issues.

So now that you know a little more about Pew, I commend the Joint Revenue Committee's commitment to addressing Wyoming's fiscal challenges; I also wish to commend your interest in pursuing an evidence-based approach to the question of how much your state should save to offset your unusually high level of budgetary risk. As you know from experience, wildly unpredictable swings in revenue can undermine your efforts to accomplish budgetary goals, regardless of whether those goals are reducing taxes, paying down debt, investing in infrastructure, or funding education.

I would like to thank Chairman Madden and Chairman Peterson for inviting our team to execute an analysis intended to inform the debate here in Wyoming about how much you should save in reserves. Our State Budget Policy team works extensively on state rainy day fund policy, and in the course of our research we learned about a leading methodology for determining the optimal amount of state savings developed by economists in the State of Minnesota. By law, this analysis is performed annually, and its results dictate Minnesota's biennial reserve fund savings target. Over the last four months, we have consulted with the individuals who pioneered this approach – Matthew Schoeppner, staff economist with Minnesota Management and Budget, and Dr. Thomas Stinson, former Minnesota state economist, of the University of Minnesota – to replicate their approach for the State of Wyoming. We are also fortunate to have worked closely with Mr. Don Richards of the Wyoming Legislative Services Office, who has been instrumental in helping us understand your revenue portfolio, which is significantly different than Minnesota's. On behalf of our entire project team at Pew, I would like to acknowledge Mr. Richards for his numerous and valuable contributions to this effort.

One of the most important questions raised by the technical assistance we have done for Wyoming is the question of just how much budgetary risk you wish to offset with reserve funds, the largest of which is your Legislative Stabilization Reserve Account, or LSRA.

Not only does your state have some of the most volatile revenues in the country, you also have a history of long periods of loss or stagnation in state revenue growth, such as during the 17-year recession that ran from 1983 until 2000. While every state stands to benefit from an evidence-based budget stabilization fund policy, the significance of these savings, and the rules that govern its accumulation and its use, are particularly valuable here in Wyoming.

In our flagship analysis of state tax volatility, Pew found that Wyoming had the second most volatile revenues in the country, second only to Alaska. Our study, which adjusts the year-over-year trend in state tax collections to control for the impact of known changes to tax policy, found that between 1995 and 2014, Wyoming's tax policy-adjusted revenues fluctuated on average by 11.9 percentage points above or below the state's long-term growth trend of 6.4 percent.

We offer this finding as a comparative starting point for the more intensive analysis we have done to address the question of how much Wyoming should save. While our 50-state study of tax volatility provides a view of how tax collections have behaved in states over a 19-year period, it is not sufficient, in our view, to use that analysis to determine how much money a state would need in reserves to guard against the possibility of recession-driven declines in revenue collections.

My colleague Jon Moody has led our team's work to adapt the methodology developed in Minnesota to recommend an ideal, evidence-based savings target the State of Wyoming. While Dr. Moody will present the findings of this analysis in depth, I would like to raise three non-technical policy considerations that are key to your role in deciding what savings goal is best for Wyoming.

First, the Minnesota methodology we have adapted here requires that you, as legislators, decide what level of coverage you wish to provide for the state to offset the impact of a revenue downturn through savings. This choice is similar to deciding what level of insurance coverage you wish to hold, with higher levels of protection requiring a higher premium, and vice versa. When Minnesota adopted this policy, they chose a 90 percent risk tolerance, which can be understood as protection from 9-out-of-10 possible revenue downturns, given their state's experience over the last 50 years.

Second, our forthcoming 50-state report on the question of how much states should save outlines how important it is for states to establish a clear, explicit purpose for saving, and to define that purpose as narrowly as possible. From an analyst's perspective, clarity around the objective of the fund – the reason states save, rather than spend – is critical to answering the question "how much do we need?" We argue that states should provide explicit statements of purpose for their funds in statute, and also define their funds narrowly enough to provide a clear scope for analysis. Examples of states that are leading the way in this regard include Connecticut—which just this year clarified that its reserve fund is explicitly dedicated to addressing fiscal imbalances due to economic fluctuations—as well as

Hawaii—which tasks its fund with maintaining essential programmatic spending levels, providing for countercyclical economic and employment programs during downturns, and covering emergency and natural disaster relief efforts.

In contrast, Wyoming currently lacks any statutory or constitutional purpose for the largest of its reserve funds, the LSRA. Perhaps consensus exists on the use of the fund, and perhaps not, but in any event, such consensus is invaluable to the question of how much you ideally should save. The chairs of the Joint Revenue Committee have requested that our team consider a ten-year horizon in this analysis, given Wyoming's past experiences with recession and energy prices in particular. With that in mind, I would urge the members of the committee to consider the question of purpose for the LSRA, since a savings account intended to smooth over a state's particular experience of recessions may be fundamentally different in focus than a savings account intended to ease the revenue shifts resulting from permanent changes to a state's economic landscape.

Third, it is valuable to provide clarity around the conditions under which reserve fund balances are available for withdrawal. In other words, rainy day funds benefit from a clear definition of what constitutes rain. For example, in Minnesota the budget reserve may be used when two conditions are met: first, when the executive and legislative branches anticipate a budget shortfall, and second, when objective measures, such as reduced growth in total wages, retail sales, or employment, suggest a downturn in the state's economy. Currently, Wyoming does not present in law clear conditions for when funds can be withdrawn. Absent this guidance, funds could be withdrawn at the wrong time, or might not be withdrawn when it might be most prudent to do so. For this reason, I urge you to engage in a policy conversation about the specific circumstances under which reserves can be used. In Pew's conversations with all three major credit rating agencies, analysts note that states that set appropriate rules for their rainy day funds into law, and which consistently follow those rules, are perceived more positively when ratings and outlooks are issued.

A conversation about when to withdraw funds is closely related to the question of the fund's intended purpose, and that there is little benefit to approaching these two issues as though they were freestanding, as they are in fact closely intertwined.

Once again, let me thank the chairs, the members of the committee, and Mr. Richards for allowing us the opportunity to be a part of this conversation. Dr. Moody, myself, and our team back in Washington, DC remain at your service, and we are happy to continue working with you to help negotiate the questions you may have about rainy day funds today and in the future.

This concludes my remarks. Dr. Moody will now walk through how we did this analysis and present the findings of our technical report, after which he and I are happy to address any and all questions you may have. Thank you.