Improved Fiscal Conditions Reflected in States’ Fiscal 2019 Budgets & Reserves

States have enacted budgets for fiscal 2019 that mark the ninth consecutive year of moderate state spending and revenue growth. Those spending plans increase general fund expenditures by 4.3 percent in fiscal 2019, with 44 states projecting positive spending growth. After two years of weak revenue performance, tax collections accelerated in fiscal 2018. Forty states exceeded their original revenue projections for fiscal 2018, the highest number to do so in over a decade. Revenue performance in early fiscal 2019 has been strong as well, with collections coming in above or on target in most states reporting. States are still trying to untangle the complicated effects of the federal Tax Cuts and Jobs Act on their revenues, as well as assess how much of the recent revenue gains are attributable to recurring versus one-time factors. Most states continue to strengthen their reserves, leveraging the recent improvement in revenue conditions and resulting budget surpluses to boost their rainy day funds and general fund ending balances, with total balances reaching a new all-time high in nominal dollars in fiscal 2018. While fiscal conditions have improved overall, states continue to face long-term budget challenges to varying degrees, as spending demands for fixed costs such as pension contributions and health care are expected to grow faster than revenues over the long term.

Figure 1.

**GENERAL FUND SPENDING PERCENTAGE CHANGE IN FISCAL 2019 ENACTED BUDGETS***

- less than 0% (6 states)
- 0% to 2% (6 states)
- 2 to 4% (18 states)
- greater than 4% (20 states)

*Compared to fiscal 2018 preliminary actual spending levels.
State Budgets for Fiscal 2019 Plan for Moderate Spending Growth

State general fund spending is forecasted to grow 4.3 percent in fiscal 2019 according to enacted budgets, totaling $874.6 billion across all 50 states. Overall, 44 states enacted general fund spending increases in fiscal 2019, with 20 of those states enacting increases greater than four percent (including most states in the west, where population and economic growth continues to outpace the national average). (See Figure 1.) This reflects a considerably improved fiscal situation for states compared to this time last year, when states enacted their original budgets for fiscal 2018 calling for an aggregate spending increase of just 2.3 percent, with 35 states enacting increases and only 11 enacting increases greater than four percent.

Preliminary actual spending growth came in higher than originally budgeted for fiscal 2018, 3.7 percent over fiscal 2017 spending levels. As revenue conditions continued to improve in fiscal 2018, a number of states had funds available to respond to additional, often one-time, spending needs or to deposit into reserves (which are recorded as expenditures when they are directly appropriated). Despite consistent aggregate spending growth in each year since fiscal 2011, general fund spending in fiscal 2018 falls slightly below the pre-recession peak level in fiscal 2008 in real terms, due in part to rising inflation.¹ Thirty states spent less from their general funds in fiscal 2018 than they did in fiscal 2008, after adjusting for inflation. (See Figure 2.)

States Direct Largest Appropriation Increases to “All Other” Program Area

States’ strengthened fiscal situation this year compared to a year ago is especially apparent when examining appropriation changes by program area for fiscal 2019. Compared to enacted budgets for fiscal 2018, states increased appropriations by $41.1 billion in their fiscal 2019 budgets, putting more money towards K-12 education, higher education, Medicaid and other government services, as well as directing surplus funds from fiscal 2018 to one-time spending needs and reserves. In contrast, when states enacted their fiscal 2018 budgets last year, they provided for appropriation increases of just $12.7 billion, as reported in NASBO’s Fall 2017 Fiscal Survey.

Figure 2.

GENERAL FUND SPENDING, FISCAL 2008 TO FISCAL 2019
IN BILLIONS

Fiscal 2019 figure is based on states’ enacted budgets. Percentages shown represent total annual general fund spending growth. The median projected growth rate for fiscal 2019 is 3.2 percent. ¹Aggregate spending level would need to total at least $843 billion in fiscal 2018 to be equivalent with or exceed real 2008 spending level.
of States. (See Figure 3.) Due to upward revisions to revenue estimates in the second half of fiscal 2018, most states ended up enacting budgets calling for higher appropriation levels compared to governors’ budget recommendations for fiscal 2019, detailed in NASBO’s Spring 2018 Fiscal Survey of States.

The largest recipient of new money in fiscal 2019 enacted budgets is the “all other” category, which received $16.3 billion in appropriation increases for a diverse range of expenditures such as pension fund contributions, employee compensation, deposits to reserve funds, debt service, disaster recovery, and homelessness programs. Overall, all program areas saw a net increase in fiscal 2019 budgets. In this improved budget environment, 29 states also reported approving across-the-board salary increases for fiscal 2019 – the highest number of states to report doing so in this survey since the Great Recession.

States Make Minimal Mid-Year Budget Cuts in Fiscal 2018

Mid-year budget actions include any actions, whether legislative or executive (e.g., executive order, withholding of excess funds), that change the appropriated or authorized expenditure level compared to the original enacted budget. Twenty-one states reported making mid-year spending increases in fiscal 2018 totaling $3.5 billion, for a net mid-year increase of $2.9 billion in general fund spending after accounting for reductions. Improved revenue conditions in states in fiscal 2018 led to significantly fewer states making mid-year budget reductions compared to the last couple of years. Just seven states reported making net mid-year budget cuts due to a shortfall, totaling $456 million in fiscal 2018 (several additional states reported mid-year budget reductions that were not attributable to a shortfall, but rather due to caseload reductions, increased resources from another funding source, or other reasons). In contrast, in fiscal 2017, 22 states made net mid-year spending decreases totaling $3.5 billion; however, at that time, NASBO’s reported figures on mid-year budget cuts were likely to be somewhat overstated, as they were not limited to states where the cuts were due to a shortfall. (See Figure 4.)

States Saw Robust Revenue Growth in Fiscal 2018; Most States Are Meeting or Exceeding Fiscal 2019 Projections So Far

Most states saw improved revenue conditions in fiscal 2018 following the slowdown experienced in tax collections in fiscal 2016 and fiscal 2017. Total state general fund revenues grew
6.4 percent in fiscal 2018, the fastest rate of growth observed in the Fiscal Survey of States since fiscal 2013. (See Figure 5) These gains were led by unusually high income tax payments from non-withholding income sources along with continued growth in the economy and jobs, a stronger performance of the stock market in calendar year 2017, and a modest recovery in most energy-producing states following steep oil and gas price declines. Fiscal 2018 revenues in a few states were also bolstered by enacted tax increases. States are still working to untangle and better understand these trends and the impacts of the federal tax law and stock market performance on taxpayer behavior, and it remains to be seen how much of the revenue gains in fiscal 2018 were one-time.

General fund collections from all revenue sources including sales, personal income, corporate income, gaming and other revenues came in above projections in 40 states in fiscal 2018, the highest number of states to come in ahead of their budget forecasts since fiscal 2006. By comparison, just 18 states had revenue collections come in above forecast in fiscal 2017.
Overall, fiscal 2018 general fund revenues, at $850.3 billion, came in 2.5 percent above the level projected in states’ enacted budgets for fiscal 2018, $829.6 billion, as reported in NASBO’s Fall 2017 Fiscal Survey of States. (See Figure 6)

According to states’ enacted budgets for fiscal 2019, revenues are expected to total $868.4 billion, a 2.1 percent increase compared to fiscal 2018 preliminary actual revenues; the median revenue growth rate for fiscal 2019 is 2.3 percent. Since fiscal 2018 preliminary actual revenues in many states came in higher than was expected when they adopted their fiscal 2019 budgets, this contributes to the low revenue growth rate projected for fiscal 2019. Compared to preliminary actual revenues for fiscal 2018, general fund revenues from sales taxes are budgeted to grow 3.6 percent on a median basis, personal income taxes 2.9 percent (median) and corporate income taxes 3.5 percent (median). (See Figure 7) At the time of data collection, 19 states were already reporting that general fund revenue collections (from all sources) to date were coming in ahead of enacted budget projections for fiscal 2019.
States Enact a Mix of Tax and Fee Increases and Decreases for Fiscal 2019, Many in Response to New Federal Tax Law

States enacted a mix of tax and fee increases and decreases, resulting in a projected net positive revenue impact in fiscal 2019 of $3.1 billion, including $2.7 billion in additional general fund revenues. Overall, 16 states approved net tax and fee increases totaling $4.6 billion in fiscal 2019, while 20 states enacted smaller net decreases totaling -$1.4 billion. (See Figure 8) Many of the changes in the personal and corporate income tax areas were made in response to federal tax changes under the Tax Cuts and Jobs Act (TCJA). In some cases, states used the revenue-raising impacts of federal tax law changes as an opportunity to lower marginal personal income and corporate tax rates. Some states acted specifically to eliminate or reduce the state income tax increases that would be caused by their conformity to the federal tax code. Other states made revenue neutral changes in reaction to the federal changes but did not report them in this survey.

New York’s elimination of the Repatriation Tax Deduction, estimated to increase corporate income tax revenues by $2 billion, represents the largest revenue action for fiscal 2019 on a dollar basis. Oklahoma’s set of tax increases represented the largest revenue increase as a percentage of the state’s general fund. Other states that enacted sizeable net tax increases include New Jersey and Louisiana. Most tax decreases enacted by states were moderately sized and in the area of personal income taxes. Missouri and Washington State reported the largest net decrease in taxes and fees enacted for fiscal 2019 on a dollar basis, while Idaho’s tax cuts represented the greatest revenue reduction as a share of the state’s general fund.

Most States Continue to Strengthen Rainy Day Funds, as Median Reserve Balance Continues to Grow

One particularly promising trend in state finances in recent years has been the strengthening of states’ reserves. Improved revenue conditions in fiscal 2018 helped many states continue to bolster their ending balances and savings accounts, or rainy day funds. Rainy day fund balances are a crucial tool that states rely on during fiscal downturns and to address shortfalls. States have made building up their reserves a priority since the Great Recession. Since fiscal 2010, the median rainy day fund balance level as a percentage of general fund spending has grown from 1.6 percent to 6.4 percent in fiscal 2018. Looking ahead, states’ enacted budgets predict that the median rainy day fund balance will continue to rise, reaching 7.3 percent of general fund spending by the end of fiscal 2019. (See Figure 9) Thirty-two states increased their rainy day fund balances in fiscal 2018, and 32 states are projecting increases in fiscal 2019.

**SUMMARY OF ENACTED STATE REVENUE CHANGES**

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<th># OF STATES ENACTING INCREASES</th>
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<th>9</th>
<th>10</th>
<th>3</th>
<th>1</th>
<th>1</th>
<th>5</th>
<th>9</th>
<th>16</th>
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<tr>
<td># OF STATES ENACTING DECREASES</td>
<td>9</td>
<td>16</td>
<td>9</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>6</td>
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<td>NET CHANGE ($ IN MILLIONS)</td>
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<td>+$2,806</td>
<td>+$298</td>
<td>+$103</td>
<td>+$28</td>
<td>-$104</td>
<td>+$376</td>
<td>+$3,147</td>
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</tbody>
</table>

![Figure 8](image_url)
Total balances include ending balances and the amounts in states’ rainy day funds (also referred to as budget stabilization funds), and reflect the surplus funds and reserves that states may use for liquidity to respond to unforeseen circumstances and to help resolve revenue shortfalls, though in some states, part of the ending balance may already be reserved for expenditure in a subsequent year. Total balances reached a new all-time high in nominal dollars in fiscal 2018, totaling $90.5 billion. The median total balance was 11.1 percent in fiscal 2018 and is expected to drop to 10.1 percent in fiscal 2019.

Outlook: Improved Fiscal Conditions in States, but Long-Term Challenges Remain

State fiscal conditions show signs of improvement compared to this time last year by a number of indicators. General fund revenue growth saw a significant uptick in fiscal 2018, with 40 states ending the year with revenues above budget projections and relatively few states having to make mid-year budget reductions. In this more stable environment, states had greater flexibility to increase their budgets in fiscal 2019 for core government services as well as targeted investments and one-time spending needs, while also depositing more money into their rainy day funds. At the same time, states are trying to untangle the complicated effects of the recent federal tax changes on their revenues, and it remains to be seen how much of the revenue gains states have experienced of late will be recurring versus one-time. While budget conditions vary by state, all states to some extent are facing long-term spending pressures in areas ranging from health care and pensions to adequately funding K-12 education and infrastructure. Even with stronger revenue growth, state spending increases are moderate by historical standards as states focus on bolstering their reserves to prepare for the next downturn and seek long-term structural balance.

1 Adjusted for inflation, the aggregate general fund spending amount in fiscal 2008 was $843.2 billion, 0.6 percent below the $838.2 billion preliminary actual figure for fiscal 2018 reported in this survey. The state and local government implicit price deflator cited by the Bureau of Economic Analysis National Income and Product Account Tables, Table 3.9.4., Line 33 (last updated on November 28, 2018), is used for inflation adjustments. Quarterly averages are used to calculate fiscal year inflation rates.

If you would like additional information, please contact Kathryn Vesey White (kwhite@nasbo.org or 202-624-5949).