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**Testimony in Support of
House Bill 7
“An Act to Strengthen the Savings Reserve”**

**North Carolina Standing Committee on Appropriations
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Senior Chairman Dollar, Chairmen, Vice-Chairmen, and members of the Committee:

Over the past four years, The Pew Charitable Trusts has extensively researched the policies that govern budget stabilization funds, commonly referred to as “rainy day funds.” Through an evidence-based assessment of all 50 states, Pew has determined the best policies for saving, withdrawing, and determining the optimal size of such funds. Upon review, Pew supports House Bill 7, “An Act to Strengthen the Savings Reserves,” because it contains four best practices that will not only improve the Savings Reserve Account, but also make North Carolina a national leader in managing volatility and reserve fund policy.

1. Creates a savings deposit rule tied to revenue growth;
2. Defines clear and objective conditions for fund use;
3. Establishes an evidence-based fund savings target;
4. Provides a mechanism to re-evaluate the rules governing the fund.

Creates a savings deposit rule tied to revenue growth

First, by setting aside 15 percent of year-over-year revenue growth, North Carolina would join 15 states that tie their rainy day fund deposits directly to revenue or economic volatility. As highlighted in Pew’s report “Building State Rainy Day Funds,” the proposed deposit rule closely follows one found in Tennessee, where savings has become a straightforward, predictable practice, rather than a yearly debate. There are two key benefits for states that choose to save based on revenue or economic growth:

- 1) It allows the state to proactively save as a part of the budget process. Currently, North Carolina statute directs a portion of the year-end general fund surplus to the Savings

Reserve Account. While this is a common method of saving by states, it can make saving a low priority, as often other budgetary concerns are addressed before saving is considered. By depositing 15 percent of revenue growth, North Carolina would create a rule that makes savings a higher priority.

- 2) By tying savings directly to revenue growth, it ensures the state is saving the most in good times. State revenues go through periods of above-normal growth as a result of the business cycle. The proposed rule would generate the largest deposits when revenue growth is the most above-normal, thereby preventing unsustainable revenue growth from being used to fund recurring expenditures. This is not only the most effective way to save, but will also help keep the state's budget structurally balanced.

Clearly clear and objective conditions for fund use

Second, the bill greatly improves the state's withdrawal provisions. Currently, North Carolina is one of only six states without clear conditions for fund use. The proposed legislation establishes clear conditions for use and includes the ability to cover a decline in general fund revenue from one year to the next. This is consistent with a Pew-identified best practice to link withdrawals to objective measures tied to revenue volatility. These types of conditions ensure reserves are only used in times of revenue or economic distress.

Establishes an evidence-based fund savings target

Third, fewer than five states are using evidence – like revenue volatility and forecast error – to determine how much they should save to meet their fund goals. By recommending that the Office of State Budget and Management and the Fiscal Research Division of the General Assembly perform a risk-based analysis using a similar technique found in Minnesota, the state would become an exemplar state at setting the appropriate maximum size for the rainy day fund.

Provides a mechanism to re-evaluate the rules governing the fund

Finally, the legislation prudently calls for a review of the changes to the Savings Reserve Account after two years. This can help ensure the policy changes are achieving the intended purpose of the General Assembly and provide an opportunity for adjustments if needed.

With a vote in favor of House Bill 7, “An Act to Strengthen the Savings Reserve,” Pew believes the House Committee on Appropriations would take a significant step to improve the state's ability to weather times of economic uncertainty in the future. Additionally, the recommendations would make North Carolina a leader at managing revenue volatility and an example for other states to follow.