Summary: NASBO State Expenditure Report

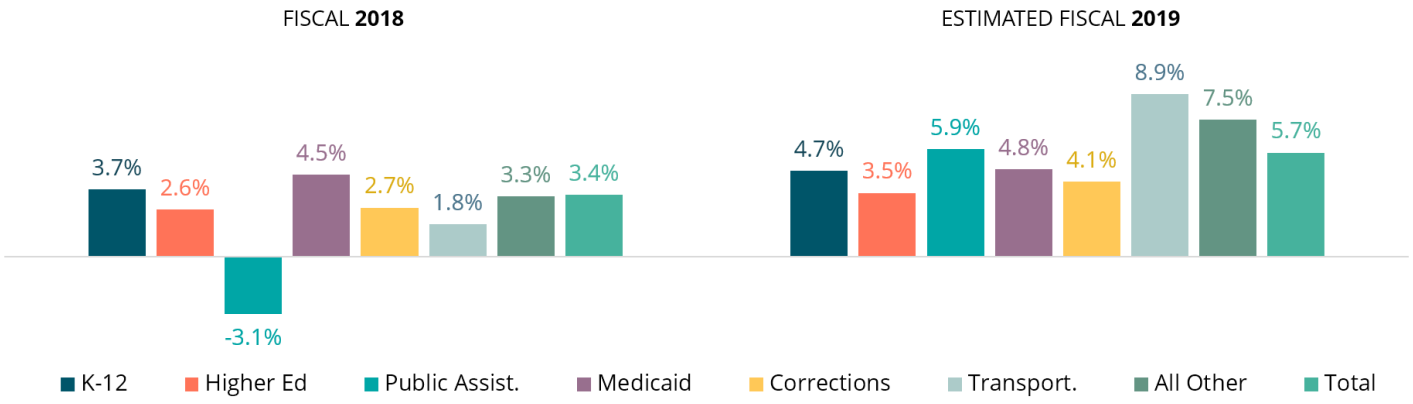
November 21, 2019

Overview: Total State Spending Accelerated in Fiscal 2019, Led by Gains in Transportation and the "All Other" Categories

Total state spending reached $2.1 trillion in fiscal 2019, rising from $2.0 trillion in fiscal 2018. In fiscal 2019 it is estimated that total state spending grew 5.7 percent, slightly above the 33-year NASBO survey historical average of 5.6 percent (not adjusted for inflation). However, the median rate was lower at 4.4 percent. Seven out of eight geographic regions saw an increase in total state spending in fiscal 2019, with the Far West region having the largest increase and the Southwest region experiencing a slight decline. Spending from states' own funds (general funds and other state funds combined, excluding bonds) rose 5.9 percent in fiscal 2019, the highest annual growth rate since the last recession, while federal funds increased 4.7 percent. Once again, the median rates were lower at 5.0 percent and 3.2 percent respectively. All seven program areas experienced an increase in total state spending in fiscal 2019, with transportation and the "all other" category seeing the largest gains. In contrast to recent years, total Medicaid spending grew at a slower rate than state spending overall, the first time since fiscal 2012 when the federal stimulus began to wind down. When looking at spending from state funds only, transportation and the "all other" category once again saw the strongest growth rates in fiscal 2019.

Total state spending grew by 3.4 percent in fiscal 2018, reaching more than $2.0 trillion for the first time.

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*

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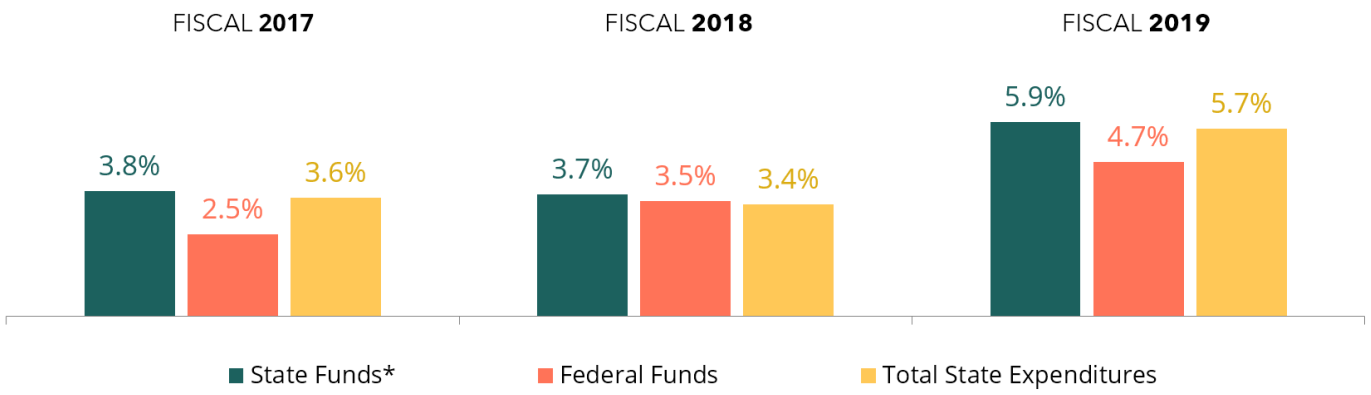
Spending from state funds rose 3.7 percent while federal funds increased 3.5 percent. On a median basis, total state spending rose 3.0 percent, state funds 2.7 percent, and federal funds 2.6 percent. In fiscal 2018, all eight geographic regions saw an increase in total state spending, with the highest rate in the Rocky Mountain region and the lowest in the Plains. Nearly all program areas experienced an increase in total state spending in fiscal 2018, with Medicaid seeing the highest growth rate and public assistance experiencing a decline. Examining state funds only, transportation had the strongest growth rate in fiscal 2018, with public assistance once again being the only program area with a decline.

Spending from Both State Funds and Federal Funds Increased in Fiscal 2019

In contrast to many recent years, in fiscal 2019 both transportation and the "all other" category experienced stronger growth than Medicaid from state funds (including general funds and other state funds, but not federal funds or bonds). The robust growth was not limited to only a handful of states; 18 states had an increase of at least 10 percent on transportation spending from state funds, while 17 states had an increase of at least 10 percent on "all other" spending from state funds. The increase in transportation spending reflects the devotion of additional state resources to address the need for maintenance and infrastructure demands. Increases in the "all other" category in fiscal 2019 included additional spending for pension fund contributions, employee compensation, deposits to reserve funds, debt service, disaster recovery, and homelessness programs. In fiscal 2019 all program areas saw at least a slight increase in spending from state funds, while in fiscal 2018 public assistance had a decline. Spending from state funds increased an estimated 5.9 percent in fiscal 2019, 3.7 percent in fiscal 2018, and 3.8 percent in fiscal 2017. In fiscal 2019, spending from state funds increased at the highest annual growth rate since the last recession.

Total federal funds to states is estimated to have grown by 4.7 percent in fiscal 2019, 3.5 percent in fiscal 2018, and 2.5 percent in fiscal 2017. Federal funds have been subject to a series of two-year spending deals for the

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.*

last several years. The *Bipartisan Budget Act of 2018* increased federal spending caps for federal fiscal years 2018 and 2019, injecting additional federal funding into state and local government budgets. Nondefense domestic discretionary spending in fiscal 2018 was increased by 11.6 percent and an additional 3.1 percent in fiscal 2019. Following passage of the spending agreement, Congress passed the *Consolidated Appropriations Act of 2018* which contained notable increases in many discretionary grant programs for fiscal 2018. Areas that received additional funds include disaster assistance, addressing the opioid crisis, rural broadband, education and election assistance.

Medicaid Declines as a Share of Total State Spending in Fiscal 2019, While K-12 Remained the Largest Category from State Funds

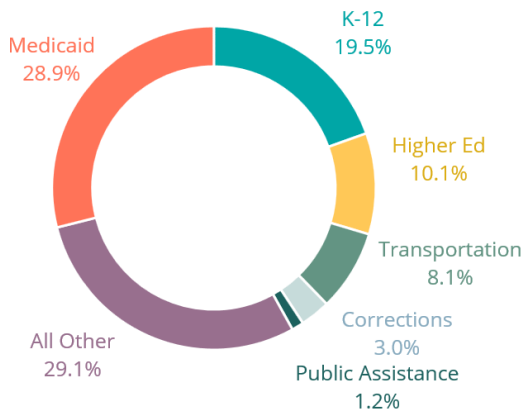
Since the beginning of the recent economic downturn and continuing through the enactment of the *Affordable Care Act*, Medicaid had risen as a percentage of total state spending, growing from 20.5 percent in fiscal 2008 to 29.7 percent in fiscal 2018. However, in estimated fiscal 2019 Medicaid slightly declined as a share of total state spending, falling to 28.9 percent. Elementary and secondary education remained the second largest area of total state spending in fiscal 2019, representing 19.5 percent. When looking at state funds only, elementary and secondary education remained the largest category in fiscal 2019 at 24.9%, while Medicaid was second at 16.4%.

The Far West Led all Regions in Spending Growth in Fiscal 2019, While the Rocky Mountain Region had the Largest Growth in Fiscal 2018

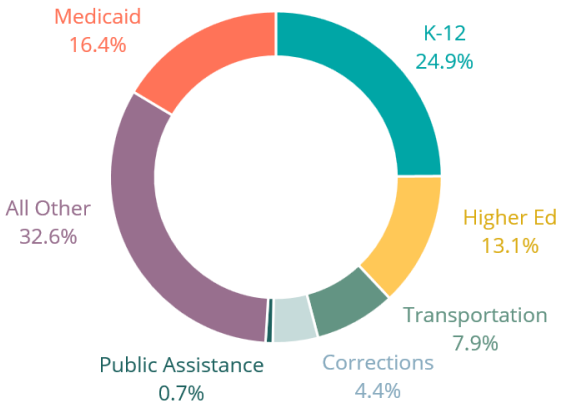
Nearly all geographic regions experienced increased spending from state funds, federal funds, and total funds in both fiscal 2019 and fiscal 2018. In estimated fiscal 2019, the Far West and Rocky Mountain regions experienced the highest growth in total spending at

Expenditures By Function
Estimated Fiscal 2019

Total State Expenditures

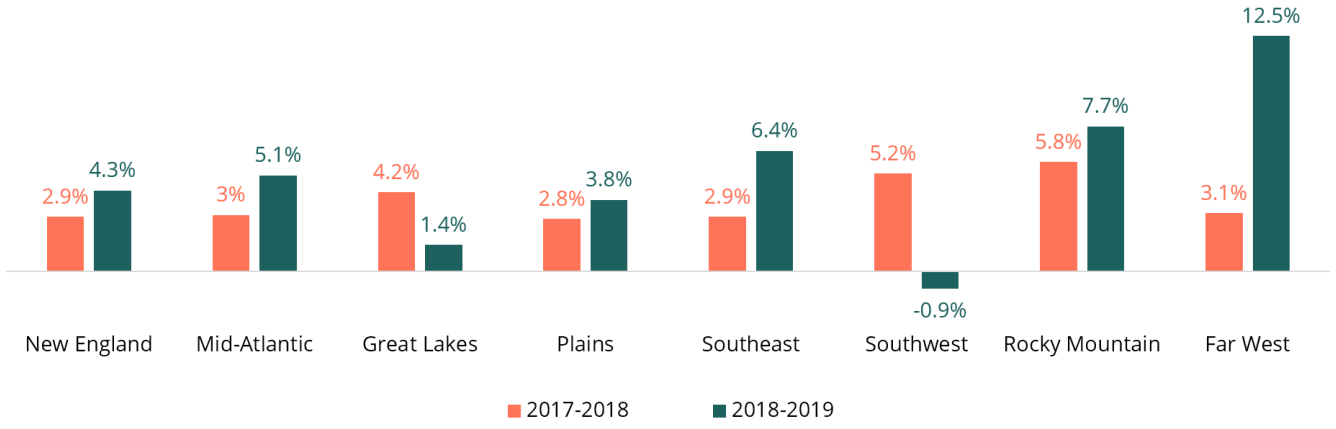


State Funds



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

Regional Percentage Change In Total Expenditures*



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

12.5 percent and 7.7 percent respectively, likely due to population growth and increased spending demands. Only the Southwest region had a slight decline in total spending in estimated fiscal 2019, mainly attributable to a substantial decline in spending in Texas due to technical reasons associated with the state's biennial budgeting practices. In fiscal 2018, the Rocky Mountain and Southwest regions had the largest increases in total spending at 5.8 percent and 5.2 percent respectively, while the Plains region had the slowest growth at 2.8 percent.

Additional state expenditure details and trends include:

- **Elementary and secondary education** total expenditures increased by 4.7 percent in estimated fiscal 2019 and by 3.7 percent in fiscal 2018. State funds for K-12 increased 4.7 percent in fiscal 2019 and 4.1 percent in fiscal 2018, while federal funds grew 6.1 percent in fiscal 2019 and increased 0.2 percent in fiscal 2018. Federal fund spending growth for K-12 education in fiscal 2019 is higher than in recent years, which is likely due to the effects of the last two-year federal budget agreement. As the national economy and state revenues grow, elementary and secondary education continues to receive increased funding in state budgets. Some states are also continuing to take targeted steps to increase teacher compensation and improve teacher recruitment and retention. Other states are increasing and adjusting their school funding formulas, including adding more funding for at-risk students and special education. Early education, school safety, and student counseling are other areas where states are investing greater resources.

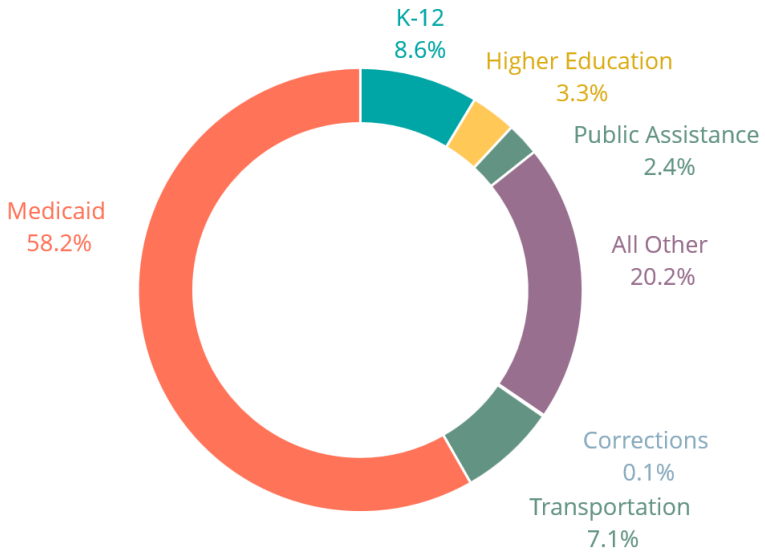
- Total expenditures for **higher education** increased by 3.5 percent in estimated fiscal 2019 and by 2.6 percent in fiscal 2018. State funds for higher education are estimated to have increased by 3.3 percent in fiscal 2019 and grew by 3.0 percent in fiscal 2018, while federal funds rose 3.2 percent in fiscal 2019 and increased by 3.0 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 annual general fund spending growth for higher education has been 3.5 percent from fiscal 2013 to fiscal 2019. By comparison, total general fund spending on all program areas has grown by a simi-

lar average annual rate of 3.6 percent over the same period. Recently, states have targeted additional funds to increase operating support for institutions and to restrict tuition increases or freeze tuition rates. States are also putting more resources toward postsecondary student financial aid, including through creating or expanding state-level "Promise" programs, last-dollar scholarship programs that guarantee free tuition, typically for in-state residents only. Additionally, states are making targeted investments in career and technical education to better align their education systems with workforce demands.

- Total **public assistance** increased by 5.9 percent in estimated fiscal 2019, after declining by 3.1 percent in fiscal 2018, while the median rate was 0.3 percent in fiscal 2019 and -2.5 in fiscal 2018. The timing of expenditures may vary from year-to-year and may not reflect underlying program activity in a given year; large swings in some states often due in part to timing and reporting issues can substantially affect average spending growth rates. Public assistance represented 1.2 percent of total state expenditures in fiscal 2019. 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. Programs in the "other cash assistance" category, which includes optional state programs for Supplemental Security Income (SSI) and General Assistance, are not funded in all states, and when funded, are relatively small programs. Other human and social services program spending is captured in the "all other" category.

- Total **Medicaid** spending of $613.1 billion for fiscal 2019 states reflected an increase of $27.8 billion over the $585.3 billion spent in fiscal 2018, a 4.8 percent increase. Spending from state funds increased by 3.9 percent and federal fund spending grew by 5.3 percent in fiscal 2019. The overall spending growth rate for total Medicaid expenditures was 4.5 percent in fiscal 2018 with state funds growing 5.3 percent and federal funds rising 4.0 percent. While Medicaid spending continued to rise in both fiscal 2018 and fiscal 2019, its growth rate was less than some recent years partly due to

Federal Funds Expenditures by Function
Estimated Fiscal 2019

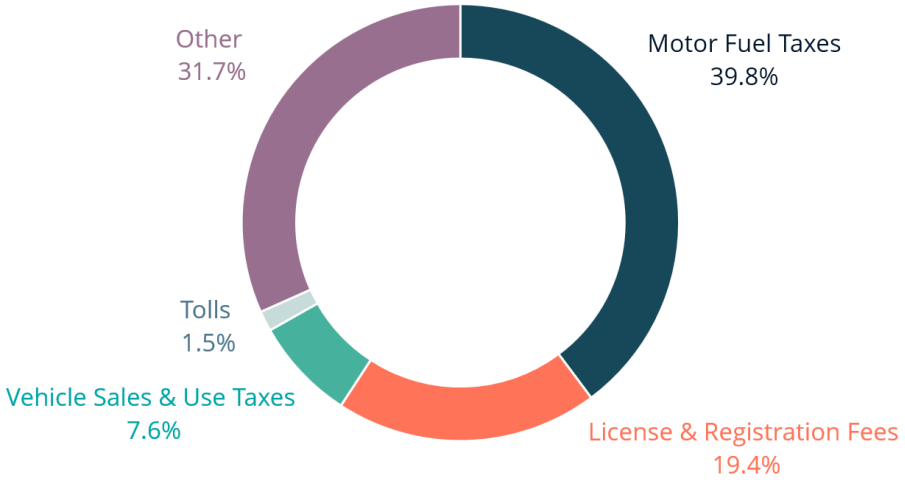


cost containment strategies and a slight decline in enrollment. Fiscal 2019 also saw two states implement Medicaid expansion during the year. Federal funds comprised 61.8 percent of total Medicaid spending, general funds 27.8 percent, and other state funds 10.5 percent, in fiscal 2019. Additionally, Medicaid comprised 58.2 percent of all federal funds to states.

- Total **corrections** expenditures increased by 4.1 percent in estimated fiscal 2019 and by 2.7 percent in fiscal 2018 (the median growth rate was 3.4 percent in fiscal 2019 and 1.5 percent in fiscal 2018). Federal funds comprise only about 1 percent of corrections spending in states. Corrections accounted for 3.0 percent of total state expenditures in fiscal 2019 and 6.6 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. First, several states have included additional funds to raise the compensation for existing and new correctional officers in recent budgets, to improve the recruitment and retention of these vital security positions. Due to a growing economy and tight labor market, states are having to increase salaries to attract applicants and retain employees. Second, states continue to invest in criminal justice reforms to reduce correctional populations and improve outcomes; these reforms include alternatives to incarceration, earning sentence credits for good behavior, parole reforms, and increased treatment to address mental health and substance abuse disorders.

- Total **transportation** spending, representing 8.1 percent of total state expenditures, increased by 8.9 percent in estimated fiscal 2019 and by 1.8 percent in fiscal 2018. In fiscal 2019, it is estimated that state funds spending rose 8.9 percent and federal funds 6.9 percent. Fifteen states experienced growth of 10 percent or higher in total transportation spending in fiscal 2019, while 18 states had a growth rate of 10 percent or higher from state funds. Median growth rates for fiscal 2019 were all funds (2.9 percent), state funds (4.2 percent), and federal funds (2.2 percent). Other state funds, which are typically earmarked revenue sources such as fuel taxes, comprised 61.1 percent of total transportation spending in estimated fiscal 2019, with federal funds at 26.9 percent, bonds at 7.3 percent, and general funds only accounting for 4.8 percent. While transportation spending can often fluctuate from year-to-year due to multi-year construction timetables and unforeseen or delayed project costs, states have also taken recent steps to increase transportation revenue for future projects. 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 (22 states have indexed or variable-rate gas taxes), new vehicle fuel economy continues to increase, and the growth in vehicle miles traveled has leveled off. Since 2013, 33 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 a share of transportation system costs, as 27

Transportation Fund Revenue Sources
Estimated Fiscal 2019



states now have fees on electric vehicles. Additionally, states continue to explore road usage charges, or mileage-based user fees, with a growing number conducting pilot programs. Finally, 32 states have constitutional restrictions that dedicate transportation funds for transportation purposes.

- In this year's State Expenditure Report, for the second time states were asked to detail **transportation fund revenue** sources. Forty-seven states reported having a separate transportation fund. Motor fuel taxes represented the largest revenue source for transportation funds at 39.8 percent, followed by license and registration fees (19.4 percent), vehicle sales and use taxes (7.6 percent), tolls (1.5 percent), and all other (31.7 percent). Transportation fund revenue sources totaled $95.9 billion in fiscal 2017, $104.3 billion in fiscal 2018, and $111.0 billion in estimated fiscal 2019. Over the last two years, transportation fund revenues have grown at an average annual rate of 7.6 percent.

- The "**all other**" category of state spending increased 7.5 percent in estimated fiscal 2019, with state funds (excluding bonds) rising 8.6 percent and federal funds increasing 1.4 percent. The sizeable increase in state funds for "all other" spending in fiscal 2019 is partly due to most states ending fiscal 2018 with budget surpluses and strong general fund ending balances, which along with continued revenue growth in fiscal 2019 helped states bolster their spending levels and make extra deposits into reserves. As NASBO's *Fall 2018 Fiscal Survey of States* noted, increases for the "all other" category in fiscal 2019 included spending increases for pension fund contributions, employee compensation, deposits to reserve funds, debt service, disaster recovery, and homelessness programs. In fiscal 2018, "all other" spending rose 3.3 percent as state funds increased 2.3 percent and federal funds increased 6.5 percent. "All other" represented 29.1 percent of total state expenditures in estimated fiscal 2019 and 26.7 percent of general fund expenditures. "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 ben-

efits, economic development, state police, environmental protection, parks and recreation, other natural resources programs, unemployment insurance, housing, general aid to local governments, and debt service.

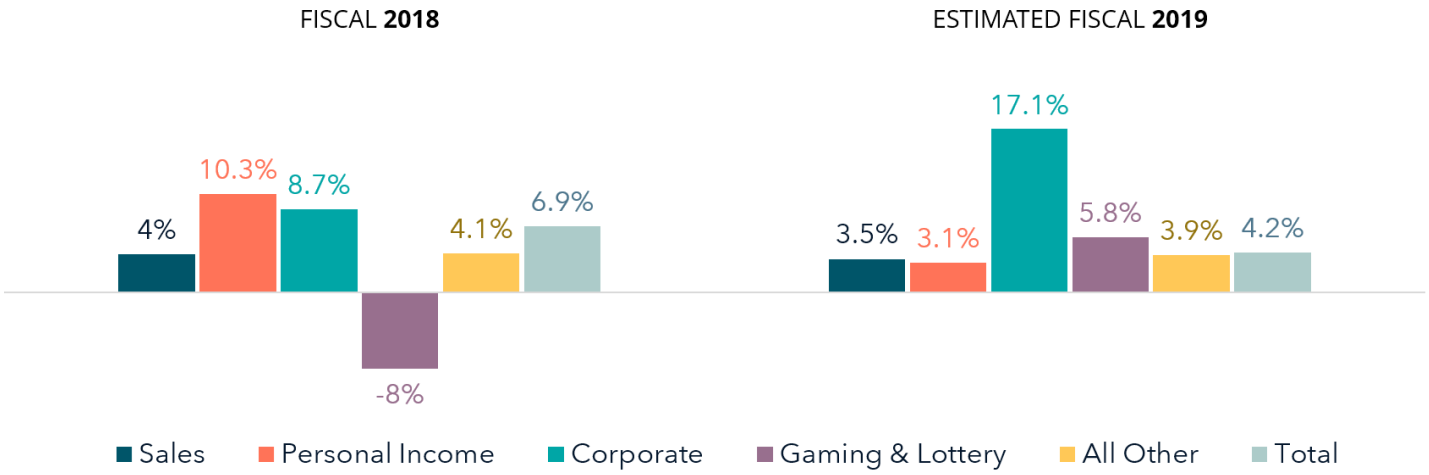
- In this year's report, states for the second time were asked to separately detail their **debt service** spending. States' spending on debt service totaled $48.3 billion in fiscal 2017, $50.2 billion in fiscal 2018, and $52.9 billion in estimated fiscal 2019. In estimated fiscal 2019, general funds represented 54.2 percent of total state spending on debt service, while other state funds comprised the remaining 45.8 percent. In fiscal year 2019, debt service represented 3.7 percent of spending from state funds (general funds and other state funds combined, excluding bonds), and 3.3 percent of spending from the general fund only. 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.

- **Capital** expenditures are made for new construction, infrastructure, major repairs and improvements, land purchases, and the acquisition of major equipment and existing structures. States increased capital spending by an estimated 7.7 percent in estimated fiscal 2019 after declining 1.2 percent in fiscal 2018. The nature of capital spending often includes multi-year construction timetables and unforeseen or delayed project costs, which explains why state specific spending on capital projects can fluctuate from year to year. States primarily use dedicated sources to finance capital spending like the transportation fund, higher education tuition and fees, set-aside funding for capital projects, federal funds, and fund surpluses. State cash sources represent 46 percent of capital spending in fiscal 2019, bonds are 27.1 percent, and federal funds are 26.8 percent. Most federal funds spent for capital purposes are for transportation (93.6 percent in fiscal 2019).

State Tax Collections Experienced Strong Gains in Both Fiscal 2018 and Fiscal 2019, Following Two Years of Slow Growth

General fund revenue, the largest source of state expenditures and the most discretionary, totaled an estimated $878.2 billion in fiscal 2019, a 4.2 percent increase over fiscal 2018. In fiscal 2018, general fund revenues grew 6.9 percent, representing the highest annual growth rate since fiscal 2011. The notable increases in fiscal 2018 and fiscal 2019 followed two years of slow growth from tax collections in fiscal 2016 and fiscal 2017. The three largest sources of general fund revenue collections (personal income, sales, and corporate income) all are estimated to have grown in both fiscal 2018 and fiscal 2019. The gains in personal income taxes have largely been driven by higher collections from non-wage income (capital gains, dividends, and bonuses), while the payroll withholding component has also grown. The growth in sales tax collections has been led by gains in consumption with some states also attributing part of the fiscal 2019 growth to expanded online sales tax collections. Increases in corporate income taxes, typically a volatile revenue source for states, may in part be due to changes from the federal *Tax Cut and Jobs Act* (TCJA). The TCJA also likely altered the timing of some tax collections during both fiscal 2018 and fiscal 2019. In fiscal 2018, states saw an acceleration of non-withholding income tax payments as taxpayers tried to take advantage of expiring tax breaks. While in fiscal

Revenue Growth By Percentage
State General Funds



2019, changes in taxpayer behavior following federal tax reform altered the timing of estimated state personal income tax payments, with some states noting that certain taxpayers no longer had an incentive to pay in December and instead made higher payments with their tax returns in the spring.

The revenue surpluses that occurred in many states in fiscal years 2018 and 2019 were not known until the latter part of each fiscal year. The revenue gains near the end of the fiscal year were the primary factor in most states ending each fiscal year with a general fund surplus. One of the most prominent uses of revenue surpluses is to deposit some or all of it into the state's rainy day fund. When the revenue surplus comes at the end of the fiscal year, states will also often carry some of it forward to the next fiscal year. The higher than expected revenue gains at the end of fiscal 2018 likely contributed to the increases in state spending in fiscal 2019.

Outlook

In fiscal 2018 and fiscal 2019, state tax collections significantly increased after two straight years of slow growth. States directed the additional revenue to priority areas such as teacher pay, school safety, overall K-12 funding, additional funds for postsecondary financial aid/scholarships, foster care, child welfare, drug treatment programs, homelessness/affordable housing, disaster recovery, election security/voting equipment, additional pension funding, road maintenance, one-time infrastructure spending, state employee pay raises and bonuses, aid to localities, debt service, and increasing the size of the rainy day fund. Looking forward, states are analyzing their tax collections to determine how much of the additional revenue may be of a one-time nature, while also monitoring economic conditions for the possibility of a future slowdown. State spending growth is expected to slow in fiscal 2020, as states also continue to promote structural balance, long-term sustainability, and strengthening their reserve funds.

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

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.