Overview: Slow Growth but Increased Stability for State Budgets

State budgets are expected to continue their trend of moderate growth in fiscal 2015 according to governors' spending proposals. Consistent year-over-year growth has helped states achieve relative budget stability, but progress remains slow for many states. With each passing year of slow improvement, more and more states are moving beyond recession induced declines and returning to spending and revenue growth. According to executive budgets, general fund spending is projected to increase by 2.9 percent in fiscal 2015. This growth rate is less than the historical average, although inflation is also currently low. This means budget growth will likely outpace inflation in many states, presenting an opportunity to accelerate fiscal progress. Governors in most states have recommended additional spending for core services such as K-12 education. However, spending continues to be impacted by limited gains in revenue. Budgetary challenges also linger from a long recovery in the national economy, unemployment rates higher than policy makers want and stagnant wages. As the economy continues along a trajectory of relatively slow growth, many states will continue to face difficult budgetary choices in fiscal 2015 and beyond.

General Fund Spending Rising; Modest State Fiscal Advancements Widespread

In fiscal 2015, general fund expenditures are projected to increase by 2.9 percent, a slower rate of growth than the estimated 5.0 percent increase in fiscal 2014. Executive budgets show general fund spending increasing to $750.5 billion in fiscal 2015, compared to $729.1 billion in fiscal 2014. General fund spending in fiscal 2013 reached $694.1 billion, a 4.1 percent increase over general fund spending in fiscal 2012.

Executive budgets in 42 states call for higher general fund spending levels in fiscal 2015 compared to fiscal 2014.

Annual General Fund Spending

Fiscal Year

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>General Fund Spending ($ In Billions)</th>
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<tbody>
<tr>
<td>2008</td>
<td>$687</td>
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<tr>
<td>2009</td>
<td>$661</td>
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<tr>
<td>2010</td>
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<tr>
<td>2014</td>
<td>$729</td>
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<tr>
<td>2015*</td>
<td>$750</td>
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*Fiscal 2015 spending is based on governors’ recommended budgets
However, additional spending is likely to be limited, with few budget dollars available to cover increasing demands in areas such as Medicaid and higher education. In addition, state spending for fiscal 2014 for the 50 states combined is still below the fiscal 2008 pre-recession peak after accounting for inflation. Aggregate spending levels would need to be at $761 billion, or 4.4 percent higher than the $729.1 billion estimated for fiscal 2014, to be equivalent with real 2008 spending levels.¹

Additional Spending Mostly Directed to K-12 Education and Medicaid in Governors’ Fiscal 2015 Spending Proposals

Governors recommended that additional budget dollars most heavily target K-12 education and Medicaid in fiscal 2015. Executive budget proposals in 39 states recommend increasing general fund spending for K-12 education by $10.9 billion. Governors also recommended that additional funds be directed to Medicaid in 34 states and to higher education in 37 states, for net increases of $4.9 billion and $3.5 billion respectively. All areas of the budget received recommended spending increases in fiscal 2015 with the exception of public assistance, although much of the net decrease was due to a shift in spending from funds outside the general fund in California.

Mid-Year Budget Cuts Minimal, Indicating Less Volatility

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

¹ See the U.S. Bureau of Economic Analysis National Income and Product Account Tables. Table 3.9.4. Price Indexes for Government Consumption Expenditures and Gross Investment last revised on April 30, 2014. Line 33, state and local price index, is used for determining changes in real purchases. Fiscal year inflation rates determined through quarterly averages. Fiscal 2014 only includes the first three quarters of the fiscal year.
to make substantial cuts and take other actions, such as expend rainy day funds, to balance their budgets. Similar to fiscal 2012 and 2013, mid-year budget cuts have been minimal in fiscal 2014. At the time of data collection, February through April, eight states enacted net mid-year budget cuts totaling $1.0 billion in fiscal 2014. This compares with 11 states enacting $1.3 billion in net mid-year budget cuts in fiscal 2013, and eight states enacting $1.7 billion in net mid-year budget cuts in fiscal 2012. In contrast, 18 states enacted mid-year spending increases in fiscal 2014 totaling $2.3 billion. Additionally, six states enacted mid-year tax decreases, and one state enacted a mid-year tax increase resulting in a net revenue reduction of $184 million in fiscal 2014. Improved revenue collections and spending controls have significantly reduced the number of states needing to make budget cuts in fiscal 2014.

**Revenues Projected to Increase Moderately in FY 2015, After Slight Gains in FY 2014**

Aggregate general fund revenues are projected to modestly increase in fiscal 2015. Governors' recommended budgets show collections are projected to increase by 3.2 percent in fiscal 2015, a faster rate of growth than the estimated 1.2 percent gain in fiscal 2014. However, the growth rate is much slower than fiscal 2013, in which revenues increased by 7.1 percent. Substantial revenue increases in fiscal 2013 were attributable in large part to a one-time gain for states as high income taxpayers shifted capital gains, dividends and personal income to calendar year 2012 to avoid higher federal tax rates that were set to begin on January 1, 2013. States planned for the revenue slowdown in fiscal 2014 accordingly, but collections may not meet expectations in some states. Revenue shortfalls in fiscal 2014 are more likely a consequence of unanticipated volatility tied to tax law changes that were part of the federal “fiscal cliff” and individual taxpayer behavior, rather than underlying changes in the economy.

Governors' budget proposals forecast total general fund tax revenues of $749.2 billion in fiscal 2015, compared to the estimated $725.6 billion collected in fiscal 2014. Total general fund revenues in fiscal 2013 reached $716.9 billion and surpassed the pre-recession highs of fiscal 2008 by $41.2 billion or 6.1 percent. Yet, aggregate revenues in fiscal 2014 are still 3.8 percent below fiscal 2008 levels after accounting for inflation. Fiscal 2014 revenues would have needed to reach $753 billion, rather than the estimated $725.6 billion, to be equivalent with inflation adjusted 2008 levels.²

**Governors Recommend Net Tax Cuts in FY 2015**

Executive budgets recommended reducing net taxes and fees by $2.5 billion in fiscal 2015, although most tax change proposals are modest. Eight governors proposed tax increases and 15 proposed tax decreases. Governors in 32 states either proposed no tax changes or changes resulting in less than $5 million. States with the largest proposed tax decreases

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²See the U.S. Bureau of Economic Analysis National Income and Product Account Tables. Table 3.9.4. Price Indexes for Government Consumption Expenditures and Gross Investment last revised on April 30, 2014. Line 33, state and local price index, is used for determining changes in real revenues. Fiscal year inflation rates determined through quarterly averages. Fiscal 2014 only includes the first three quarters of the fiscal year.
include Florida, Minnesota, New York and Ohio. States with
governors proposing the largest tax increases include Delaware,
Massachusetts and New Jersey, which took efforts to close
corporate tax loopholes. Governors have also proposed $440
million in new revenue measures in fiscal 2015. State legislatures
enacted net tax cuts in fiscal 2014; however, fiscal 2015 is the
first time since the onset of the recession that governors put
forth recommendations to reduce rather than increase net taxes
and fees. In fiscal 2014, states cut taxes and fees by $2.1 billion,
after raising taxes and fees by $6.9 billion in fiscal 2013.

**Total Balances Expected to Decrease in FY 2015**

In fiscal 2013, total balances, which include ending balances
and rainy day funds, reached $73.5 billion, or 10.6 percent
of general fund expenditures. This marked an all-time high
for states in terms of actual dollars, though not as a percent
of expenditures. Budget reserves increased substantially in
fiscal 2013 as one-time revenues attributable to the federal
fiscal cliff resulted in collections higher than projections.
This led to budget surpluses in many states and greater
than anticipated ending balances by the close of fiscal 2013.
However, total balances declined in fiscal 2014 as states
utilized ending balances from fiscal 2013 to acclimate budgets
to the slowdown in revenue collections. Total balances are
estimated to be $63 billion or 8.6 percent of expenditures in
fiscal 2014. And governors recommended decreasing total
balance levels in fiscal 2015 to $55.4 billion or 7.4 percent
of general fund expenditures. In addition, two states have
a disproportionate share of states’ budget reserves. The
balance levels of Alaska and Texas are estimated to make
up 37 percent of total state balance levels in fiscal 2014 and
37.7 percent in fiscal 2015. The remaining 48 states have
balance levels that represent only 3.5 percent of general fund
expenditures for fiscal 2014 and 3.0 percent for fiscal 2015.
Medicaid Outlook

For fiscal 2014, total Medicaid spending is estimated to grow by 13.0 percent with state funds increasing by 5.9 percent and federal funds increasing by 18.3 percent. Executive budgets for fiscal 2015 assume an increase in Medicaid spending of 7.6 percent in total funds with state funds increasing by 5.8 percent and federal funds increasing by 10.2 percent. The projected growth rates in fiscal 2014 and in fiscal 2015 reflect both the Affordable Care Act’s Medicaid expansion option that began on January 1, 2014, in addition to ongoing program spending. The rate of growth in federal funds 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 enrollment is estimated to increase by 6.9 percent in fiscal 2014. In governors’ recommended budgets for fiscal 2015, Medicaid enrollment would rise by an additional 8.9 percent. This reflects both the impact from the Affordable Care Act including increased enrollment in states that have implemented the Medicaid expansion that began in January 1, 2014, as well as increased participation among those currently eligible in both states that did and did not implement the expansion.

Conclusion: Growth to Continue in Fiscal 2015 but Progress Slow

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 recession, states have transitioned to a sustained period of fiscal rebuilding. However, progress is slow and structural challenges remain. Spending challenges persist in areas such as health care and higher education, and governors’ recommended budgets indicate that revenue growth may not be sufficient to meet all the competing demands for state resources. As states shift some of their focus from immediate budgetary pressures, long-term challenges are likely to persist in fiscal 2015 as revenue growth remains modest.

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