

SUMMARY: NASBO STATE EXPENDITURE REPORT

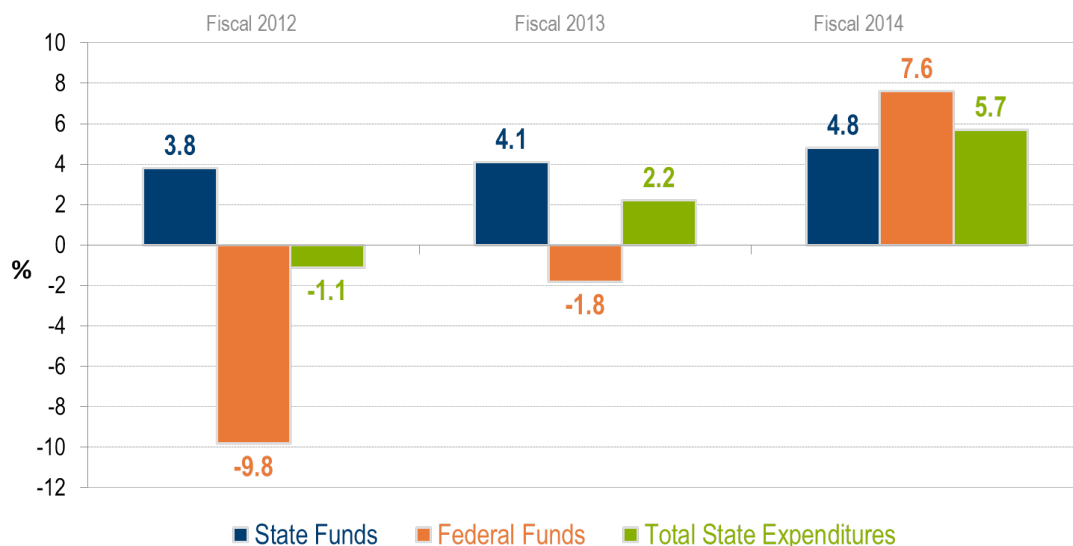
November 20, 2014

Overview: Total State Spending Accelerates in Fiscal 2014 After Returning to Positive Growth in Fiscal 2013

Total state spending has experienced several shifts since the end of the recession. Over the past three fiscal years, spending from states' own revenue sources has moderately grown each year, while total state expenditure levels (including all state and federal funds) have been more volatile due to the impact of federal funding changes. Federal funds to states have fluctuated as a result of both the Affordable Care Act and the Recovery Act. State funds (general funds and other state funds combined, excluding bonds) are estimated to have grown by 4.8 percent in fiscal 2014, 4.1 percent in fiscal 2013, and 3.8 percent in fiscal 2012. Federal funds to states, on the other hand, are estimated to have increased by 7.6 percent in fiscal 2014, declined by 1.8 percent in fiscal 2013, and decreased by 9.8 percent in fiscal 2012.

The large increase in federal funds to states in fiscal 2014 was almost solely due to additional Medicaid dollars, mainly resulting from the expansion of Medicaid in a majority of states under the Affordable Care Act. While federal Medicaid funds to states increased \$41.8 billion in fiscal 2014, all other federal funds to states are estimated to have declined \$3.4 billion. In fiscal 2012 and fiscal 2013, the declines in federal funds resulted from the wind down of spending from the Recovery Act. In fact, in fiscal 2012, the combination of a sharp decline in federal funds and a slow increase in state funds led to a 1.1 percent reduction in total state expenditures, the first and only nominal decline in total state expenditures in the 27-year history of the State Expenditure Report. In fiscal 2013, total state spending grew 2.2 percent as the moderate growth in state funds was partially offset by the continued decline in federal funds. In fiscal 2014, it is estimated that total state spending grew 5.7 percent, resulting from both modest growth in state funds and strong growth in federal funds.

Year-Over-Year Percentage Spending Growth by Fund Source



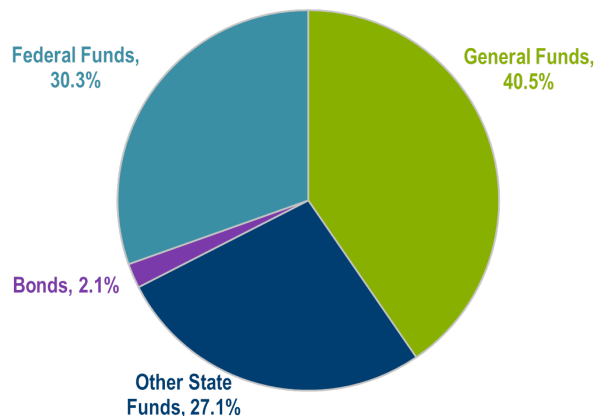
State funds are general funds and other state funds combined, excluding bonds. Total state expenditures are all federal and state funds.

Federal Funds Once Again Increasing as a Share of Total State Spending

The Recovery Act and the Affordable Care Act have also contributed to shifts in the distribution of funding sources for state expenditures. Over a two-year period from fiscal 2008 to fiscal 2010, general funds shrunk from representing 45.9 percent of total state expenditures to 38.1 percent, while federal funds rose from 26.3 percent to 34.9 percent. However, due to the expiration of Recovery Act funds, general funds started to once again make up a larger component of total state expenditures. By fiscal 2013, general funds accounted for 40.9 percent of total state expenditures and federal funds 29.8 percent. In fiscal 2014, it is estimated that federal funds will grow to 30.3 percent of total state spending, while general funds will decline slightly to 40.5 percent. The increase in federal funds in fiscal 2014 was almost solely due to additional Medicaid dollars.

Total State Expenditures by Fund Source

Estimated Fiscal 2014



Medicaid Remains Largest Category of Total Spending, while K-12 is Largest from State Only Funds

Medicaid, the largest component of total state spending, is estimated to account for a greater share of expenditures in fiscal 2014, representing 25.8 percent of total state expenditures, up from 24.5 percent in fiscal 2013. Meanwhile, elementary and secondary education declined slightly, representing 19.5

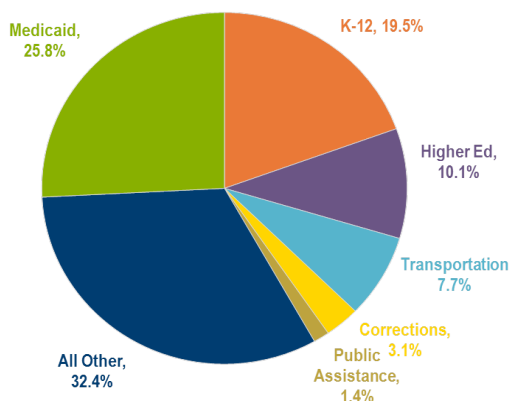
percent of total state expenditures in fiscal 2014, compared to 19.8 percent in fiscal 2013.

While Medicaid continues to represent the greatest share of total state expenditures, elementary and secondary education remains by far the largest category of spending from state funds (general funds and other state funds combined, excluding bonds). In fiscal 2014 it is estimated that K-12 will represent 24.2 percent of state funds, with Medicaid second at 15.3 percent.

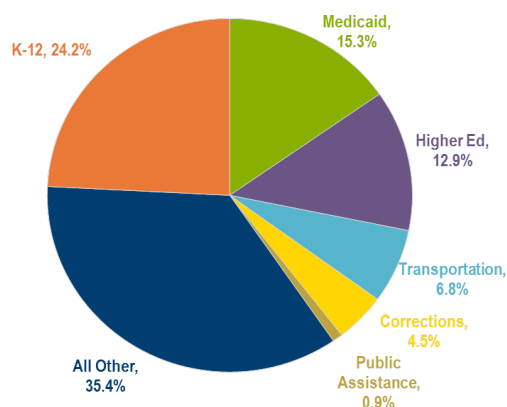
State Expenditures by Function

Estimated Fiscal 2014

Total State Expenditures



State Funds



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

Spending in Most Program Areas Has Recently Increased

Nearly all areas of total state spending grew in both fiscal 2013 and estimated fiscal 2014 with only the “all other” category slightly declining in fiscal 2013, and public assistance declining in fiscal 2014. In contrast, five of seven program areas experienced declines in total spending in fiscal 2012. Medicaid spending experienced the largest gain in fiscal 2014, rising 11.3 percent. However, most of the increase was due to additional federal funds as part of the Affordable Care Act. Federal funds for Medicaid rose 17.8 percent in estimated fiscal 2014, while states’ own funds only grew 2.7 percent.

Additional state expenditure details and trends include:

- Total state spending on **elementary and secondary education** grew 4.1 percent in estimated fiscal 2014. However, K-12 declined as a percentage of total state expenditures since its growth level was less than Medicaid’s growth.
- Total expenditures for **higher education** increased by 1.0 percent in fiscal 2013 and are estimated to have increased by 3.7 percent in fiscal 2014. Much of the recent growth in higher education comes from other state funds, which includes tuition and fees in most states, and not from general funds.

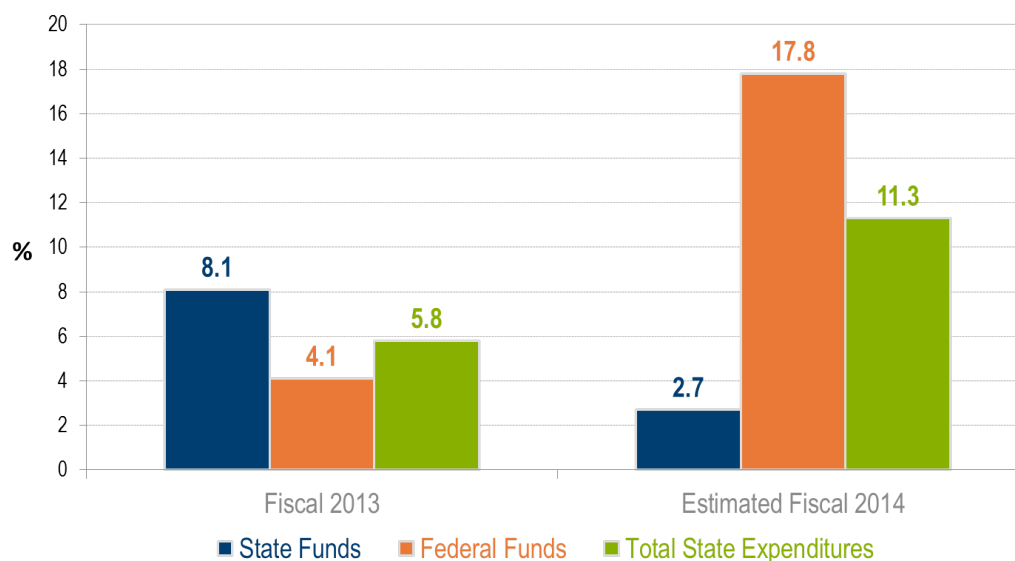
- Total **public assistance** increased 3.1 percent in fiscal 2013 but declined 1.4 percent in estimated fiscal 2014. Public assistance spending was the only area that declined in fiscal 2014.

- Total **corrections** expenditures increased by only 0.5 percent in fiscal 2013 but rose by 4.0 percent in fiscal 2014. In recent years states have attempted to control costs through a number of measures including enacting sentencing reforms, implementing changes to parole and probation systems, and enhancing community supervision and drug treatment programs.

- Total **transportation** spending rose 2.7 percent in fiscal 2013 and an estimated 4.2 percent in fiscal 2014. States and the federal government are concerned that in the long term, gas tax revenue will not be sufficient to meet transportation needs and have begun exploring other funding options.

- In total general fund **revenues** increased 7.0 percent in fiscal 2013 but only 1.4 percent in fiscal 2014. The strong growth in fiscal 2013 can be attributed to modest economic improvements, strong gains in the stock market, and to the impact of the federal “fiscal cliff,” in which many taxpayers shifted capital gains and other income to calendar year 2012 to avoid higher scheduled federal tax rates. Likewise, the slower growth in fiscal 2014 was mostly due to prior tax shifting brought on by the federal tax uncertainty.

Annual Percentage Change in Medicaid Expenditures



Outlook

Since the end of the economic downturn, total state expenditure growth levels have fluctuated largely due to the ebb and flow of federal funds to states. While state funds have moderately grown each year since 2011, federal funds to states have fallen and risen due to the wind down of Recovery Act funds and the subsequent additional Medicaid dollars provided through the Affordable Care Act. With the exception of Medicaid dollars,

federal funds to states have slowed since the passage of the Budget Control Act of 2011, which has resulted in automatic federal budget cuts known as sequestration. Looking forward, states remain concerned about both the short- and long-term outlook due to increased spending demands, recent volatility in states revenues, and uncertainty surrounding future federal fiscal policies. However, there are indications that state fiscal conditions will continue to improve along with growth in the national economy.

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 actual fiscal 2012, actual fiscal 2013, and estimated fiscal 2014. The report details the seven main functional categories of state spending: elementary and secondary education, higher education, public assistance, Medicaid, corrections, transportation, and “all other.”

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