Overview: Moderate Improvements in State Fiscal Conditions, Although Progress is Slow

This report shows moderate growth and stability for state budgets in fiscal 2015. General fund spending and revenue are projected to increase for the fifth consecutive year, based on states’ enacted budgets. In contrast to the period immediately following the Great Recession, consistent year-over-year growth has helped states steadily increase spending, reduce taxes and fees, close budget gaps and minimize mid-year budget cuts. More and more states are moving beyond recession induced declines, but spending growth is below average in fiscal 2015, as it has been throughout the economic recovery. Additionally, states face rising costs in critical areas of the budget, such as Medicaid and higher education, which continue to outpace inflation as well as general fund revenue growth. Overall, states are in a better position than they were a few years ago, but as the economy continues along a trajectory of slow growth, fiscal challenges are likely to persist from rising spending demands and limited gains in revenue collections.

General Fund Spending Rising; Modest State Fiscal Advancements Widespread

Forty-three states enacted higher general fund spending levels in fiscal 2015 compared to fiscal 2014. Aggregate spending levels are also expected to rise in fiscal 2015, although by less than the historical average. This means that for most states, spending growth will be limited. General fund expenditures are projected to reach $751.6 billion in fiscal 2015, an increase of $22.7 billion or 3.1 percent over fiscal 2014. Spending increased by 4.9 percent in fiscal 2014, the fastest rise in general fund expenditures since fiscal 2008. General fund spending accelerated in fiscal 2014 in part because state revenue collections outpaced projections in fiscal 2013, leaving many states with ending balances that were used to bolster spending. General fund spending surpassed pre-recession highs for the first time in fiscal 2013, and is expected to end fiscal 2015 9.4 percent above the pre-recession peak, without adjusting for inflation. Additionally, most states have surpassed pre-recession revenue and spending levels, a key milestone in resuming long-term budget growth. However, it has taken states many years to recover, and with budget growth still below average in fiscal 2015, difficult spending decisions are likely to remain for states.

General Fund Spending: FY 2008-FY 2015

<table>
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<th>Fiscal Year</th>
<th>2008</th>
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<th>2010</th>
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Spending Increases Most Heavily Target K-12 Education and Medicaid

Spending increases in fiscal 2015 continued to be most heavily directed towards K-12 education and Medicaid, which received the majority of additional budget dollars. Thirty-nine states enacted general fund spending increases for K-12 education for a net increase of $11.1 billion. Thirty-six states increased spending for Medicaid for a net increase of $8.5 billion. Forty states also increased spending for higher education for a net increase of $4.4 billion. Additionally, thirty-five states increased spending for corrections, 12 states enacted increases for transportation and 36 states increased spending for the all other category.

All areas of the budget experienced aggregate spending increases in fiscal 2015 with the exception of public assistance, which has received net budget cuts for the second consecutive fiscal year. Twelve states made general fund budget cuts to public assistance, resulting in a net decline of $590 million. Additionally, six states enacted budget cuts to K-12 education, seven states made cuts to higher education, seven states cut spending for Medicaid, 12 states enacted budget cuts for corrections and eight states cut general fund spending for transportation.

Minimal Mid-Year Budget Cuts So Far in Fiscal 2015

States have enacted minimal mid-year spending cuts over the last several years, indicating that states’ fiscal situations have stabilized. Mid-year budget cuts have subsided compared to the years immediately following the recession when states had to make substantial cuts and take other actions such as expend rainy day funds to balance their budgets. For example, in fiscal 2010, 39 states made $18.3 billion in mid-year budget cuts. By comparison, 11 states enacted net mid-year budget cuts totaling $1.3 billion in fiscal 2013, and eight states made $1.0 billion in mid-year budget cuts in fiscal 2014. For fiscal 2015, seven states have made $852 million in mid-year budget cuts. This represents an increase in the number of states and the amount of budget cuts compared to the same time period in fiscal 2014. However, mid-year budget cuts are still relatively small compared to fiscal 2009 and fiscal 2010. Improved revenue collections and spending controls have significantly reduced the number of states needing to make mid-year budget cuts in fiscal 2014 and fiscal 2015.
Growth in General Fund Revenue Projected to Increase in Fiscal 2015, After Significant Slowdown in Fiscal 2014

According to enacted budgets, state revenue growth is projected to accelerate in fiscal 2015, after a significant slowdown in fiscal 2014. General fund revenues are projected to increase by 3.1 percent in fiscal 2015, an improvement from the estimated 1.3 percent gain in fiscal 2014. Moderate revenue growth is expected to be widespread; 44 states enacted fiscal 2015 budgets with higher general fund revenues than in fiscal 2014. Economic growth and declines in the unemployment rate have led to an improved outlook for state revenues in fiscal 2015, but state budgets still face challenges from stagnant wages. Enacted fiscal 2015 budgets forecast total general fund revenues of $748.3 billion, compared to an estimated $726.1 billion collected in fiscal 2014.

State tax revenues softened in fiscal 2014 in part because states experienced one-time gains in fiscal 2013 when taxpayers shifted capital gains, dividends and personal income to the 2012 calendar year to avoid higher federal taxes that were set to automatically begin on January 1, 2013. As a result, general fund revenues sharply increased in fiscal 2013 and subsequently slowed in fiscal 2014. General fund revenue collections increased by 7.1 percent in fiscal 2013, followed by a 1.3 percent gain in fiscal 2014. The slowdown in fiscal 2014 revenues proved difficult for a number of states, with 19 experiencing revenue declines. And revenue collections fell short of projections in 20 states in fiscal 2014, possibly because the revenue impact from the federal fiscal cliff was greater than some states estimated. However, after a challenging spring for states' tax collections, revenues are projected to grow more quickly in fiscal 2015.

Personal income tax collections are expected to increase by 4.7 percent, outpacing the 4.0 percent projected growth in sales taxes. Sales tax collections performed reasonably well in fiscal 2014, growing by 4.9 percent and helping to offset the slowdown in personal income tax collections. Fiscal 2015 general fund revenues from all sources, including sales, personal income, corporate income and all other taxes and fees, were exceeding original forecasts in 7 states, on target in 26 states and below forecasts in 10 states. Seven states were not able to report fiscal 2015 revenue collections compared to projections at the time of data collection.
States Enact Net Tax Cuts for the Second Consecutive Year in Fiscal 2015

For the second consecutive year, states enacted net tax cuts in fiscal 2015. States cut net taxes and fees in fiscal 2015 by $2.3 billion, after reducing taxes by $2.1 billion fiscal 2014. Overall, 21 states enacted net tax cuts and 10 states enacted increases. States have cut taxes in three of the last four fiscal years, as revenues have stabilized and spending pressures have subsided compared to the years immediately following the recession. However, tax cuts have been relatively minor in most states, indicating continued uncertainty regarding the economy and state revenues. In addition to tax and fee changes, states also enacted $699 million in new revenue measures in fiscal 2015. These measures enhance or reduce general fund revenue, but do not affect taxpayer liability. States with the largest reductions in taxes and fees in fiscal 2015 include Florida, Minnesota, New York and Texas. Fiscal 2015 marks a substantial change from fiscal 2010, a year in which severe revenue declines prompted states to enact $23.9 billion in net tax and fee increases along with $7.7 billion in other revenue measures.

Total Balances to Decrease in Fiscal 2015

Total balances include ending balances and the amounts in budget stabilization funds, or “rainy day” funds, and are a crucial tool that states heavily rely on during economic downturns or budget shortfalls. Balances reflect the surplus funds that states may use to respond to unforeseen circumstances, helping to offset potential revenue declines and increased spending demands. States have made progress rebuilding budgetary reserves since revenues precipitously declined in fiscal 2009 and 2010. For example, in fiscal 2013, revenues outpaced projections, resulting in a sizeable increase in ending balances, bringing total balances to $70.6 billion, or 10.5 percent of general fund expenditures. This nears an all-time high for states in terms of actual dollars, though not as a percent of expenditures. By fiscal 2014, total balances declined to $62.7 billion, or 8.9 percent of expenditures. Based on enacted budgets, states project balances to decrease further in fiscal 2015 to $53.1 billion, or 7.3 percent of general fund expenditures. The decline in total balances from fiscal 2013 to fiscal 2015 is due primarily to decreases in states’ ending balances; rainy day fund balances have remained relatively stable. However, the combined balance levels of Alaska and Texas at $20.6 billion still account for a disproportionate share of total state balance levels, representing 38.8 percent of states’ total balances in fiscal 2015. The remaining states have average balance levels of 4.8 percent of expenditures, according to enacted fiscal 2015 budgets.
Conclusion: Resource Constraints, Limited Budget Growth Continues in Fiscal 2015

State budgets are expected to continue their trend of moderate improvement in fiscal 2015, after several years of recovery in the national economy. Since the end of the recession, states have successfully transitioned to a sustained period of fiscal rebuilding, but progress remains slow. Budget growth has remained below the historical average throughout the recovery period. And growth in general fund revenues in fiscal 2014 was minimal, with collections below projections in a number of states. Overall, states are in a much better position than they were a few years ago; most have surpassed pre-recession revenue and spending levels, a key milestone in resuming long-term budget growth. However the cumulative effect of slow revenue growth and rising spending demands indicates that budgetary tradeoffs are likely to persist in fiscal 2015.

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