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State reserves: The differing roles of permanent trust funds and state rainy day funds

NM Revenue Stabilization and Tax Policy Committee

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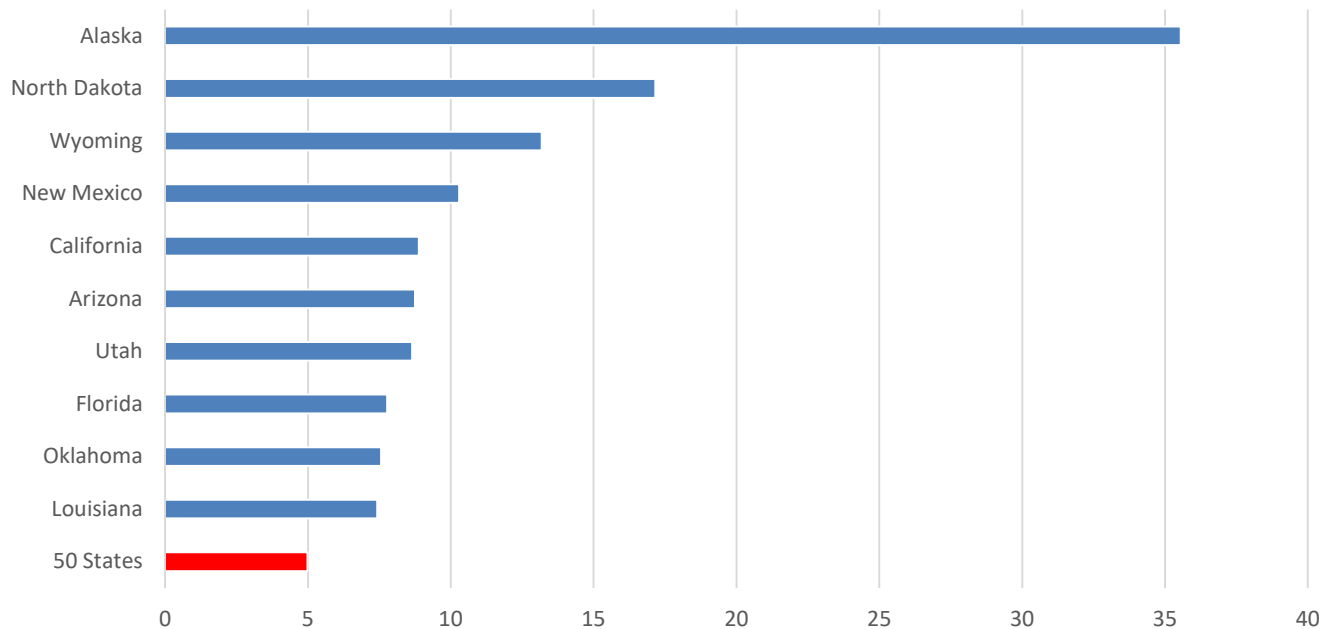
- The Pew Charitable Trusts is a non-profit, nonpartisan organization informing and improving public policy through evidence-based research
- The state fiscal policy project seeks to help states manage their finances effectively and provides them with research and best practices to inform their analyses and toolkits

What we'll cover

- General overview and best practices for rainy day funds and permanent trust funds
- Principles for managing one-time money
- How to decide how much to save

Tax revenue volatility is a key factor to consider

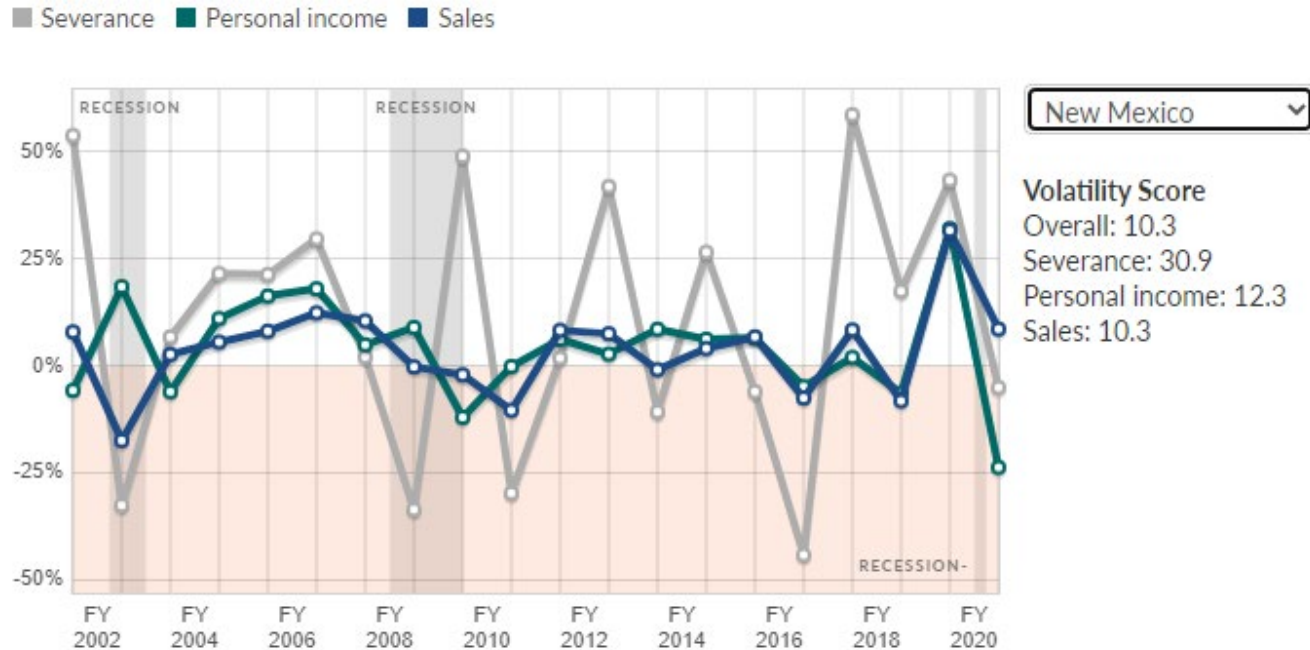
State volatility scores, FY 2001-2020



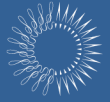
Source: The Pew Charitable Trusts, [Fiscal 50](#)

Volatility can vary over time

Year-over-year percent change of major tax revenue sources, FY 2001-2020



Source: The Pew Charitable Trusts, [Fiscal 50](#)



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Rainy day funds

Overview of rainy day funds

- Rainy day funds are sometimes referred to as Budget Stabilization Funds
- Majority of states have a formal Rainy Day Fund
- They vary widely in structure, rules, and overall balance
- Some states have multiple reserve funds or rainy day funds that serve different purposes

Source: *The Pew Charitable Trusts*, [Building State Rainy Day Funds](#)

Rainy day fund design principles

Determining optimal size

Deposit rules

Withdrawal procedures

Minimum and maximum size requirements

Source: The Pew Charitable Trusts, [Rainy Day Fund Best Practices](#)

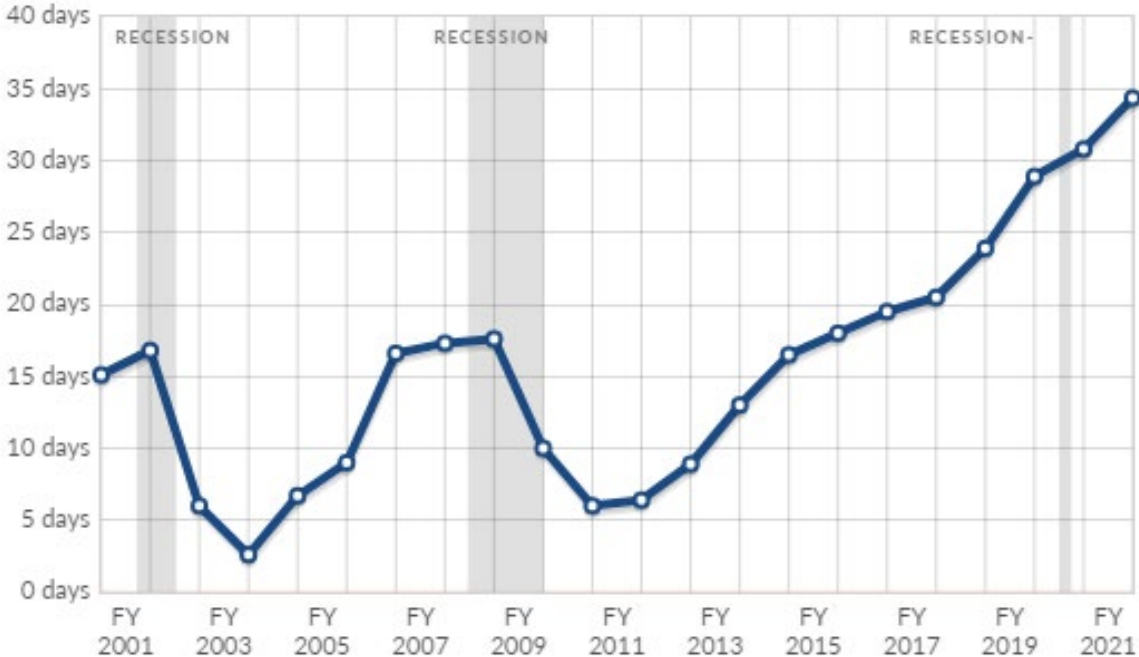
Rainy day funds and COVID-19

- Rainy day fund balances dipped in 2020, but have since increased greatly
- In FY 2020, 15 states withdrew a combined \$8.2 billion to cover shortfalls as a result of the COVID-19 pandemic
- New Mexico drew \$780 million in reserves during FY 2021

Source: The Pew Charitable Trusts, [States' Total Rainy Day Funds Fall for the First Time Since Great Recession](#)

Days each state could run on only rainy day funds, FY 2021

■ 50-state median



Source: The Pew Charitable Trusts, [Fiscal 50](#)

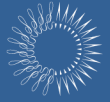
An overview of New Mexico's reserves

Tax Stabilization Reserve Fund

- New Mexico's General Fund Consensus Revenue Estimate helps inform the state's reserves
- Reserve targets of 20–25% in recent sessions

Early Childhood Trust Fund

- Established in 2020
- Relies on two surplus revenue streams



Permanent trust funds

Overview of permanent trust funds

- Permanent trust funds are income accrued from excess revenue and long term investments from finite natural resource
- This income can be volatile and overreliance on these funds can pose risks to overall structural balance
- This income can be used to achieve longer-term goals, including intergenerational savings, targeted development, and budget stabilization

Permanent trust fund design principles

Establish framework and management

Revenue source, deposit rules, withdrawal procedure

Investment guidelines

Beneficiaries

Source: *The Pew Charitable Trusts, [From Volatile Severance Taxes to Sustained Revenue](#)*

New Mexico's permanent funds

Land Grant Permanent Fund

- Land lease revenue and oil and gas royalties become enduring resources to help fund education

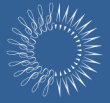
Severance Tax Permanent Fund

- Excess revenue from natural resource severance taxes

Principles for managing one-time money

Key principles for one-time money

- Using a one-time revenue source to fund ongoing commitments can lead to structural deficits
- Examples of one-time revenues include:
 - Money withdrawn from a rainy day fund
 - Federal stimulus dollars
- Volatile revenue streams and investment income, while not the same as one-time money, are unreliable sources of revenue



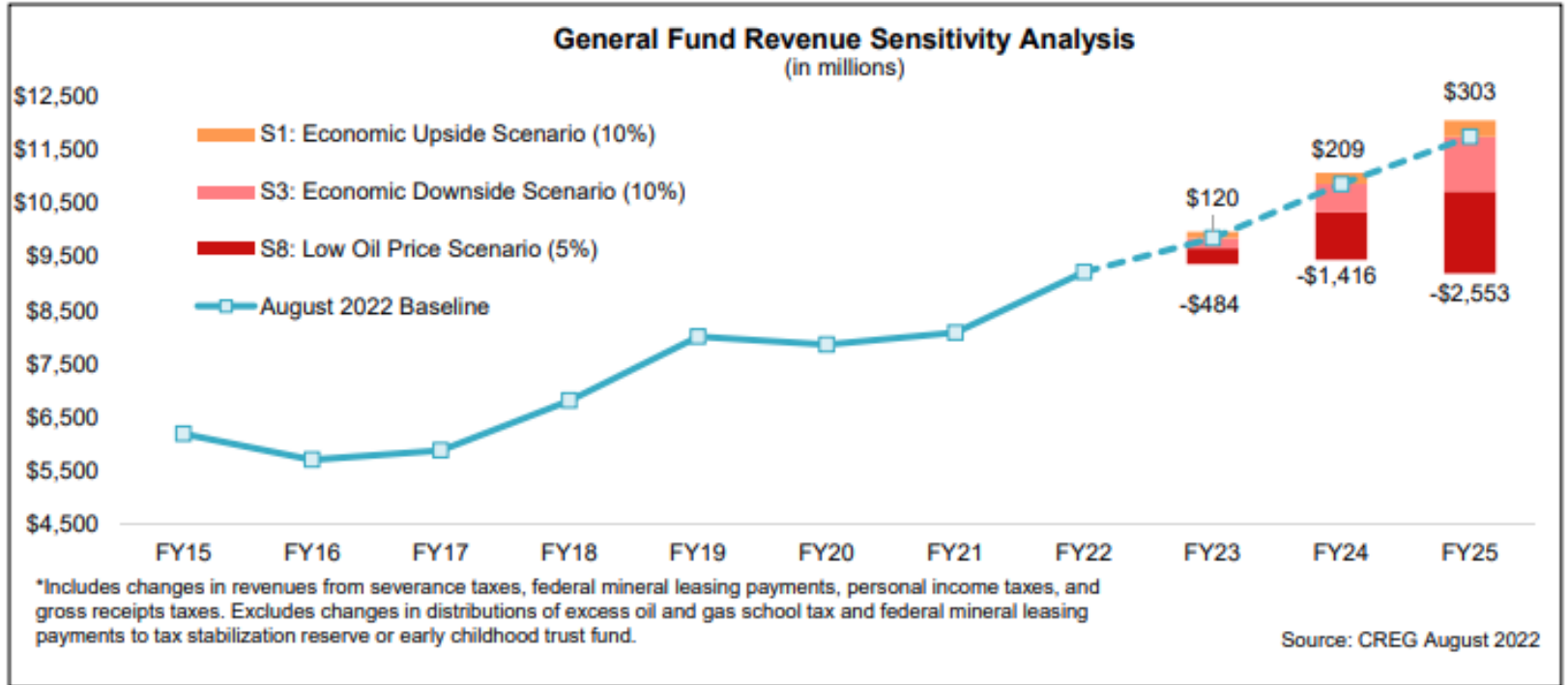
How to decide how much to save

Determining how much to save

- Determining how much to save is not a one size fits all approach
- Every state has a different economy, options, and needs that will impact savings targets
- Using a budget stress test can help a state set more targeted reserve goals

Source: The Pew Charitable Trusts, [State Budget Stress Tests Help Policymakers Set Savings Targets](#)

New Mexico's Budget Stress Test



Source: New Mexico [General Fund Consensus Revenue Estimate](#), August 2022

Questions?

For questions or information, please contact:

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<https://www.pewtrusts.org/projects/states-fiscal-health>