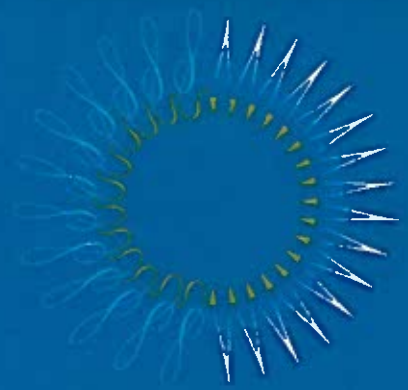

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Best Practices for Budget Stabilization Funds

House Appropriations Committee

Stephen Bailey, Associate Manager, State Fiscal Health

December 6, 2017

Research by Pew on Rainy Day Funds

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Three Pew reports to date have identified elements of sound rainy day fund design

Best practices for depositing money into rainy day funds

Defining purpose and optimal size of rainy day funds

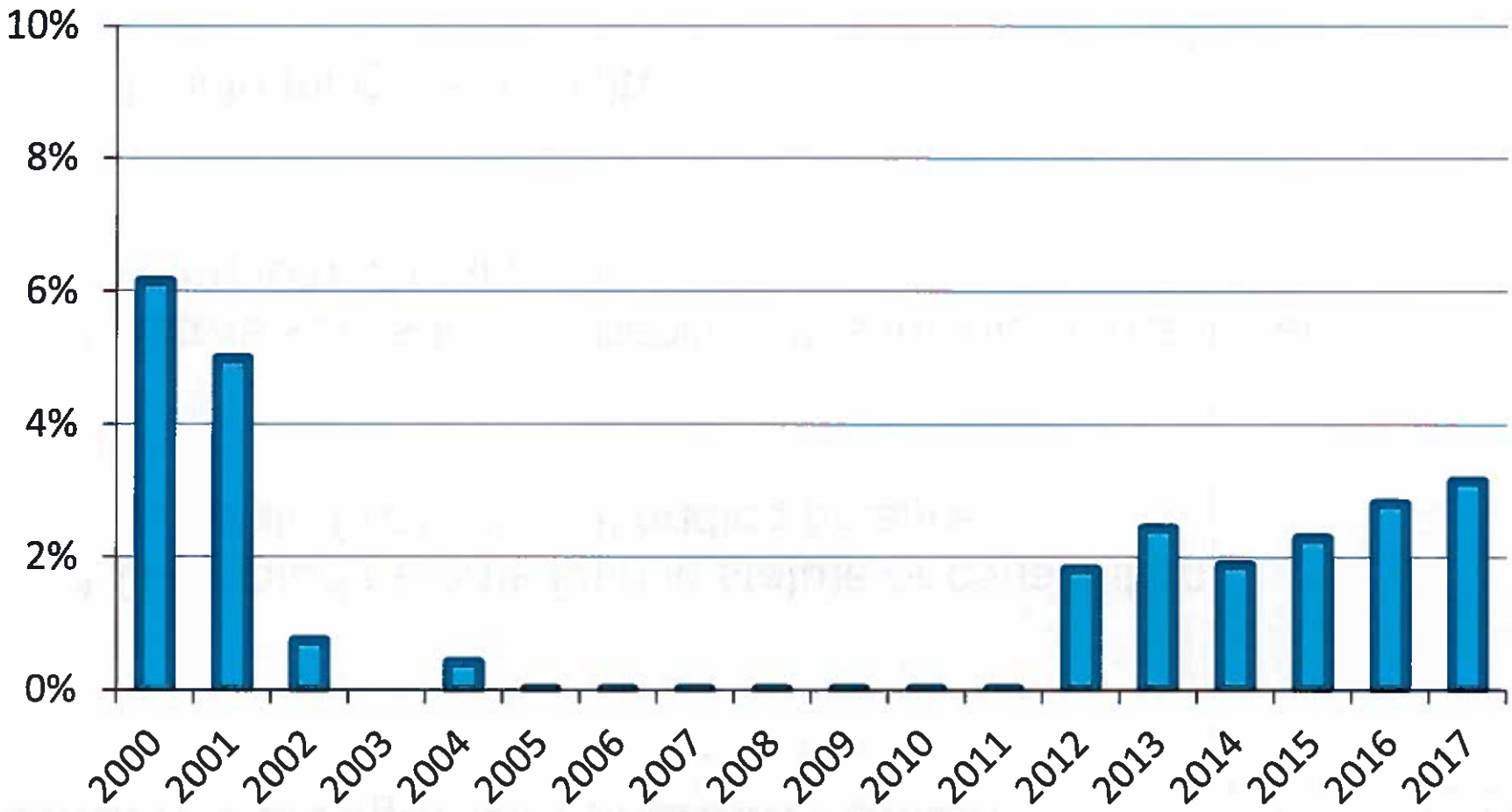
Best practices for withdrawing money from rainy day funds

What are Budget Stabilization Funds?

- Dedicated reserve fund in statute or constitution, separate from general ending balance
- Allows states to set specific rules for when to save and when to use reserves
- Tool to mitigate volatility

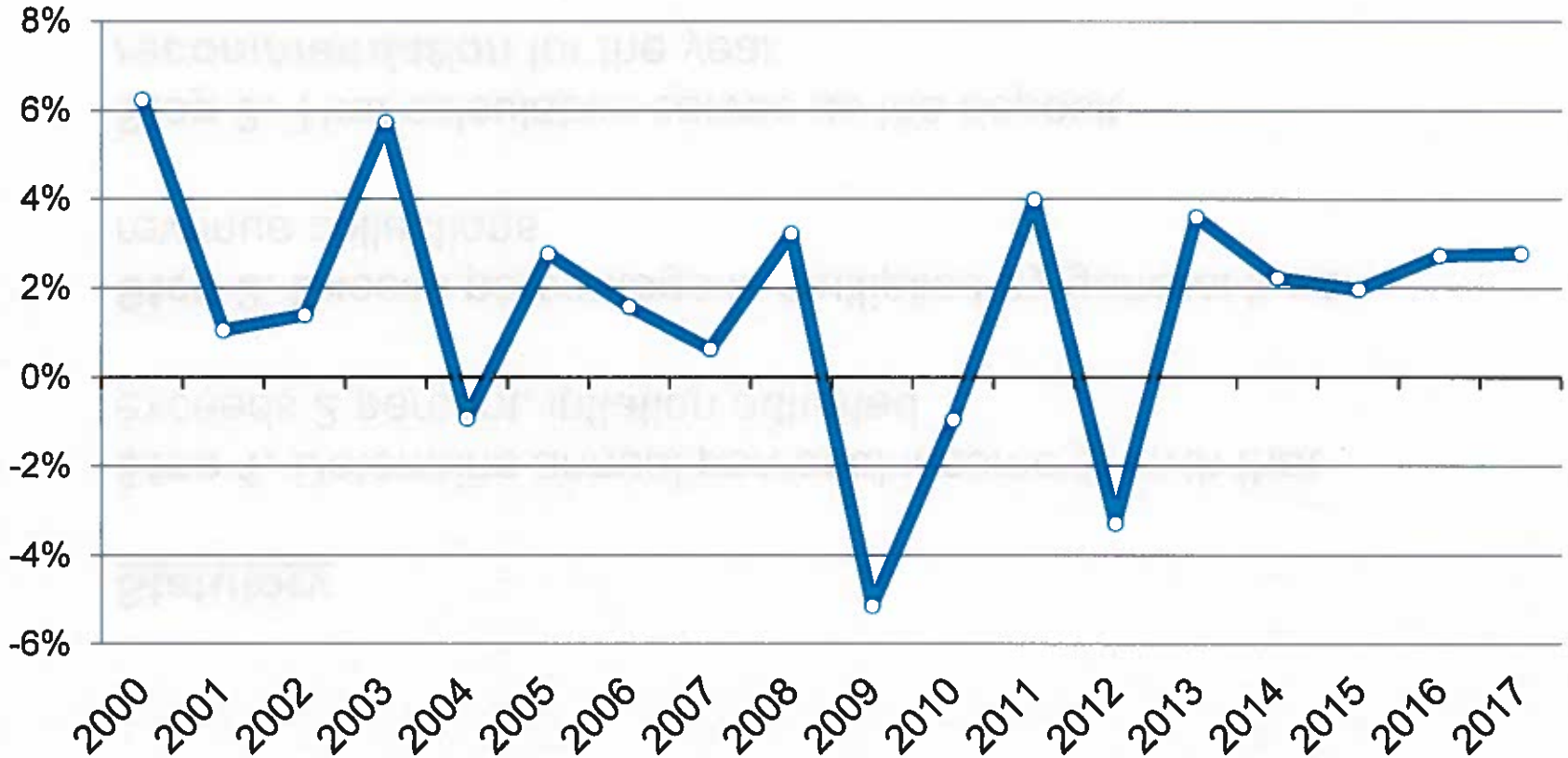
Michigan's Budget Stabilization Fund Size

Budget Stabilization Fund balance, as a percent of combined general fund and school aid fund revenues



Michigan's Combined General Fund and School Aid Fund Revenues

Annual percent change in total collections, FY2000-2017



Michigan's BSF Savings Framework

How the deposit recommendation is calculated

Statutory

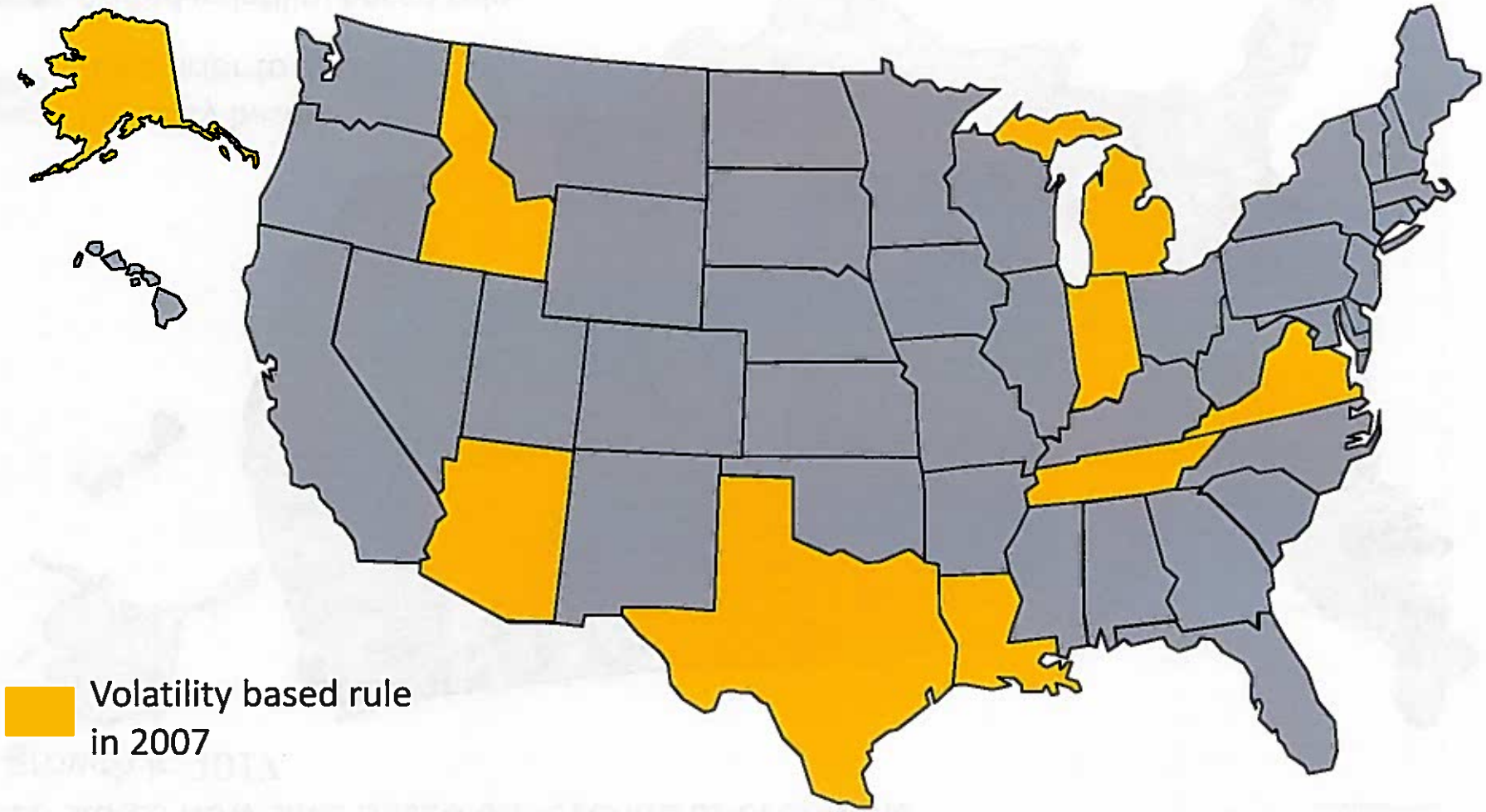
Step 1. Determine annual personal income growth that exceeds 2 percent, inflation adjusted

Step 2. Excess percentage is multiplied by general fund revenue collections

Step 3. That calculation serves as the deposit ***recommendation*** for the year

Savings Tied to Volatility

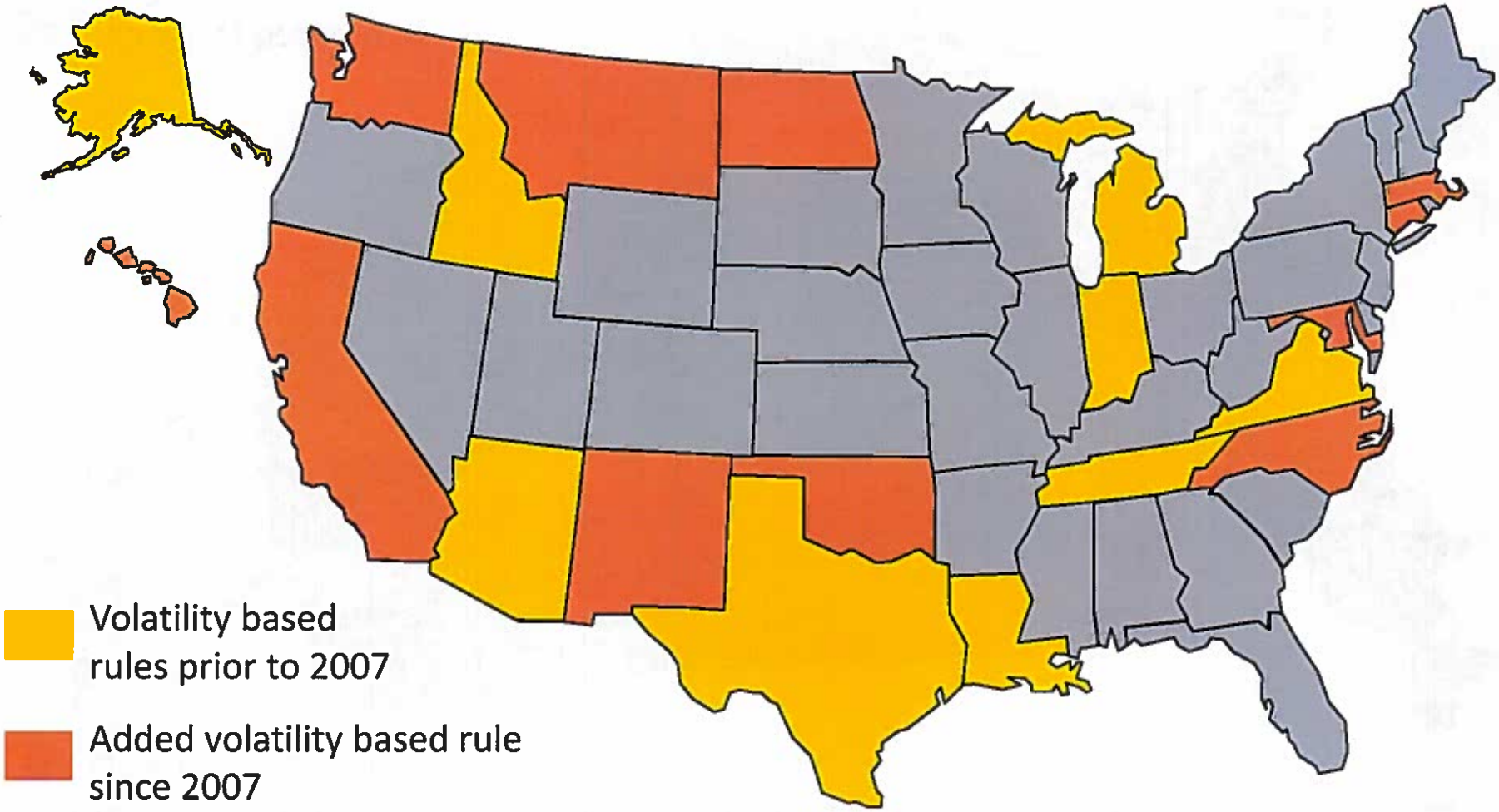
9 states saved based on revenue or economic growth prior to the Great Recession



Volatility based rule in 2007

Savings Tied to Volatility

20 states now save based on revenue or economic growth in 2017



Harnessing Volatility for Deposit Rules

Some states link deposits to volatility in overall revenues

Deposits half of general revenue that exceeds the **six-year average growth rate.**

Deposits are made if general fund revenue **grows more than 4 percent**. Deposits do not exceed 1 percent of annual revenues.

Harnessing Volatility for Deposit Rules

Some states link deposits to a single, volatile revenue stream

Maryland deposits **non-withholding income taxes** in excess of a threshold based on the previous 10-year average.

Oklahoma deposits **corporate income tax** collections that exceed the previous 5-year average contribution to the general fund.

Harnessing Volatility for Other Uses

Some states link one-time revenues to other one-time priorities

In 2015, legislators directed **above-trend general fund** revenue toward capital improvements.

Passed legislation to use some **non-withholding income tax collections** to pay down State Employee Retirement Fund's unfunded liabilities.

Items for the Committee to Consider in Regard to Deposit Rules

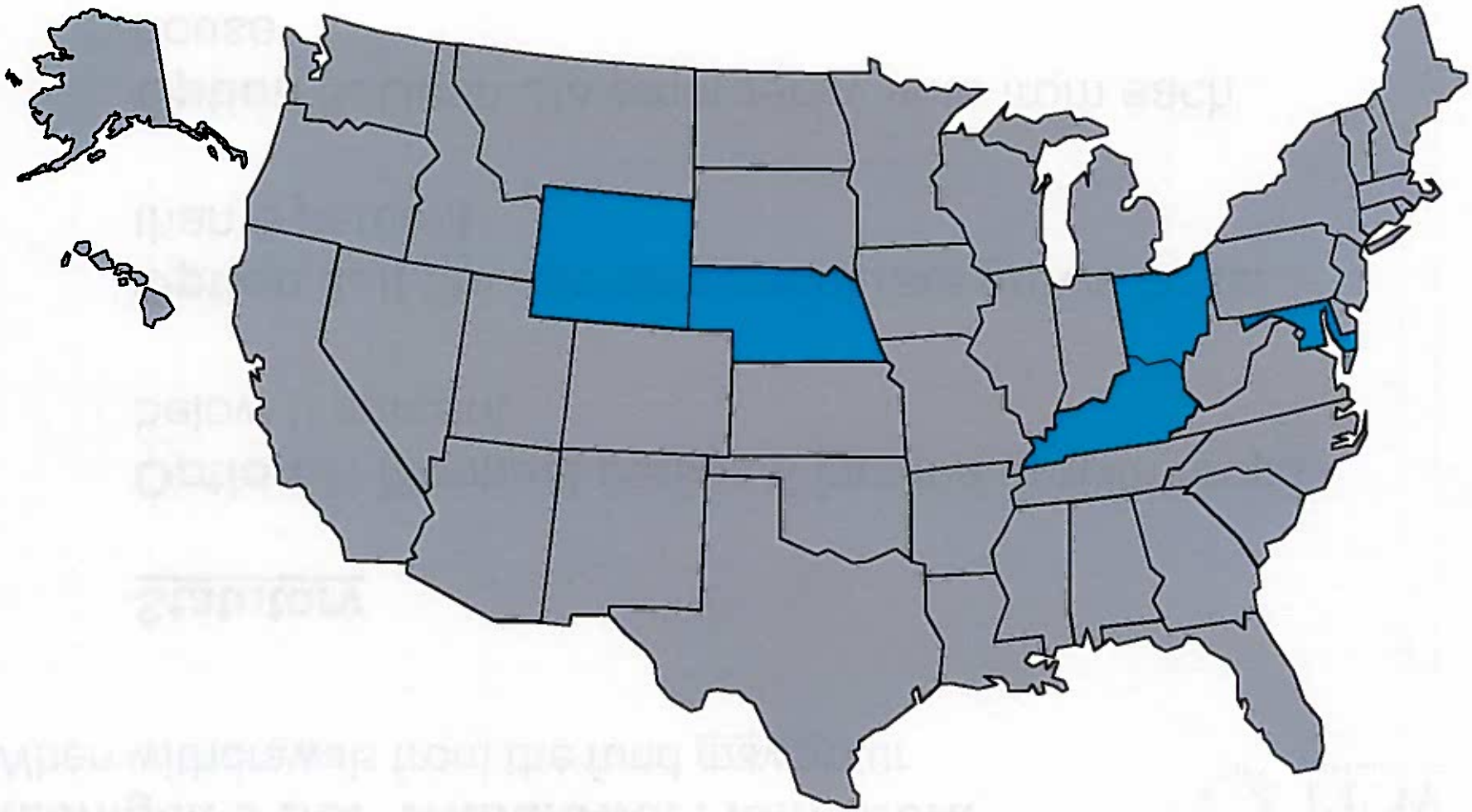
1. Reassess the current deposit rule tied to personal income growth

2. Consider if there are certain unpredictable revenue sources that should be saved when they spike

3. Consider whether "above-trend" growth may be used for other one-time priorities in addition to saving

When to Use Budget Stabilization Funds

Only 5 states do not have conditions in law for when their fund may be used



Michigan's BSF Withdrawal Framework

When withdrawals from the fund may occur

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Statutory

Option 1. If annual personal income growth drops below 0 percent

Option 2. If the unemployment rate grows larger than 8 percent

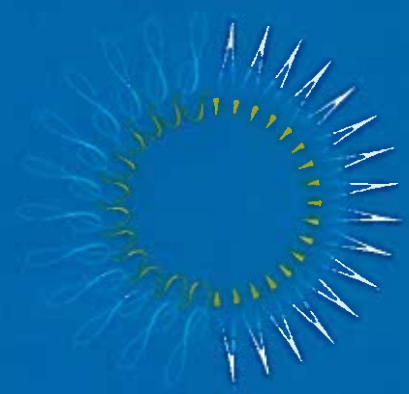
Option 3. Upon 2/3 emergency vote from each house

Items for the Committee to Consider in Regard to Withdrawal Conditions

1. Decide whether withdrawal conditions are appropriate for Michigan

2. Consider if there are other fiscal conditions that would warrant the use of the BSF (e.g. revenue forecast is missed by certain percentage, revenues decline, etc.)

3. Determine if there should be a limit on how much can be taken from the fund each year



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