

SUMMARY: NASBO STATE EXPENDITURE REPORT

November 15, 2018

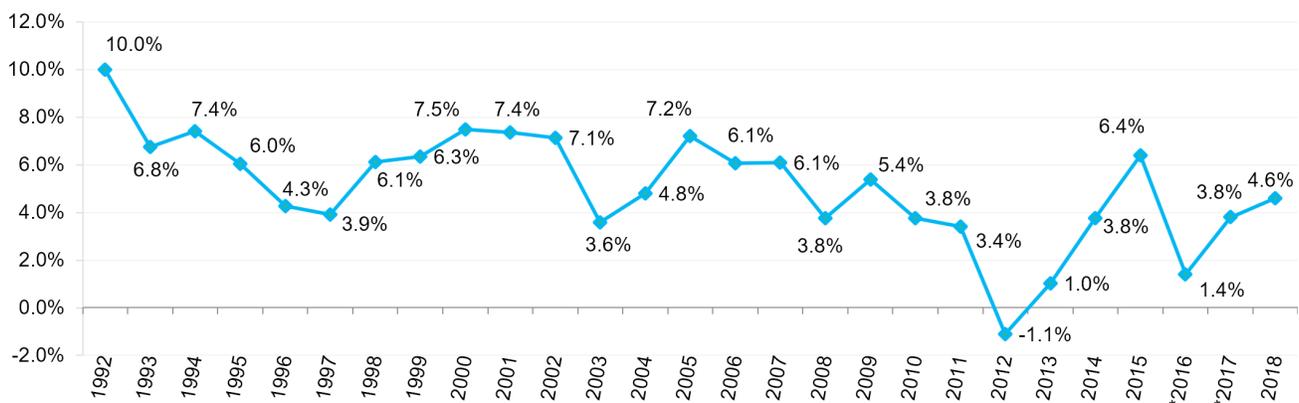
Overview: Total State Spending Rose in Fiscal 2018, Exceeding \$2 Trillion for the First Time

Total state spending from all fund sources rose in fiscal 2018 to exceed \$2.0 trillion for the first time. In fiscal 2018 it is estimated that total state spending grew 4.6 percent, compared to 3.8 percent in fiscal 2017. However, in both years spending growth was below the 32-year NASBO survey historical average of 5.6 percent (not adjusted for inflation). Total state spending growth rates are lower on a median basis, at 3.2 percent in fiscal 2018 and 3.0 percent in fiscal 2017. All eight geographic regions saw at least a slight rise in total state spending in fiscal 2018, with the strongest growth reported in the Far West and the Southeast. Additionally, all program areas experienced an increase in total state spending, with the largest percentage increase in Medicaid. Spending from states' own funds (general funds

and other state funds, excluding bonds) and federal funds rose in fiscal 2018, increasing 4.1 percent and 5.7 percent respectively. Transportation, Medicaid, and elementary and secondary education all experienced strong percentage spending growth from states' own funds in estimated fiscal 2018.

In fiscal 2017, total state spending grew by 3.8 percent in fiscal 2017. State funds increased by 4.3 percent while federal funds rose 2.9 percent. All program areas except for public assistance saw at least a small increase in spending. In addition, all eight geographic regions experienced at least modest growth in total state spending in fiscal 2017, led by the Great Lakes region. Expenditure growth in the Great Lakes region was impacted by Illinois, as spending in the state returned to more historical levels following enactment of a full-year budget after not having one in place for fiscal 2016.

YEAR-OVER-YEAR PERCENTAGE INCREASES IN TOTAL STATE EXPENDITURES**



*Excluding Illinois, which did not enact a full-year budget in FY2016, total state spending increased 2.0% in FY 2016 and 3.2% in FY 2017.

**Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states.



THE NATIONAL ASSOCIATION OF STATE BUDGET OFFICERS

444 N. CAPITOL STREET NW, STE. 642, WASHINGTON DC 20001 | (202) 624-5382 WWW.NASBO.ORG

Spending from Both Federal Funds and State Funds Increased in Fiscal 2018

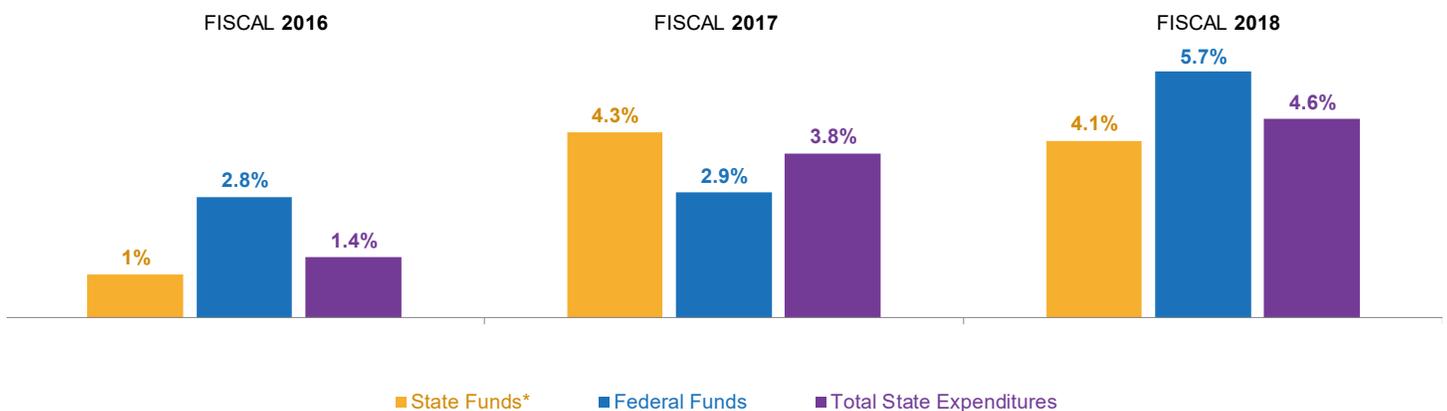
Total state spending growth has been heavily impacted by changes in the level of federal funds to states in recent years. Medicaid, an entitlement program, has become an increasingly larger share of federal dollars spent by state governments. In fiscal 2008, Medicaid made up 43 percent of the federal funds received by states, growing to 58 percent in fiscal 2018. Aside from the Medicaid program, education and transportation reflect the next largest areas of federal fund participation in state spending. State spending from federal funds, excluding Medicaid, are estimated to grow by 4.5 percent in fiscal 2018, following a 2.0 percent growth rate in fiscal 2017 and a 0.9 percent decline in fiscal 2016. The fiscal 2018 amount reflects the highest growth rate since fiscal 2005, notwithstanding the prime years of federal stimulus funding during the Great Recession. Total federal fund spending, including Medicaid, is estimated to grow by 5.7 percent in fiscal 2018 (the median growth rate is 3.3 percent), led by Medicaid at 6.6 percent and transportation at 6.3 percent. Total state spending from federal funds grew by 2.9 percent in fiscal 2017 and by 2.8 percent in fiscal 2016.

While the level of federal funding to states has fluctuated over the past several years, spending growth from states' own funding sources has been more stable as the national economy has gradually improved and states' revenues have slowly rebounded from the national recession. Spending from state funds (including general funds and other state funds, but not federal funds or bonds) increased 4.6 percent in fiscal 2011, 3.8 percent in fiscal 2012, 2.6 percent in fiscal 2013, 4.1 percent in fiscal 2014, 4.9 percent in fiscal 2015, 1.0 percent in fiscal 2016, 4.3 percent in fiscal 2017, and an estimated 4.1 percent in fiscal 2018. Removing Illinois, state funds increased 3.3 percent in fiscal 2017 and an estimated 4.2 percent in fiscal 2018.

Medicaid Continued to Increase as a Share of Total State Spending, While K-12 Remained the Largest Category from State Funds

Since the beginning of the recent economic downturn and continuing through the enactment of the Affordable Care Act, Medicaid has risen as a percentage of total state spending, growing from 20.5 percent in fiscal 2008 to an estimated 29.7 percent in fiscal 2018. Over the same

YEAR-OVER-YEAR PERCENTAGE SPENDING GROWTH
BY FUND SOURCE

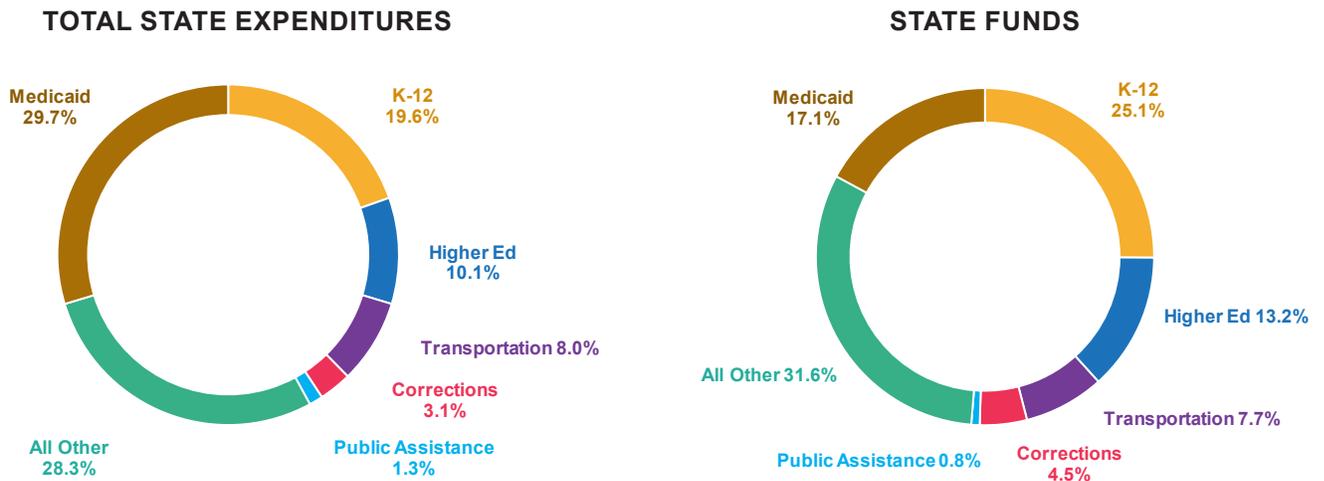


*Excluding Illinois, which did not enact a full-year budget in FY2016, state funds increased 1.9% in FY 2016 and 3.3% in FY 2017.
State funds are general funds and other state funds combined, excluding bonds. Total state expenditures are all federal and state funds.



EXPENDITURES BY FUNCTION

ESTIMATED FISCAL 2018



Total state expenditures are all federal and state funds. State funds are general funds and other state funds combined, excluding bonds.

period, elementary and secondary education has gone from representing 22.0 percent of total state spending in fiscal 2008 to an estimated 19.6 percent. The reason for elementary and secondary education representing a smaller share of total state spending is not because nominal K-12 education spending has declined; instead it is a result of its growth rate being slower than the growth in total Medicaid spending. For example, in fiscal 2018 it is estimated that total K-12 education spending grew 4.6 percent while total Medicaid spending grew 7.3 percent.

Total State Spending Increased for All Program Areas in Fiscal 2018, With Medicaid, Transportation, and K-12 Experiencing Strong Growth

In fiscal 2018, it is estimated that all seven program areas experienced at least moderate growth, ranging from the public assistance category at 0.7 percent to Medicaid at 7.3 percent. In fiscal 2017, elementary and secondary education, higher education, Medicaid, corrections, transportation, and the “all other” category all experienced growth, while public assistance declined.

Additional state expenditure details and trends include:

- When looking only at general fund spending, **elementary and secondary education** remains the largest category in fiscal 2018, representing 35.8 percent of general fund expenditures, with **Medicaid** second at 20.2 percent. Those two categories, combined with **higher education** at 9.7 percent, account for nearly two-thirds of general fund spending. Those proportionate shares of general fund spending have remained mostly steady for the last six years.
- **Elementary and secondary** total expenditures increased by 4.6 percent in estimated fiscal 2018 and by 2.8 percent in fiscal 2017. State funds for elementary and secondary education increased 3.4 percent in fiscal 2017 and 4.6 percent in fiscal 2018, while federal funds declined 0.1 percent in fiscal 2017 and increased 3.0 percent in fiscal 2018. As the national economy and state revenues grow moderately, elementary and secondary education continues to receive increased funding in state budgets. Some states are also taking targeted steps to increase teacher compensation to improve recruitment and retention, as well as in response to teacher shortages



TOTAL STATE EXPENDITURES PERCENTAGE SPENDING GROWTH BY PROGRAM AREA



*Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states

and walkouts. Other states are boosting spending levels and improving funding equity in response to court mandates. Early education is another area where states are investing greater resources.

- Total expenditures for **higher education** increased by 3.2 percent in estimated fiscal 2018 and by 3.1 percent in fiscal 2017. State funds for higher education increased by 4.1 percent in fiscal 2017 and are estimated to have increased by 3.5 percent in fiscal 2018, while federal funds declined 0.5 percent in fiscal 2017 and increased by an estimated 1.1 percent in fiscal 2018. After a series of significant reductions beginning in fiscal 2009 through 2012, which were somewhat offset by additional federal stimulus funds, the average higher education annual general fund spending growth has been 3.4 percent from fiscal 2013 to fiscal 2018. By comparison, total general fund spending on all program areas has grown by an average annual rate of 3.7 percent over the same period.
- Total **corrections** expenditures increased by 4.6 percent in estimated fiscal 2018 and by 3.9 percent in fiscal 2017 (the median growth rate was 1.6 percent in fiscal 2018 and 2.7 percent in fiscal 2017, with the higher average growth rate being largely driven by a few

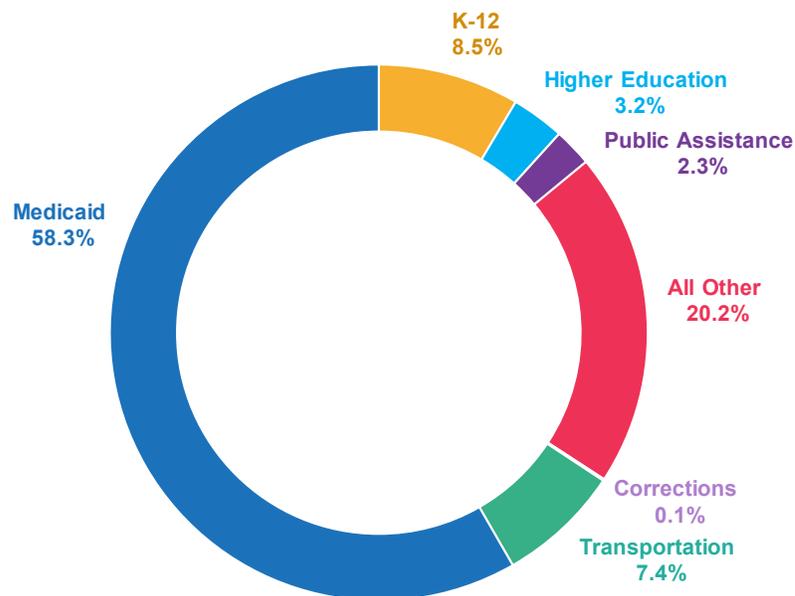
states). Federal funds comprise only about 1 percent of corrections spending in states. Corrections accounted for 3.1 percent of total state expenditures in fiscal 2018 and 6.8 percent of general funds. In recent years, state prisoner populations have slowly declined. Even as the number of prisoners continues a gradual decrease, state spending on corrections has seen annual growth. Higher state spending on corrections can be attributed to several factors including states having to increase salaries to attract applicants and retain employees, states continuing to invest in criminal justice reforms to reduce correctional populations and improve outcomes, and rising health care costs along with the aging of the prison population.

- Total **Medicaid** spending of \$603.2 billion for fiscal 2018 reflected an increase of \$41.0 billion over the \$562.2 billion spent in fiscal 2017, a 4.4 percent increase on a median basis. Spending from state funds increased by 4.8 percent and federal fund spending grew by 4.9 percent on a median basis. The timing of Medicaid expenditures may vary from year-to-year and may not reflect underlying program activity in a given year. Given large swings in some states – due in part to accounting issues – that can substantially influence



FEDERAL FUNDS EXPENDITURES BY FUNCTION

ESTIMATED FISCAL 2018



average Medicaid spending growth rates, examining the median percentage change can better reflect underlying trends. The overall spending growth rate for total Medicaid expenditures was 7.3 percent in fiscal 2018 and 4.4 percent in fiscal 2017.

- Total **public assistance** increased by 0.7 percent in estimated fiscal 2018, after declining by 2.1 percent in fiscal 2017. Public assistance represented 1.3 percent of total state expenditures in fiscal 2018, and spending in this area tends to fluctuate with caseload adjustments. Public assistance data in this report is narrowly defined as spending on the Temporary Assistance for Needy Families (TANF) program and other cash assistance programs.
- Total **transportation** spending, representing 8.0 percent of total state expenditures, increased by 6.5 percent in estimated fiscal 2018 and by 2.1 percent in fiscal 2017. In fiscal 2018, it is estimated that state fund spending rose 8.8 percent and federal funds 6.3 percent. Other state funds, which are typically earmarked revenue sources such as fuel taxes, comprised 61.2 percent of total transportation spending in estimated fiscal 2018, with federal funds at 29.1 percent, bonds at 6.4 percent,

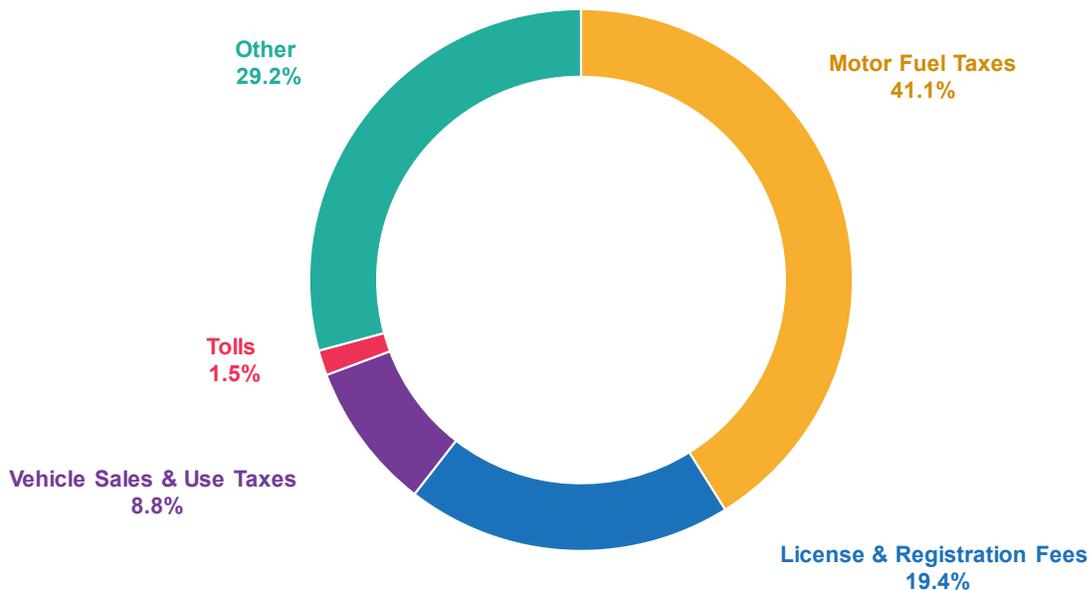
and general funds only accounting for 3.3 percent. States are concerned that in the long-term, the current structure of state and federal fuel tax revenue will not be able to meet transportation needs as most gas taxes are set at fixed rates and do not rise with inflation, and the average vehicle fuel economy continues to grow. Over the past five years, more than half of the states have taken actions to raise their fuel tax revenues. Many of the actions were the result of multi-year transportation plans and were combined with other revenue-raising actions. One of the more notable recent actions has been the institution of registration fees on electric and hybrid vehicles to ensure that all vehicles pay their fair share of the transportation system. Thirty-two states have constitutional restrictions that dedicate transportation funds for transportation purposes.

- In this year's State Expenditure Report, for the first time states were asked to detail **transportation fund revenue** sources, if their state has a transportation fund. Forty-six states reported having a separate transportation fund. Motor fuel taxes represented the largest revenue source for transportation funds at 41.1 percent, followed by license and registration fees (19.4 percent), vehicle



TRANSPORTATION FUND REVENUE SOURCES

ESTIMATED FISCAL 2018



sales and use taxes (8.8 percent), tolls (1.5 percent), and all other (29.2 percent). Transportation fund revenue sources totaled \$90.8 billion in fiscal 2016, \$96.7 billion in fiscal 2017, and \$103.6 billion in estimated fiscal 2018. Over the last two years, transportation fund revenues have grown at an average annual rate of almost 7 percent, and spending from state funds have grown accordingly.

- The “**all other**” category of state spending increased 2.2 percent in estimated fiscal 2018, with state funds (excluding bonds) rising 0.8 percent and federal funds increasing 5.4 percent. In fiscal 2017, “all other” spending rose 5.0 percent as state funds increased 4.8 percent and federal funds increased 5.9 percent. “All other” represented 28.3 percent of total state expenditures in estimated fiscal 2018 and 25.8 percent of general fund expenditures; over the last ten years, the “all other” category has declined as a share of both total spending and general fund spending. “All Other” spending in states includes the Children’s Health Insurance Program (CHIP), care for the mentally ill and developmentally disabled, public health programs,

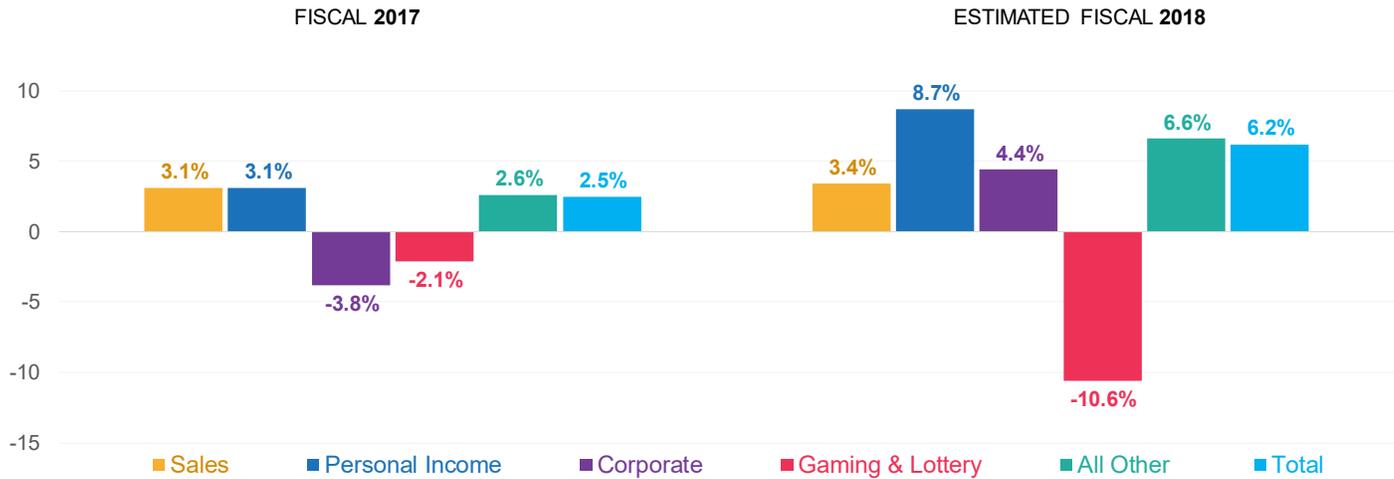
child welfare and family services, constitutional officers, the legislative and judicial branches, some employer contributions to pensions and health benefits, economic development, state police, environmental protection, parks and recreation, other natural resources programs, unemployment insurance, housing, general aid to local governments, and debt service.

- In this year’s report, states were asked to separately detail their **debt service** spending. States’ spending on debt service totaled \$48.2 billion in fiscal 2016, \$49.5 billion in fiscal 2017, and \$51.3 billion in estimated fiscal 2018. In estimated fiscal 2018, general funds represented 54.2 percent of total state spending on debt service, while other state funds comprised the remaining 45.8 percent. Some states reflect no general fund spending for debt service because they earmark certain tax revenue streams to support bond repayments and direct those resources to state funds other than the general fund. In fiscal years 2016, 2017, and 2018, debt service represented 3.8 percent of spending from state funds (general funds and other state funds combined, excluding bonds).



REVENUE GROWTH BY PERCENTAGE

STATE GENERAL FUNDS



State Revenue Collections Grew More Rapidly in Fiscal 2018

General fund revenue, the largest source of state expenditures and the most discretionary, totaled an estimated \$837.7 billion in fiscal 2018, a 6.2 percent increase over fiscal 2017, and the highest growth rate since fiscal 2011. In comparison, general fund revenues grew 2.5 percent in fiscal 2017. Most states saw stronger revenue growth in fiscal 2018 led by unusually high-income tax payments from non-withholding income sources along with continued growth in the national economy. Specifically, states saw a significant uptick in their personal income tax collections in the last eight months. States have been analyzing their revenue collections to understand the amounts that may be of a one-time nature, such as higher than normal capital gains and dividend income, or repatriated income in response to the federal tax changes. Personal income taxes accounted for 45.6 percent, sales and use taxes for 30.5 percent, and corporate income taxes for 5.6 percent of total general fund revenues in fiscal 2018. All other general fund revenue represented 17.3 percent of general fund revenues, while gaming and lottery revenue were just 0.9 percent.

In contrast to fiscal 2016, general fund revenue growth accelerated in fiscal 2015, increasing 4.8 percent. Personal income taxes experienced the largest increase in fiscal 2015

at 7.3 percent, while corporate income taxes grew 6.8 percent and sales taxes increased 5.4 percent. Gaming taxes were flat in fiscal 2015, while other taxes and fees declined 2.5 percent. The decrease in other taxes and fees was likely largely due to the decline in oil and natural gas prices impacting severance taxes, which are included within other taxes and fees.

Outlook

Looking forward, states are anticipating modest growth in state revenue collections, and continue to contend with long-term spending pressures in areas ranging from health care and pensions to adequately funding K-12 and infrastructure. While tax collections increased in fiscal 2018, states have been analyzing their revenue collections to understand the amounts that may be of a one-time nature, such as higher than normal capital gains and dividend income, or repatriated income in response to the federal tax changes. Additionally, while federal uncertainty has lessened in the short-run due to recent spending agreements, the lack of changes to Medicaid's federal/state sharing arrangement, and the enactment of tax reform, questions remain about the level of federal funds to states in 2019 and beyond. In this current environment, states are likely to continue to emphasize structural balance, long-term sustainability, and strengthening their reserve funds.



Since its inception in 1987, the State Expenditure Report has developed into a definitive baseline for the analysis of state spending. This edition of the report includes data from estimated fiscal 2018, actual fiscal 2017, and actual fiscal 2016. The report details by funding source the seven main functional categories of state spending: elementary and secondary education, higher education, public assistance, Medicaid, corrections, transportation, and “all other.” In addition, the report separately breaks out capital spending by program area, as well as contains data on general fund and transportation fund revenue collections.

If you would like additional information, please contact Brian Sigritz (bsigritz@nasbo.org or 202-624-8439).

