State budget surpluses and strategies to improve long-term fiscal stability

CSG Midwest Annual Meeting, July 2023

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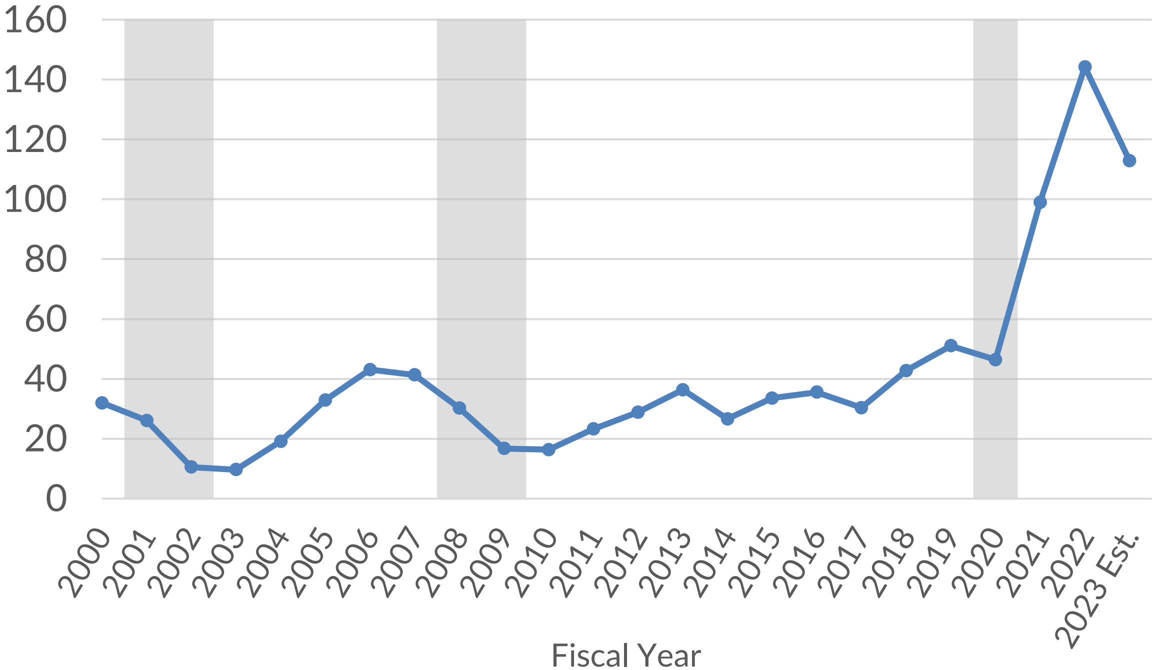
Big Picture: State Fiscal Conditions are Strong *Today*

Days' Worth of General Fund Spending in Total Balances

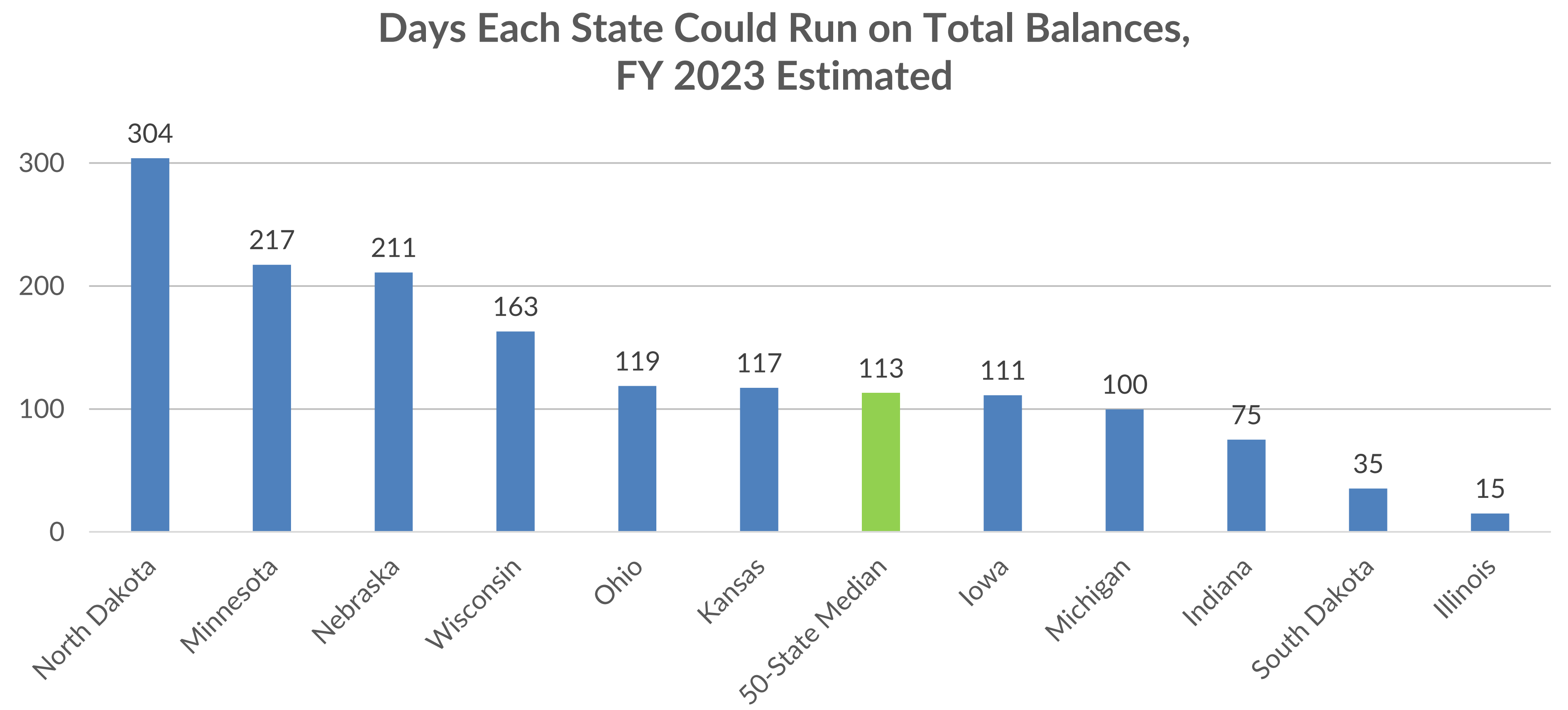


Source: Pew analysis of data from the National Association of State Budget

Key question: Is my state's surplus driven by temporary or structural factors?

- **Budget surpluses abound**
- **Higher-than-forecasted tax revenue**
- **Historic federal pandemic aid available**
- **Reserves at all-time highs**

The Midwest



Source: Pew analysis of data from the National Association of State Budget Officers

Temporary factors are driving state budget surpluses

Higher-than-expected tax revenue

- Federal pandemic aid to individuals and businesses
- Temporary, pandemic-driven shift in consumer spending patterns

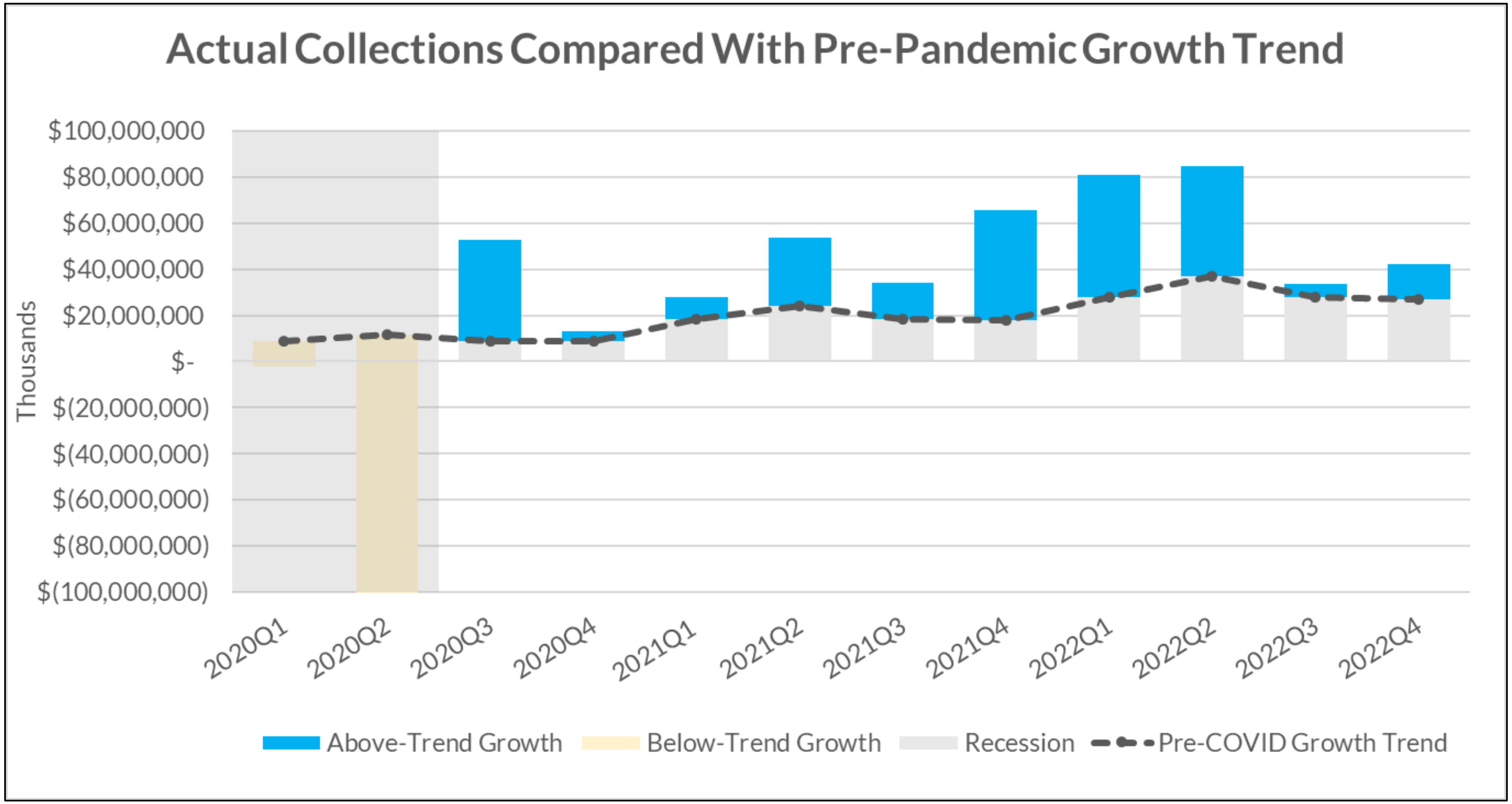
Federal pandemic aid to state governments

- More than $800 billion to states
- Examples: Added Medicaid dollars, flexible ARPA funds

Conservative budgeting

- High level of fiscal and economic uncertainties spurred cautious forecasts

Above-trend state tax revenue estimated at $160 billion



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Analytical tools

Budget stress tests: Estimate the size of budget shortfalls that would result from recessions or other economic events and assess whether your state is prepared for these events.

Long-term budget assessments: Project revenue and spending several years into the future and, in doing so, show whether your state faces structural budget deficits and, if so, why.

Strategies to shore up your state's long-term fiscal stability

1) Bolster rainy day funds

2) Shore up disaster accounts

3) Pay down pension obligations

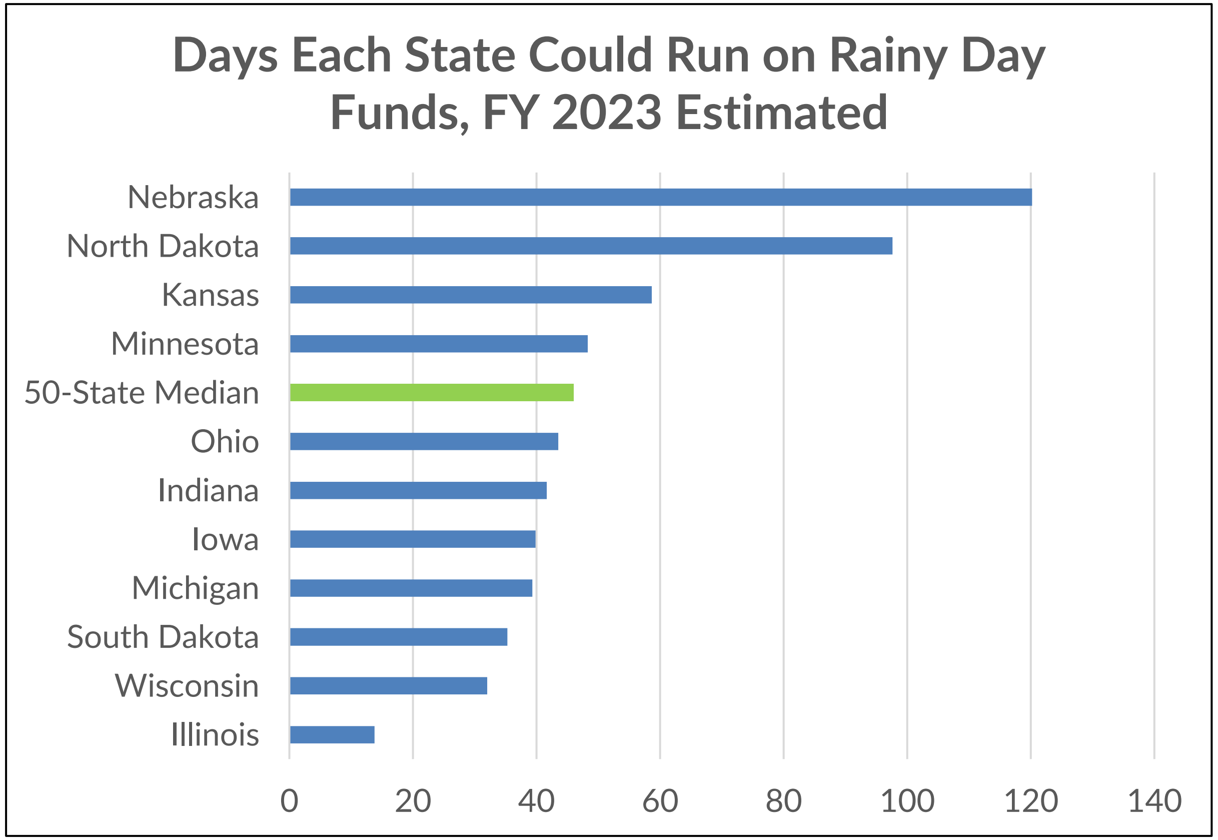
4) Invest in infrastructure

Bolster rainy day funds

Balances are at all-time highs nationally and in most states.

- **By the close of fiscal 2023, combined state savings reached an estimated $160.2 billion – with most states reaching all-time highs.**

Still, only budget stress tests can determine whether reserve levels are enough to weather the next storm.



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Bolster rainy day funds

State examples

- **Several states are already using budget stress tests to inform their target savings amounts**
  - **Utah –** Sufficient savings for a *severe* recession
  - **Maine –** Prepared for a *moderate* recession
  - **California –** Not prepared for a recession

- **Rhode Island –** New fund created in fiscal 2024 budget

- **Tennessee -** 10% of year-over-year tax revenue growth automatically deposited annually

Shore up disaster accounts

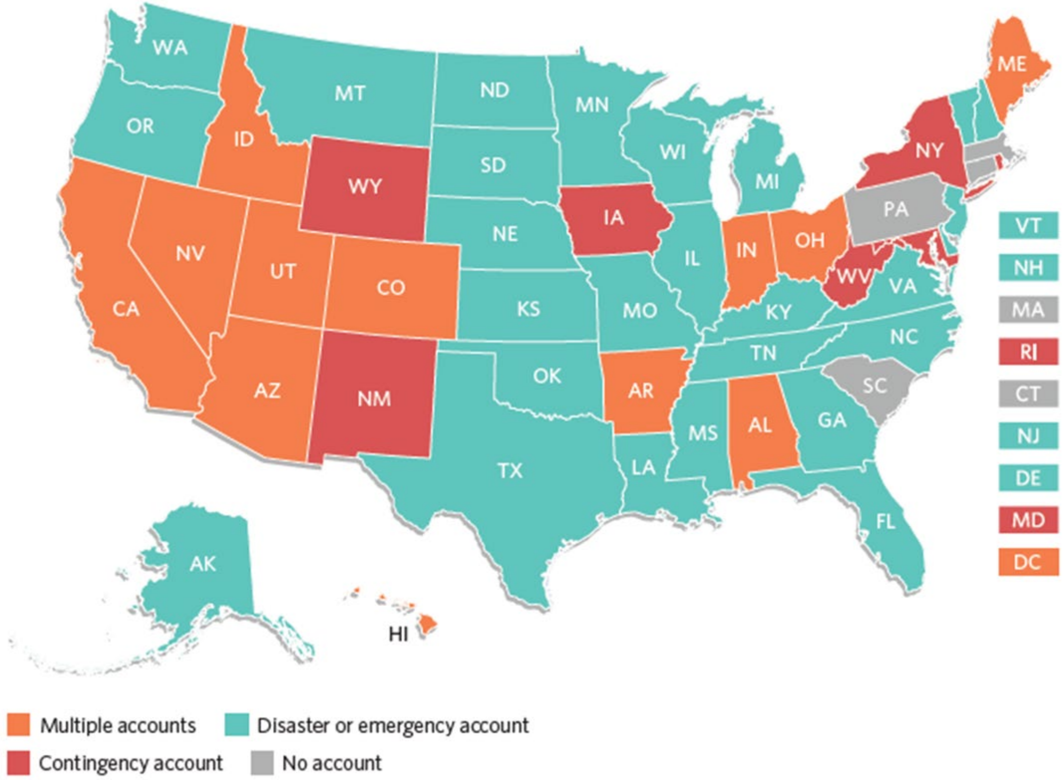
States play a key role in paying for natural disasters.

Most states have a specific disaster or emergency account.

- Funding levels vary widely

One-time investments to shore up accounts would be a wise use of current surpluses.

- Coupled with efforts to identify more consistent long-term funding sources



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Pay down pension obligations

Unfunded pension liabilities are the largest of three major long-term liabilities weighing on future finances.

- As of fiscal 2020, states owed a total of $1.4 trillion in unfunded pension benefits.

Real budget consequences now and later.

Prioritize annually required contributions and put policies in place to help manage risk and uncertainty.

State	Liability (Total Pension Liability)*	Assets (Plan Net Position)*	Pension Debt (Net Pension Liability)*	Funded Ratio, 2022
Wisconsin	$118,723,255	$124,966,394	-$6,243,139	105%
South Dakota	$12,292,995	$12,297,338	-$4,343	100%
Nebraska	$16,961,231	$15,563,170	$1,398,061	92%
Iowa	$42,068,738	$34,883,750	$7,184,987	83%
Ohio	$213,325,248	$174,236,038	$39,089,211	82%
Minnesota	$88,259,260	$71,190,792	$17,068,468	81%
50-states	$4,531,452,555	$3,147,913,946	$1,383,538,610	69%
Indiana	$44,983,169	$31,060,611	$13,922,558	69%
Kansas	$31,080,439	$20,606,874	$10,473,565	66%
Michigan	$108,229,435	$65,421,214	$42,808,221	60%
North Dakota	$10,803,194	$5,982,318	$4,820,876	55%
Illinois	$246,152,776	$92,306,663	$153,846,113	37%
**In thousands*				

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Pay down pension obligations

State examples

- **Since fiscal 2021, at least 12 states have made supplemental payments in addition to required contributions.**

- **Connecticut and Indiana –** Automatically direct a portion of excess budgetary reserves to public pension systems by law.

- **Illinois, New Jersey, and Tennessee –** Authorized supplemental payments through their regular budget processes.

- **Michigan** – Using budget surpluses to shore up local pension systems.

Invest in infrastructure

States face estimated unfunded liabilities of at least $1 trillion in deferred infrastructure maintenance.

Real budget consequences now and later.

Dedicating a portion of today's surpluses to help address the maintenance backlogs would reduce future fiscal risks.

Invest in infrastructure and maintenance

State examples

- **Idaho and Maine–** $200 million and $100 million in one-time state funds, respectively, for improvements to local roads and bridges.

- **California and New Mexico –** $2.8 billion and $128 million in one-time state funds, respectively, for water infrastructure projects.

- **Idaho and Federal Pandemic Aid**
  - One of several states to invest ARPA funds in water infrastructure.
  - Appropriated more than half of the state’s $1.1 billion to improving public water systems.

Key takeaways

Recent budget surpluses are driven largely by **temporary factors**. Using one-time revenue to fund ongoing spending **increases state fiscal risks.**

Long-term budget assessments and budget **stress tests** can help identify how today's temporary surpluses could be best used to improve *your* state's long-term fiscal stability.

In general, states should consider using today's surpluses to **bolster reserves**, **pay down pension liabilities**, and **address deferred infrastructure maintenance.**

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