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
P 202.552.2000
F 202.552.2299
pewtrusts.org

Testimony to House Committee on Appropriations
In Support of House Bill No. 2419
April 5, 2017

Chairman Waymaster and Members of the Committee:

Thank you for the opportunity to provide testimony in support of House Bill 2419. My name is Stephen Bailey, and I am a senior researcher on state budget policy issues at The Pew Charitable Trusts. Over the past four years, Pew has extensively researched the policies that govern budget stabilization funds, commonly referred to as "rainy day funds." Through an evidence-based assessment of laws in all 50 states, Pew has determined best practices for budget stabilization fund design. While Kansas does not currently have the resources to begin saving, it is important to put in place a reserve policy framework to guide future savings.

Pew supports this bill because it is consistent with the best practices found in our research. Specifically, H.B. 2419 saves above-average collections of estimated payments, which is a volatile portion of Kansas' personal income tax receipts, and establishes clear guidance for use of the budget stabilization fund.

Deposits a Volatile Revenue Source – Estimated Payments

As a best practice, states should set aside particularly volatile sources of revenue when their growth is above-average. This technique prevents unreliable revenues from funding the general budget and ensures larger reserves are available to use when revenues decline. Historically, states with a high reliance on severance tax-related activities such as Alaska, Louisiana, and Texas were the first to set aside money in this way. However, since the Great Recession, five states—most recently Maryland and Virginia—have decided to set aside the most volatile parts of their personal income taxes in a rainy day fund.

Estimated payments are the portions of the individual income tax in Kansas that, in some cases, are required on income not subject to withholding, such as earnings from interest, dividends, or capital gains. From 2006 to 2015, this tax source made up 14 percent of personal income taxes and approximately 5 percent of all tax receipts in Kansas.

Although estimated payments make up a relatively small share of total taxes, they can cause large problems in the state's budget because of their unpredictability. Saving above-average amounts of this tax source would provide Kansas with a number of long-term budget advantages:

- **Reduces volatility in the general fund:** The estimated payments portion of the individual income tax is highly volatile; for example, from fiscal year 2006 to 2008 collections increased by 34 percent, only to drop by over 32 percentage points from 2008 to 2010. This bill creates a more sustained stream of funding for the general fund and prevents unreliable, one-time spikes from funding the recurring budget.

- **Builds reserves for future downturns:** In fiscal year 2008, the three-year average of estimated payments was $391 million, yet actual receipts spiked to an all-time high of $531 million; this bill's proposed rule would have directed $130 million into the budget stabilization fund that year. In total, the bill would have generated $751 million in savings from 1995 to 2016.

- **Promotes a structural balance:** Saving higher than average revenue collections will not only mitigate the severity of revenue downturns, but also reduce the need for tax increases or program cuts, since the Budget Stabilization Fund can be used to fill in shortfalls.

- **Mitigates revenue forecast errors:** As outlined in Pew's report "Managing Volatile Tax Collections in State Revenue Forecasts," unpredictable tax sources such as capital gains are becoming increasingly difficult to forecast. This bill would help offset that issue by reducing the reliance of the general fund on unsustainable revenue spikes.

Establishes Clear Withdrawal Rules Based on Revenue Fluctuations

An advantage of a budget stabilization fund is that Kansas can set clear and objective rules for withdrawal. With this bill, Kansas state law will explicitly define what constitutes a "rainy day." When conditions are not specified or unclear, they can complicate—rather than simplify—the policy debate.

H.B. 2419 establishes clear conditions for the fund's 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.

With a vote in favor of H.B. 2419, 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. This bill will give Kansas the opportunity to set aside money when revenue conditions have recovered and help put the state on a path of structural stability across the entire business cycle.