

SUMMARY: SPRING 2015 FISCAL SURVEY OF STATES

Slow and Stable Budget Growth Expected to Continue for States in Fiscal 2016

June 16, 2015

Overview: Modest Growth and Continued Stability for State Budgets

State budgets continue to grow at a moderate pace after several years of slow recovery in the national economy following the Great Recession. According to executive budget proposals, general fund spending is projected to grow 3.1 percent in fiscal 2016. This growth rate falls below the historical average, though the current inflation rate remains low as well. Forty-two governors recommended spending increases in fiscal 2016 compared to the current fiscal year, helping to bolster core services such as K-12 education and health care. Mid-year budget cuts in fiscal 2015 remain fairly minimal compared to the levels observed during and immediately following the Great Recession. However, progress is slow for a number of states and structural issues remain. States vary in their fiscal health due to a combination of economic, demographic and policy factors. Long-term spending pressures in areas such as health care, education, infrastructure, and pensions continue to pose challenges for many states that will

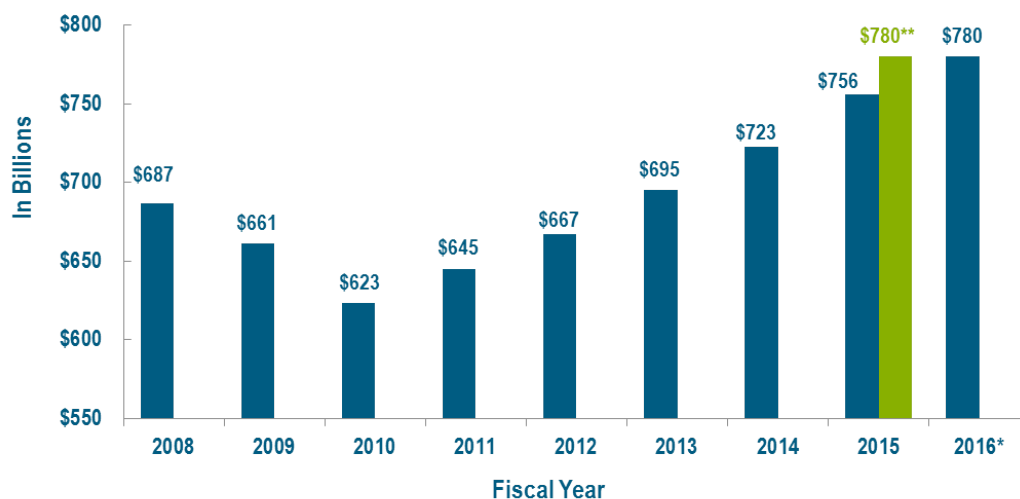
require difficult budgetary decisions. Meanwhile, state tax revenue growth remains limited, as employment continues to grow slowly, wages remain relatively stagnant, and labor force participation is low. States' spending proposals continue to be cautious as they plan for modest revenue growth and seek structural balance.

General Fund Spending Rising Moderately in Most States

In fiscal 2016, general fund expenditures are projected to increase by 3.1 percent, a slower rate of growth than the estimated 4.6 percent increase in fiscal 2015. Executive budgets show general fund spending increasing to \$779.6 billion in fiscal 2016, compared to \$756.2 billion in fiscal 2015. General fund spending in fiscal 2014 reached \$722.8 billion, a 4.1 percent increase over general fund spending in fiscal 2013.

Executive budgets in 42 states call for higher general fund spending levels in fiscal 2016 compared to fiscal 2015. However, new spending is expected to be limited, with few addi-

Annual General Fund Spending



*Fiscal 2016 spending is based on governors' recommended budgets.

**Aggregating spending levels would need to total \$780 billion in fiscal 2015 to be equivalent with real 2008 spending levels.



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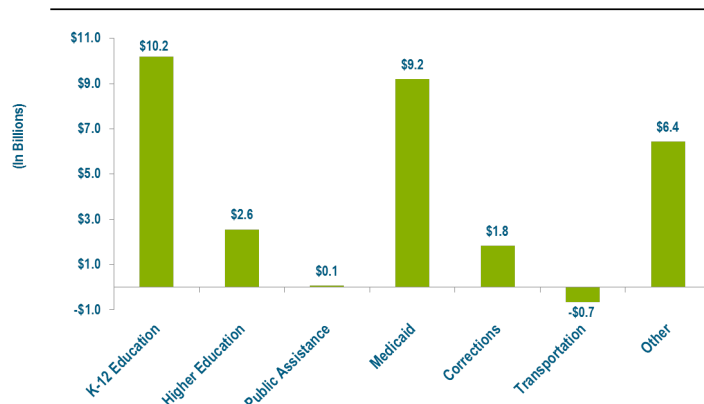
tional budget dollars available to address competing spending demands. Eight states project negative growth, while a majority of states (28) recommended positive spending growth of less than five percent in fiscal 2016. Meanwhile, 10 states project growth between five and ten percent and four states project growth of ten percent or more.

Despite five consecutive years of budget growth and the low inflation environment, state general fund spending for fiscal 2015 for the 50 states combined remains below the fiscal 2008 pre-recession peak after accounting for inflation. Aggregate spending levels would need to be at \$780.5 billion, or 3.2 percent higher than the \$756.2 billion estimated for fiscal 2015, to be equivalent with real 2008 spending levels.¹

Executive Budgets Direct Most Additional Spending to K-12 Education and Medicaid in Fiscal 2016

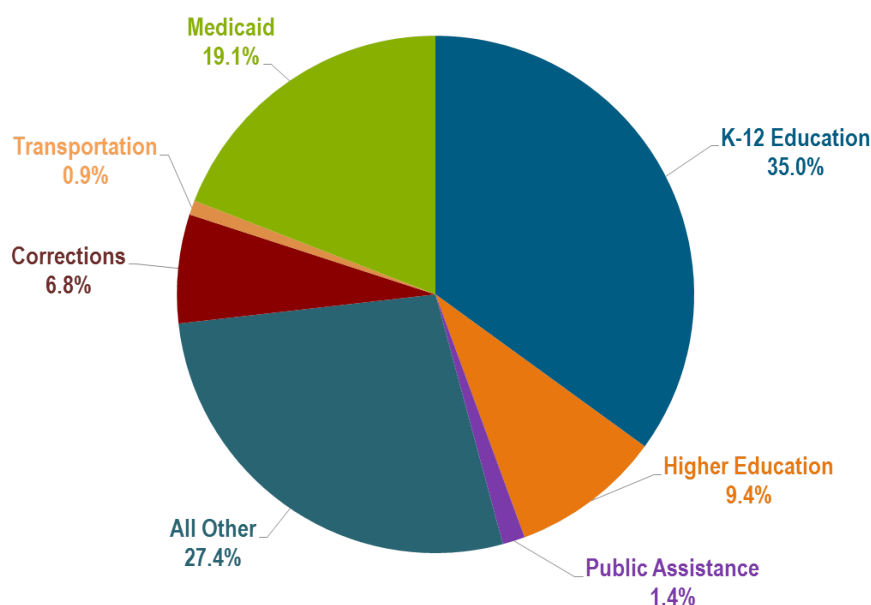
Governors recommended that additional budget dollars most heavily target K-12 education and Medicaid in fiscal 2016, the two largest areas of state general fund expenditures. Governors recommended that additional funds be directed to K-12 education in 42 states and to Medicaid in 38 states, for net increases of

Recommended Budget Adjustments, Fiscal 2016



\$10.2 billion and \$9.2 billion, respectively. K-12 education and Medicaid together comprise a majority of state general fund spending, according to NASBO's State Expenditure Report. Spending increases were recommended for all other areas of the budget in fiscal 2016 with the exception of transportation. However, since most states primarily rely on other fund sources to finance transportation spending, general fund spending adjustments are not necessarily indicative of overall recommended state spending changes for transportation in fiscal 2016. In fact, some states that reported a net decrease in recommended general fund spending on transportation indicated that additional funding from dedicated fund sources (not captured in this report) are recommended for infrastructure investments for the upcoming fiscal year.

General Fund Expenditures by Function, Estimated Fiscal 2014*



*Source: NASBO State Expenditure Report

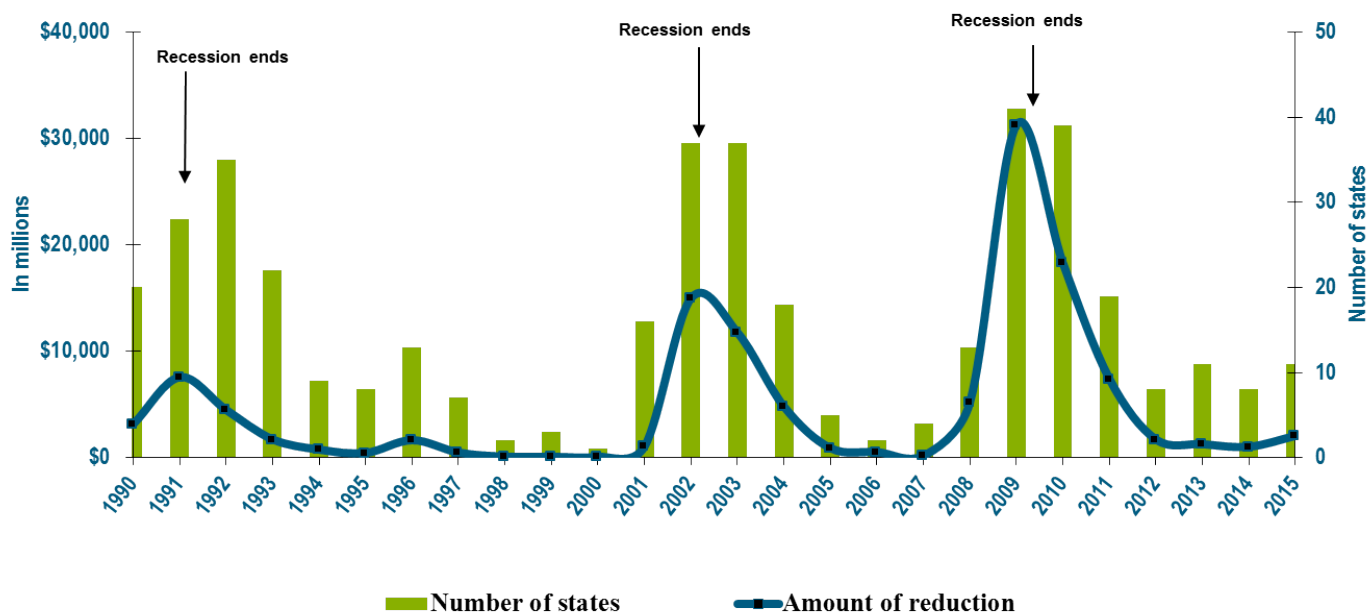
Mid-Year Spending Increases Narrowly Exceed Budget Cuts in Fiscal 2015

State budget gaps that arise during the fiscal year are primarily solved through a reduction in previously appropriated spending. 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. Similar to recent years, mid-year budget cuts have been minimal in fiscal 2015, though they did exceed the previous year's level. At the time of data collection, 11 states enacted net mid-year budget cuts totaling \$2.0 billion in fiscal 2015. This compares with eight states enacting \$1.0 billion in net mid-year budget cuts by this time in fiscal 2014, and 11 states enacting \$1.3 billion in net mid-year budget cuts in fiscal 2013. Meanwhile, 16 states enacted net mid-year spending increases in fiscal 2015 totaling \$2.3 billion. Additionally, four states enacted mid-year tax decreases, and one state enacted a mid-year tax increase resulting in a net revenue reduction of \$1.3 billion in fiscal 2015.

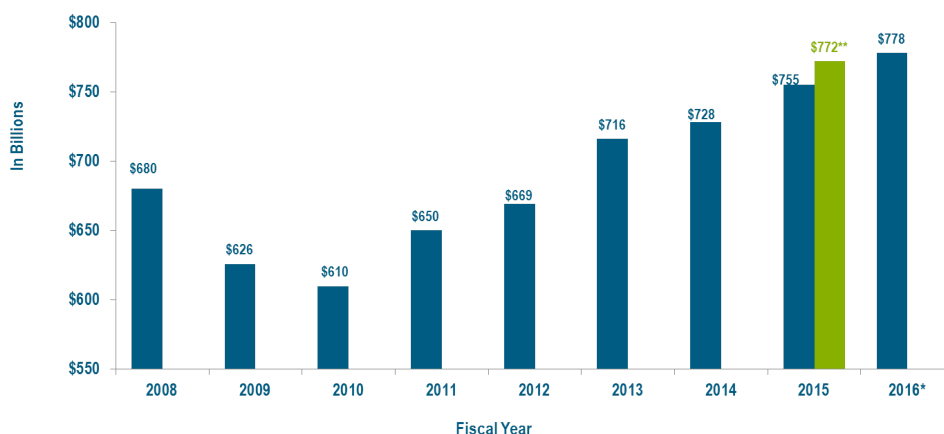
Revenue Growth Stabilizes, with Moderate Increase Projected in Fiscal 2016

Aggregate general fund revenues are projected to modestly increase in fiscal 2016. Governors' recommended budgets show revenue collections are projected to increase by 3.0 percent in fiscal 2016, a slightly slower growth rate than the estimated 3.7 percent gain in fiscal 2015. However, the growth rate is higher than observed in fiscal 2014, when revenues increased by only 1.6 percent. The revenue slowdown in fiscal 2014 can be largely attributed to the volatility caused by individuals shifting capital gains, dividends and personal income to the 2012 calendar year to avoid higher federal tax rates that were set to take effect on January 1, 2013. This one-time shift led to a substantial acceleration of revenue growth in fiscal 2013, followed by the slowdown in fiscal 2014. With more distance now from the impact of the so-called "federal fiscal cliff," most states appear to be returning to more stable patterns of modest annual revenue growth. However, the steep decline in oil prices recently has placed significant downward pressure on revenues in certain energy-producing states.

**Budget Cuts Made After the Budget Passed
Fiscal 1990 to Fiscal 2015**



Annual General Fund Revenues



*Fiscal 2016 revenues are based on governors' recommended budgets.

**Aggregate revenue levels would need to total \$772 billion in fiscal 2015 to be equivalent with real 2008 revenue levels.

Governors' budget proposals forecast total general fund tax revenues of \$777.6 billion in fiscal 2016, compared to the estimated \$755.1 billion collected in fiscal 2015. Total general fund revenues in fiscal 2014 reached \$728.1 billion. Despite five years of consecutive growth, aggregate revenues are still 2.3 percent below fiscal 2008 levels after accounting for inflation. Fiscal 2015 revenues would have needed to reach \$772.5 billion, rather than the estimated \$755.1 billion, to be equivalent with inflation adjusted 2008 levels.² The data for this report were collected prior to April tax collections coming in. Many states had a positive "April surprise" this year after taxpayers filed their income tax returns, due to the strong stock market performance in calendar year 2014, which will likely help more states stabilize their budgets.

Governors Recommend a Mix of Tax Increases and Decreases in Fiscal 2016

Governors in 16 states proposed net tax and fee increases, while governors in 12 states proposed net decreases in fiscal 2016, resulting in an aggregate net increase of \$3.0 billion. For the most part, increases were proposed for general sales taxes and cigarette taxes – ten states recommended a sales tax increase and nine states recommended increased taxes on cigarettes and tobacco products. Meanwhile, a dozen states proposed decreases for personal income taxes. Pennsylvania was the largest driver of the net increase, recommending \$4.6 billion in tax and fee increases for fiscal 2016, followed by Connecticut and

Enacted State Revenue Changes, Fiscal 1980 to Fiscal 2015 & Recommended State Revenue Actions, Fiscal 2016



Alabama. Texas recommended the largest decrease, followed by Florida and Ohio. It should be noted that since many states limited reporting on tax changes to those impacting the general fund only, not all proposed changes to dedicated revenue sources, including state motor fuel taxes, are reflected in this report. Governors have also proposed \$1.7 billion in new revenue measures in fiscal 2016.

Total Balances Expected to Decline in Fiscal 2016

Total balances include both ending balances and the amounts in states' budget stabilization funds (rainy day funds and reserves). In fiscal 2014, total balances amounted to \$71.2 billion, or 9.9 percent of general fund expenditures. This marks a slight decline compared to fiscal 2013, when strong budget surpluses due to increased revenue collections helped to bolster states' balance levels, reaching \$72.2 billion (10.4 percent), an all-time high for states in terms of actual dollars, though not as a percentage of expenditures. Total balances are estimated to have declined again in fiscal 2015 to \$60.3 billion or 8.0 percent of expenditures, though this decrease is mostly attributable to an \$8.9 billion drop in Alaska's balance levels as the state has tapped its reserves to respond to the revenue impacts of declining oil prices. Governors recommended reducing total balance levels in fiscal 2016 to \$55.2 billion or 7.1 percent of general fund expenditures.³

In recent years, two states – Alaska and Texas – have held a disproportionate share of states' budget reserves. In fiscal 2014, the balance levels of Alaska and Texas made up 39 percent of total state balance levels. However, Alaska's share has declined substantially according to estimated balance levels in fiscal 2015 and recommended levels in fiscal 2016. Texas's reserves, meanwhile, are expected to continue growing, and by fiscal 2016, are projected to comprise 34 percent of states' total balances. The remaining 48 states – excluding Oklahoma (see footnote on page 6) – are projected to have total balance levels representing 5.0 percent of general fund expenditures in fiscal 2016.

Medicaid Spending and Enrollment Growth Accelerates in Fiscal 2015, Projected to Slow in Fiscal 2016

In fiscal 2015, total Medicaid spending is estimated to grow by 18.2 percent, with state funds increasing by 5.2 percent and federal funds increasing by 24.2 percent. The substantial increase in Medicaid spending in fiscal 2015 is largely attributable to the fact that this is the first full fiscal year reflecting the impact of Medicaid expansion under the Affordable Care Act (ACA) for almost all of the expansion states. Fiscal 2014 reflected a partial year impact of the optional Medicaid expansion under the ACA for those states that began expan-

Total Year-End Balances as a Percentage of Expenditures



sion on January 1, 2014. Total Medicaid spending increased by 8.6 percent in fiscal 2014, with state funds growing by 5.9 percent and federal funds growing by 11.9 percent. The rate of growth in federal funds significantly exceeds the state fund growth rate since costs for those newly eligible for coverage are fully federally funded in calendar years 2014, 2015, and 2016, with federal financing phasing down to 90 percent by 2020. Medicaid spending growth in fiscal 2016 is expected to slow significantly according to governors' proposed budgets. Fiscal 2016 spending on Medicaid from all funds is projected to increase by 5.2 percent, with federal funds increasing by 6.9 percent and state funds increasing by 3.1 percent (roughly equivalent to recommended overall state budget growth).

Medicaid enrollment is estimated to increase by 13.4 percent in fiscal 2015, after having increased 9.5 percent in fiscal 2014. This reflects both the impact from the Affordable Care Act including increased enrollment in states that have implemented the Medicaid expansion that began on January 1, 2014, as well as increased participation among those currently eligible in both states that did and did not implement the expansion. In governors' recommended budgets for fiscal 2016, Medicaid enrollment growth is expected to slow, increasing by 4.6 percent.

Conclusion: Modest Growth in Fiscal 2016 but Challenges Remain

State budgets are projected to grow again in fiscal 2016 for a sixth consecutive year, extending the period of fiscal rebuilding for states. Most states continue on a path of stable, moderate spending and revenue growth, though some states face structural budget challenges that will need to be addressed going forward. Long-term spending pressures on K-12 education, health care, pensions and other critical areas continue to grow, often faster than state revenue growth. Overall, state finances continue to improve, but growth is modest and governors' spending proposals for fiscal 2016 remain cautious.

¹See Bureau of Economic Analysis National Income and Product Account Tables, Table 3.9.4, Line 33 in April 2015, which provides state and local government implicit price deflator. The fiscal 2015 inflation rate determined based on average of first three quarters.

²See Bureau of Economic Analysis National Income and Product Account Tables, Table 3.9.4, Line 33 in April 2015, which provides state and local government implicit price deflator. The fiscal 2015 inflation rate determined based on average of first three quarters.

³ Fiscal 2015 and Fiscal 2016 figures for Total Balances exclude Oklahoma, due to complete balance data being unavailable for these years.

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