

# SUMMARY: NASBO STATE EXPENDITURE REPORT

November 16, 2017

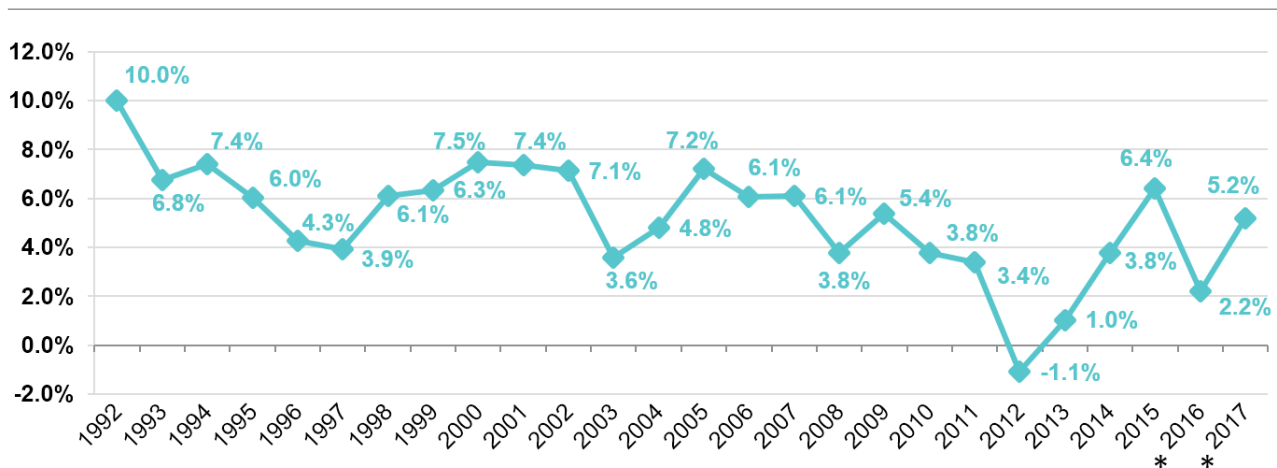
## Overview: Total State Spending Grew Moderately in Fiscal 2017, Following a Slowdown in 2016

Total estimated state spending from all fund sources in fiscal 2017 reached almost \$2.0 trillion, a 5.2 percent increase over fiscal 2016, while the median growth levels for state general fund spending was 3.0 percent. Fiscal 2017 spending totals were impacted by Illinois, as spending in the state returned to more historical levels following the enactment of a full-year budget. Excluding Illinois, total state spending growth in fiscal 2017 was 4.6 percent. All eight geographic regions saw at least a slight rise in total state spending in fiscal 2017, with the strongest growth reported in the Far West and the Southeast. Additionally, both spending from states' own funds (general funds and other state funds, excluding bonds) and federal funds rose in fiscal 2017, increasing 4.9 percent

and 5.3 percent respectively. The rise in spending from both state and federal funds was partly driven by increases in spending for the Medicaid program. Calendar year 2017 was the first time that the 31 states which expanded Medicaid under the Affordable Care Act (ACA) began to pay matching funds (5 percent in 2017) for that component of the program. Both higher education and transportation experienced strong spending growth from states' own funds in estimated fiscal 2017.

Total state spending grew by 2.2 percent in fiscal 2016. State funds increased by 1.8 percent while federal funds rose 3.8 percent. The more modest 1.8 percent increase in spending from states' own funds was largely driven by low growth in revenues. Although total state spending growth began to slow in fiscal 2016, all program areas except for public assistance and the "all other" category saw at least a small increase in spending. In addition, fiscal 2016 spending totals were

**INCREASES IN TOTAL STATE SPENDING**  
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 2.9% in FY 2016 and 4.6% in FY 2017.

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



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impacted by Illinois ending the year without a fully enacted general fund budget, which led to certain areas of the state's budget receiving less funding than historical levels. Excluding Illinois, total state spending increased 2.9 percent in fiscal 2016.

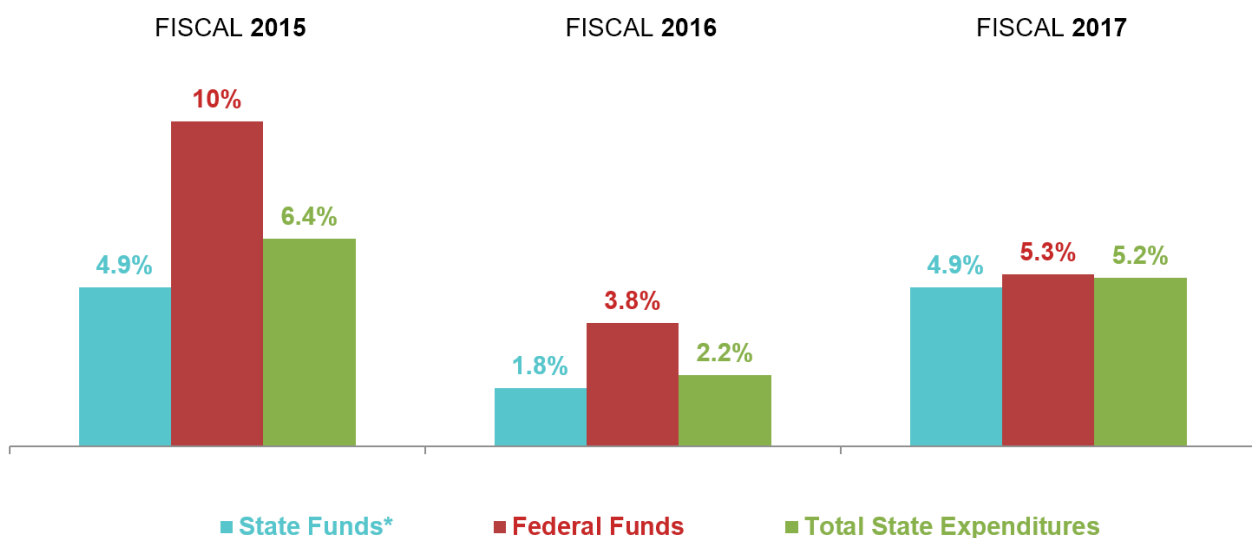
## Spending from Both Federal Funds and State Funds Increased in Fiscal 2017

The level of federal funds to states has seen numerous shifts during the most recent recession and subsequent recovery. For example, over the last five years, federal funds to states have seen a slight decline when excluding Medicaid. After growing a relatively modest 2.9 percent in fiscal 2007 and 2.4 percent in fiscal 2008, federal fund spending increased 19.3 percent in fiscal 2009 and 21.4 percent in fiscal 2010. This unusual increase in federal funds to states was due to the infusion of spending from the *American Recovery and Reinvestment Act of 2009* (ARRA), also known as the Recovery Act or stimulus. The swift wind down of ARRA funds led federal fund spending to grow only 1.0 percent in fiscal 2011, decline 9.8 percent in fiscal 2012 and decrease an additional 2.6 percent in fiscal 2013. Federal funds began to increase again in fiscal

2014, rising 3.4 percent, almost entirely related to Medicaid as some states began to receive additional Medicaid funds through the *Affordable Care Act* (ACA) in January 2014. In fiscal 2015, federal funds to states rose 10.0 percent during the first full year of the optional Medicaid expansion under the ACA. However, in fiscal 2016 federal fund spending growth began to slow, increasing only 3.8 percent, partly due to a deceleration in Medicaid enrollment growth as states entered the second full year of Medicaid expansion. In fiscal 2017, it is estimated that federal funds to states increased 5.3 percent.

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, 1.8 percent in fiscal 2016, and an estimated 4.9 percent in fiscal 2017. Removing Illinois, state funds increased 2.7 percent in fiscal 2016 and an estimated 4.1 percent in fiscal 2017.

**YEAR-OVER-YEAR PERCENTAGE SPENDING  
BY FUND SOURCE**



Excluding Illinois, which did not enact a full-year budget in FY2016, state funds increased 2.7% in FY 2016 and 4.1% in FY 2017.

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



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

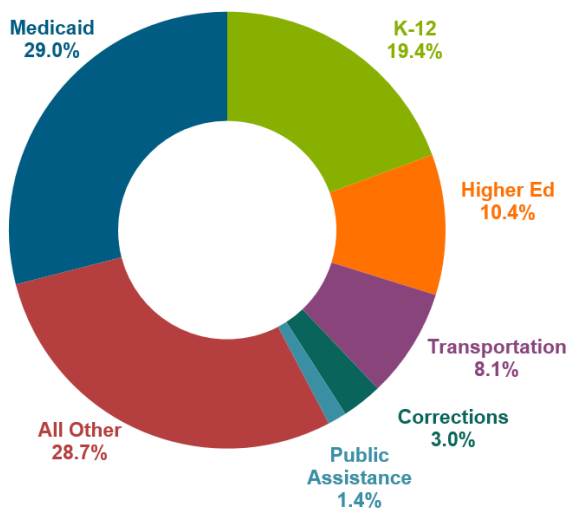
Since the beginning of the recent economic downturn and continuing through the enactment of the *Affordable Care Act*, Medicaid has risen as a percentage of total state spending, growing from 20.5 percent in fiscal 2008 to an estimated 29.0 percent in fiscal 2017. At the same time, elementary and secondary education has gone from representing 22.0 percent of total state spending in fiscal 2008 to an estimated 19.4 percent in fiscal 2017. Elementary and secondary education represents a smaller share of total state spending not because nominal K-12 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 2017 it is estimated that total elementary and secondary education spending grew 3.9 percent while total Medicaid spending grew 6.1 percent.

## Total State Spending Increased for All Program Areas in Fiscal 2017, While Transportation and Higher Education Experienced Strong Growth from State Funds

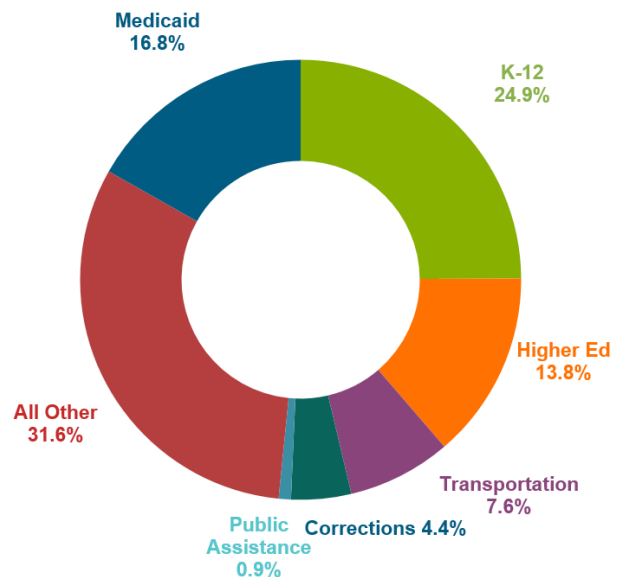
Nearly all program areas of total state spending (including all state and federal funds) and spending from just states' own funds grew in both fiscal 2016 and estimated fiscal 2017 with only the public assistance and "all other" categories declining in fiscal 2016. While Medicaid experienced the largest increases in both total state spending and states' own funds in fiscal 2016 and estimated fiscal 2017, transportation and higher education also saw strong spending growth from states' own funds in fiscal 2017. In transportation, many states have recently acted to raise revenue to meet infrastructure demands. Regarding higher education, states have been working to address issues around college affordability and access, especially as they also try to boost educational attainment and completion rates.

### EXPENDITURES BY FUNCTION ESTIMATED FISCAL 2017

TOTAL STATE EXPENDITURES



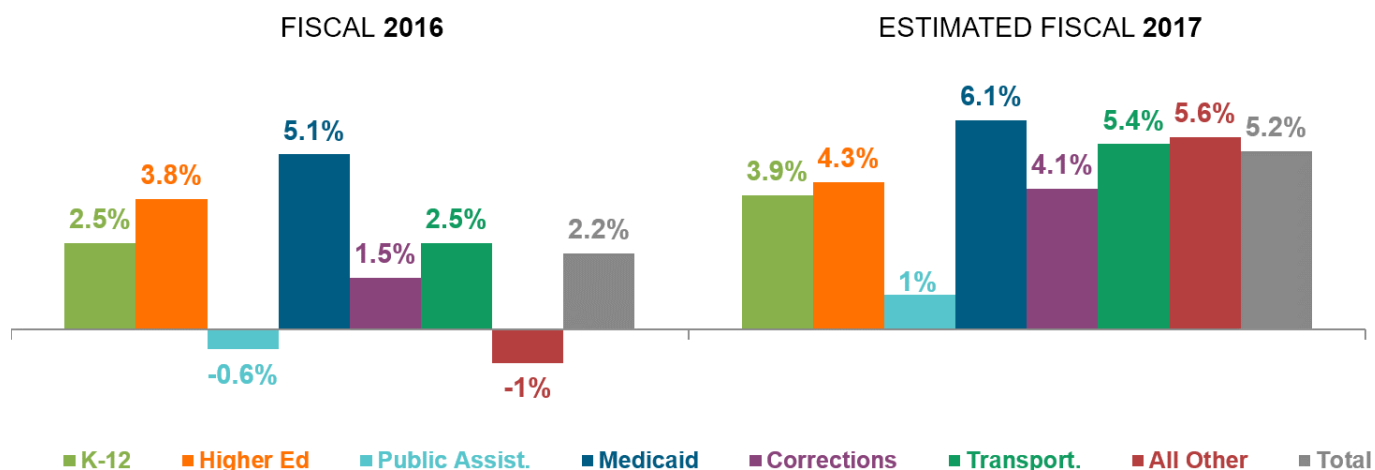
STATE FUNDS



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



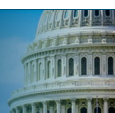
## TOTAL STATE EXPENDITURES PERCENTAGE SPENDING GROWTH BY PROGRAM AREA



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

Additional state expenditure details and trends include:

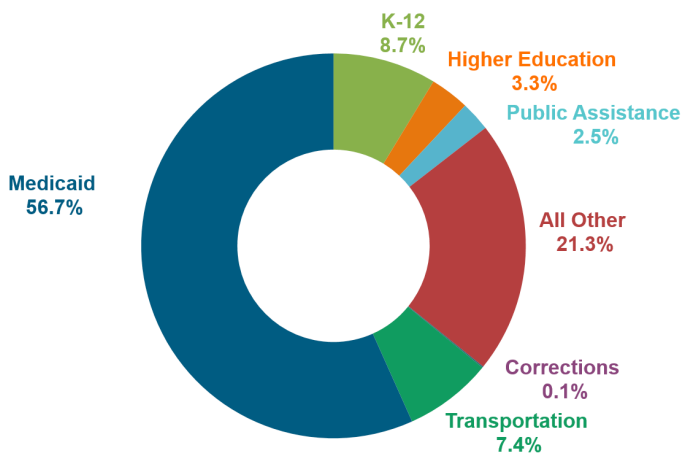
- When looking only at general fund spending, **elementary and secondary education** remains the largest category in fiscal 2017, representing 35.4 percent of general fund expenditures, with Medicaid second at 20.3 percent. Those two categories, combined with **higher education** at 9.9 percent, account for nearly two-thirds of general fund spending.
- **Elementary and secondary education** total expenditures increased by 3.9 percent in estimated fiscal 2017 and by 2.5 percent in fiscal 2016. State funds for K-12 increased 2.9 percent in fiscal 2016 and 4.0 percent in fiscal 2017, while federal funds grew 1.5 percent in fiscal 2016 and 4.3 percent in fiscal 2017. As the national economy and state revenues continue to grow modestly, states have restored prior cuts made to K-12 education due to the most recent recession. Some states are also taking targeted steps to increase teacher compensation to improve recruitment and retention, while others are working to boost spending levels and improve funding equity in response to court mandates.
- Total expenditures for **higher education** increased by 4.3 percent in estimated fiscal 2017 and by 3.8 percent in fiscal 2016. State funds for higher education increased by 4.9 percent in fiscal 2016 and are estimated to have increased by 5.2 percent in fiscal 2017, while federal funds declined 0.6 percent in fiscal 2016 and increased by an estimated 0.9 percent in fiscal 2017. Over the years, the “Other State Funds” source (which includes tuition and fees for most states) has grown as a percentage of higher education spending, comprising 50.0 percent of total state higher education expenditures in fiscal 2017.
- Total **public assistance** increased by 1.0 percent in estimated fiscal 2017 and declined by 0.6 percent in fiscal 2016. Public assistance represented 1.4 percent of total state expenditures in fiscal 2016. The public assistance chapter in this report contains data primarily on cash assistance provided through the Temporary Assistance for Needy Families (TANF) program and other cash assistance programs.
- In fiscal 2017, total estimated **Medicaid** state expenditures increased 6.1 percent, with state funds growing 7.8 percent and federal funds increasing 5.0 percent. In fiscal 2016, total Medicaid state expenditures increased 5.1 percent, with state funds growing 4.1 percent and federal funds increasing at a rate of 5.7 percent. While total Medicaid spending grew faster than all other areas



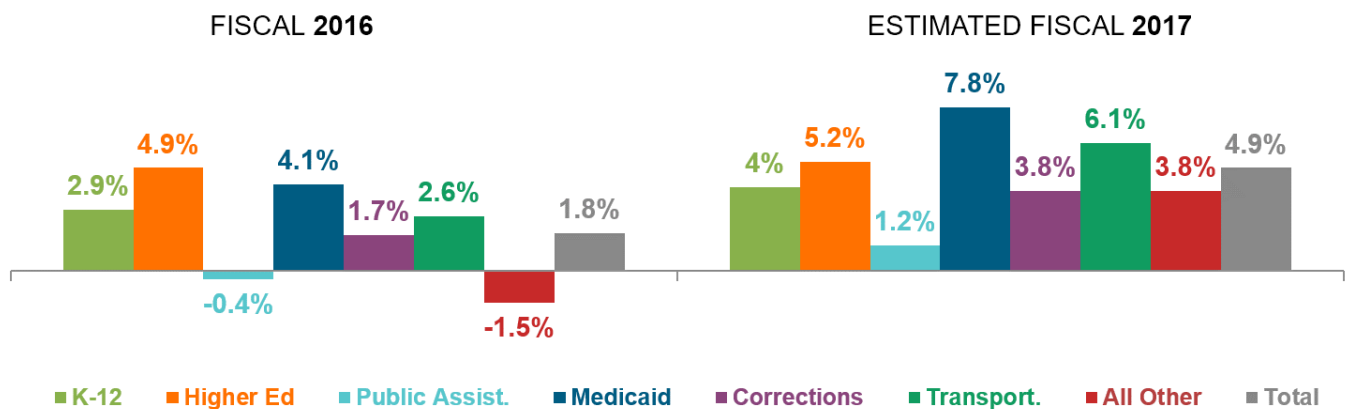
of state spending in both fiscal 2016 and estimated fiscal 2017, the growth rate slowed from fiscal 2015 following the initial implementation of the **Affordable Care Act**. In fiscal 2017, federal funds made up 61.2 percent of total Medicaid spending. Finally, it is estimated that in fiscal 2017 Medicaid represented 56.7 percent of all federal funds to states.

- Total **corrections** expenditures increased by 4.1 percent in estimated fiscal 2017 and by 1.5 percent in fiscal 2016. Federal funds comprise only about 1 percent of corrections spending in states. Corrections accounted for 3.0 percent of total state expenditures in fiscal 2017 and 6.7 percent of general funds. In recent years, states have begun efforts to control costs through reducing recidivism rates, implementing changes to parole and probation systems, enhancing community supervision, offering increased treatment to address mental health and substance abuse disorders, and enacting sentencing reforms. Some of the recent growth in corrections spending can be attributed to efforts to increase pay for correctional officers, the rising cost of inmate health care, and the maintenance of its large physical plant.
- Total **transportation** spending, representing 8.1 percent of total state expenditures, increased by 5.4 percent in estimated fiscal 2017 and by 2.5 percent in fiscal 2016. In fiscal 2017, it is estimated that all fund sources for transportation increased with state fund spending rising 6.1 percent and federal funds increasing 3.6 percent. In fiscal 2016, state funds for transportation (excluding bonds) grew 2.6 percent while federal funds rose 4.8

### FEDERAL FUNDS EXPENDITURES BY FUNCTION ESTIMATED FISCAL 2017



### STATE FUNDS PERCENTAGE SPENDING GROWTH BY PROGRAM AREA



\*State funds are general funds and other state funds combined, excluding bonds





percent; however, spending from bonds declined 6.2 percent. Other state funds, which are typically earmarked revenue sources such as fuel taxes, comprised 59.4 percent of total transportation spending in estimated fiscal 2017, with federal funds at 28.7 percent, bonds at 8.1 percent, and general funds only accounting for 3.8 percent. States have been responding to the diminishing buying power of fuel tax revenues resulting from more fuel-efficient vehicles. 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 growth in vehicle miles traveled has leveled off. Since 2013, over half the states have taken actions to raise their fuel tax revenues, including eight states in the 2017 legislative sessions. 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 contribute towards funding the transportation system.

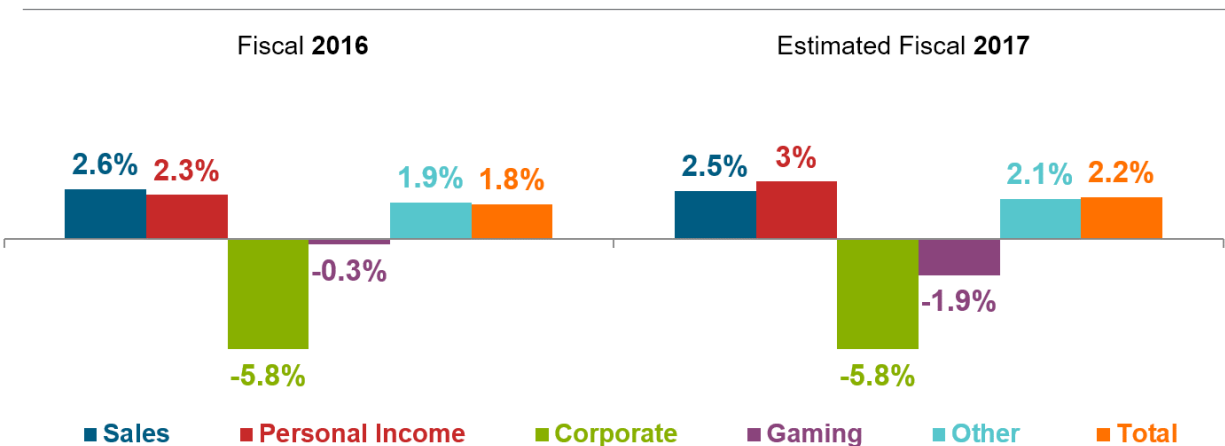
- The “**all other**” category of state spending increased 5.6 percent in estimated fiscal 2017, with state funds rising 3.8 percent and federal funds increasing 8.4 percent. In fiscal 2016, “all other” spending declined 1.0 percent as state funds (excluding bonds) declined 1.5 percent and federal funds increased 0.8 percent. “All other” represented 28.7

percent of total state expenditures and 25.8 percent of general fund expenditures in estimated fiscal 2017; over the last ten years, the “all other” category has declined as a share of both total spending and general fund spending. The “all other” category includes the Children’s Health Insurance Program (CHIP), institutional and community care for the mentally ill and developmentally disabled, public health programs, Medicaid administration, some employer contributions to pensions and health benefits, economic development, environmental projects, state police, parks and recreation, housing, and general aid to local governments.

## Similar to Fiscal 2016, State Revenue Collections Grew Slowly in Fiscal 2017

State general fund revenues continued to grow slowly, increasing by 2.2 percent in fiscal 2017, following 1.8 percent growth in fiscal 2016. In three out of the last four years, revenues have grown slowly or declined. Personal income taxes, representing about 45 percent of general fund revenues, saw a median growth rate of 2.9 percent in fiscal 2017 and 2.8 percent in fiscal 2016. The median growth rate for sales taxes, which represent about 31 percent of general fund revenues, was 2.5 percent in fiscal 2017 and 2.7 percent in fiscal 2016. Corporate income taxes declined in both fiscal 2017 and fiscal

**REVENUE GROWTH BY PERCENTAGE**  
STATE GENERAL FUNDS



2016, meaning that in six out of the last ten years median corporate tax receipts have declined. In both fiscal 2017 and fiscal 2016, many states were forced to lower their revenue projections from the ones used for their enacted budgets. The downward revisions resulted from overly optimistic economic forecasts of GDP and income, declines in the price of tangible goods, low wage growth, volatility in capital gains, weaknesses in energy states, and other factors.

## Outlook

Looking forward, state spending growth in the near future will likely remain modest as states contend with sluggish revenue collections and modest growth in the national economy. States are expected to target spending increases to certain priority areas, while also focusing on addressing long-term obligations, building up reserves, and promoting structural balance. Additionally, states are facing federal uncertainty in a number of areas including the possibility of federal tax reform, the consideration of healthcare changes, and discussions regarding various infrastructure proposals, which has the potential to impact future spending plans.

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*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 2017, actual fiscal 2016, and actual fiscal 2015. 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 revenue collections.*

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