States in Strong Fiscal Position as They Spend Surpluses, with Slower Growth Expected

Governors’ budgets for fiscal 2023 call for a 4.2 percent increase in general fund spending compared to estimated levels for fiscal 2022. This follows 13.6 percent spending growth in fiscal 2022, the highest annual increase recorded in the Fiscal Survey of States in more than 40 years. As states spend down their revenue surpluses from fiscal 2021 and fiscal 2022, mostly on one-time expenditures, this has led to larger than usual fluctuations in spending from year to year. Looking at average spending growth for states over three years – fiscal 2021, fiscal 2022 (estimated), and fiscal 2023 (recommended) – the median annual growth rate is 5.3 percent.

State revenues have continued to perform better than was expected earlier in the pandemic, with tax collections coming in ahead of budget projections in nearly all states for both fiscal 2021 and fiscal 2022. After experiencing record annual growth in general fund revenue in fiscal 2021, largely attributable to one-time factors, fiscal 2022 general fund revenue is estimated to grow 3.2 percent, though final collections are likely to come in higher than estimated in this survey.

Revenue projections in governors’ recommended budgets for fiscal 2023 show slow growth of 1.4 percent after incorporating the forecasted impacts of proposed tax policy changes for fiscal 2023 that would reduce general fund revenue by an estimated $14.1 billion (or 1.3 percent of total general fund revenues). Many states have revised their projections upward since these forecasts were produced, based on more recent collections data. At the same time, state revenue forecasters are watching closely for warning signs about the economy as the Federal Reserve tries to bring inflation under control, the Russia-Ukraine conflict continues to put upward pressure on gas prices, and labor shortages and supply chain issues continue to present challenges for states and businesses.

States continue to strengthen their reserves to guard against this uncertainty and prepare for the next downturn. Rainy day funds in fiscal 2022 are estimated to reach new heights, with 41 states projecting increases. This follows fiscal 2021, when aggregate rainy day fund balances increased 62 percent after nearly all states experienced revenue surpluses. Total balances, meanwhile, have risen sharply over the last couple of years as well, and states are planning to spend down some of these funds according to governors’ fiscal 2023 budgets.

Fiscal 2023 Recommended Budgets Call for Moderate Spending Growth Following Largest Annual Increase in Over 40 Years

Governors’ budget recommendations call for general fund spending totaling $1.10 trillion in fiscal 2023, a 4.2 percent increase over estimated spending levels for fiscal 2022. This projected spending growth is considerably more modest than the estimated increase reported by states in fiscal 2022, which was largely driven by one-time expenditures from surplus state funds, as well as federal funds in a few instances. Overall, 36 states are projecting general fund spending increases in fiscal 2023, while 13 states are forecasting declines and one state was unable to report data on fiscal 2023. Fiscal 2023 recommended budgets were introduced in late calendar year 2021 and early 2022, and upward revenue forecast revisions since then may alter these spending plans.
Based on current estimates (or governors’ budget recommendations in some cases), general fund spending is on track to total $1.05 trillion in fiscal 2022, a 13.6 percent increase over fiscal 2021 levels. This is the fastest annual growth rate recorded in the Fiscal Survey since fiscal 1981, driven by a number of variables, including: states spending down surplus funds from fiscal 2021 (and fiscal 2022) on one-time investments; a shift from a reliance on federal funds to general funds in certain areas; a lower baseline in fiscal 2021, when some states made budget cuts in anticipation of revenue shortfalls; and the inclusion of federal COVID-19 funds in expenditure amounts for a few states. Inflation is likely also a driver behind the increase. Adjusted for inflation, general fund spending in fiscal 2022 is estimated to grow 7.0 percent.2 (See Figure 1.)

**Recommended Budgets for Fiscal 2023 Call for Net Increases in Nearly All Program Areas, at Similar Levels to Proposals One Year Earlier**

Recommended budgets for fiscal 2023 call for $74.8 billion in increases over fiscal 2022 enacted appropriation levels. All program areas would see net increases in general fund appropriations according to governors’ budget recommendations for fiscal 2023 except transportation, a program area that is primarily funded by special fund sources outside of the general fund. The “All Other” category would receive the largest net increase, closely followed by the projected increase in Medicaid, as governors’ budgets planned the end of the enhanced Federal Medical Assistance Percentage (FMAP) tied to the Public Health Emergency in fiscal 2023. K-12 education, higher education, public assistance, and corrections would see increases as well. Appropriation increases for fiscal 2023 also reflect a shift from reliance on federal funds for certain expenditures to a greater reliance on general funds, especially for Medicaid.

Governors’ budgets for fiscal 2023, in terms of spending changes by program area and the overall scale of net increases, resemble proposals one year ago for fiscal 2022 in many ways, when governors proposed $70.5 billion in net appropriation increases. (See Figure 2.) Enacted budgets for fiscal 2022 ended up being considerably larger than what governors proposed, thanks to upward revisions in revenue projections. It is possible that this could happen to some extent again for fiscal 2023 enacted budgets, as revenue collections have been running ahead of the forecasts used in governors’ budgets for most states.

**Due to Strong Fiscal Conditions, States Report Minimal Use of Budget Cuts and Other Balancing Actions**

In order to manage their budgets, particularly in an economic downturn, states employ a variety of strategies and tools, including spending reductions (across-the-board or targeted), revenue changes, personnel actions, efficiency savings, and one-
time measures. Given strong fiscal conditions currently in most states, budget management strategies reported in this survey were fairly minimal and targeted.

In fiscal 2023 recommended budgets, only five states reported making targeted spending cuts and one state reported making across-the-board cuts. In contrast, one year earlier, governors recommended targeted cuts in 17 states and across-the-board cuts in three states. The use of personnel actions was minimal as well in fiscal 2023, with only three states continuing hiring freezes and none imposing furloughs. Similarly low use of various budget balancing tools was reported for the middle of fiscal 2022 as well. (See Figure 3.)

Regarding mid-year budget actions, states also reported on spending changes considered or adopted in the middle of fiscal 2022 in quantitative terms. Overall, 22 states reported net mid-year increases in general fund spending for fiscal 2022, while seven states reported decreases compared to their enacted budgets. Among the seven states that reported net mid-year cuts, none reported these cuts were made in response to a revenue shortfall. (See Figure 4.) Rather, states with decreases reported the reductions were attributed to lower spending needs or in areas where federal assistance was able to be used in place of general funds. For the states that reported net mid-year increases in general fund spending, these included supplemental appropriations for fiscal 2022 to address additional spending needs, including disaster assistance and COVID-related expenses, as well as one-time expenditures using surplus funds for capital construction, paying off debt, rainy day fund deposits, and supplemental pension payments.
49 States Report Collections Outperforming Budget Projections in Fiscal 2022

General fund collections for fiscal 2022 from all revenue sources were exceeding original projections used to adopt budgets in 49 out of 50 states at the time of data collection. This marks the second consecutive year when virtually all states saw tax collections outperform budget forecasts. (See Figure 5.) Additionally, 33 states reported collections were coming in above their most recent official forecasts for fiscal 2022 at the time of survey completion, while 11 states said they were on target and the remaining states were unable to report; no states said they were coming in lower than their most recent forecasts. Just as with fiscal 2021, state revenues in fiscal 2022 have been helped by the economic impacts of federal stimulus. Additionally, recent employment and wage growth, increased consumption, a strong stock market performance in 2021, and rising inflation are likely helping to drive these revenue gains.

Figure 4.
Budget Cuts Made After The Budget Passed

Gray boxes denote recessionary periods, based on a July-June fiscal year calendar that most states follow. Recession dates are as follows: Early 1990s recession (July 1990 to March 1991); Early 2000s recession (March 2001 to November 2001); Great Recession (December 2007 to June 2009); COVID-19 Recession (February 2020 – April 2020).

Note: Beginning in Fiscal 2018, NASBO asked states reporting net mid-year budget reductions whether the reductions were made due, at least in part, to a revenue shortfall. Effective in FY2018 going forward, only states reporting mid-year budget cuts due to a revenue shortfall are included in the totals reported in this figure. Prior to FY2018, particularly in non-recessionary periods, states that reported mid-year cuts that were due to other reasons, such as a reduction in caseload, would have been included in the counts above.

Figure 5.
General Fund Revenue Collections Compared To Original Budget Projections (By Fiscal Year)

*Fiscal 2022 is ongoing; figures are subject to change.
State Revenue Growth Projected to Slow in Fiscal 2023

Governors’ budgets for fiscal 2023 are based on general fund revenues totaling $1.07 trillion, which would represent modest growth of 1.4 percent compared to fiscal 2022 levels. This slow growth rate is from a high baseline, as it follows record high growth in fiscal 2021 and moderate growth estimated in fiscal 2022. Based on the strong performance of recent revenue collections, many states have revised their fiscal 2023 forecasts upward compared to the projections used in governors’ recommendations. Among the states able to report more current projections for fiscal 2023, all reported upward revisions compared to the estimates used in governors’ budgets. That said, there are also some downside risks to fiscal 2023 revenue forecasts that states are mindful of, including the steep rise in gas prices due to the Russia-Ukraine conflict, the impacts of high inflation, and the potential for a recession.

States reported in this survey fiscal 2022 general fund revenue estimates totaling $1.05 trillion, representing a 3.2 percent increase compared to fiscal 2021 levels. This data was mostly collected before states had data on April tax collections, which significantly outperformed forecasts in most states, and final fiscal 2022 collections are likely to exceed the estimates in this report.

State revenues performed considerably better in fiscal 2021 than was expected earlier in the pandemic, due in large part to federal stimulus that pumped additional money into the economy. States reported fiscal 2021 general fund revenues totaling $1.02 trillion, representing a sharp 16.5 percent increase over fiscal 2020 actual collections – the highest annual growth rate ever recorded in the Fiscal Survey of States. Several one-time factors contributed to this increase, including a low baseline in fiscal 2020, the impact of the tax deadline shift on when revenues in some states were recognized, and the inclusion of federal funds, borrowing and other sources in at least a few states. (See Figure 6.)

As referenced above, the annual percentage changes in general fund revenue in fiscal 2021 and fiscal 2022 were affected by the shift in the tax deadline from April 15, 2020 to July 15, 2020. Nineteen states reported that they recognized these revenues due to the deadline shift in fiscal 2021 instead of fiscal 2020 (most states end their fiscal year on June 30), while the other 31 states did not defer the delayed revenue, either because they recognized receipts on an accrual basis, they do not collect an income tax, or follow a different fiscal year. Deferring states were much more likely to report large, double-digit percentage increases in fiscal 2021, followed by slower growth or decreases again in fiscal 2022. Comparing the median general fund growth rates for fiscal 2021 and fiscal 2022 for states that deferred revenues to those that did not defer can help illuminate this. The median growth rates for all 50 states were 15.6 percent in fiscal 2021 and 0.9 percent in fiscal 2022. For the 31 states that did not defer revenues due to the deadline change, median growth was 12.2 percent in fiscal 2021 and 2.5 percent in fiscal 2022. For those states that deferred revenue, median growth was 20.6 percent in fiscal 2021 and -2.3 percent in fiscal 2022.

Figure 6. Annual General Fund Revenue Changes, Fiscal 2007 To Fiscal 2023 (Percentage Change)

Note: Fiscal 2022 figure is estimated; fiscal 2023 figure is based on recommended budgets.
General Fund Revenue Estimates Have Improved Over Course of Pandemic

State revenues performed considerably better than was expected earlier in the pandemic for several reasons. First, federal stimulus measures put a lot of additional money into the economy and directly boosted personal income. Second, personal income taxes were not as impacted as expected due to the recession disproportionately affecting low-income workers while high-income earners have been relatively insulated. Third, the pandemic’s effects on economic activity largely curtailed consumption of services that most states do not tax, while consumption of goods, which are taxed, was less affected. Fourth, increased online sales tax collections following the U.S. Supreme Court decision in Wayfair v. South Dakota has mitigated sales tax losses.

This trajectory of continued improvement in revenue forecasts is evident in NASBO’s Fiscal Survey of States. Eighteen months ago, state revenue estimates reported in the Fall 2020 Fiscal Survey predicted that general fund revenue would record an annual decline of 3.5 percent in fiscal 2021. Meanwhile, in this survey, states reported final actual collections for fiscal 2021 that recorded a 16.5 percent increase over prior-year levels. This large swing speaks to the many difficulties of and tremendous uncertainty surrounding state revenue forecasts during the pandemic. Most states saw general fund collections come in above their pre-COVID forecasts as well. Examining general fund revenue for fiscal 2020 and fiscal 2021 combined, aggregate collections came in 3.2 percent above states’ (mostly) pre-COVID forecasts reported in NASBO’s Spring 2020 Fiscal Survey. Fiscal 2022 revenue estimates have seen significant improvement as well since they were first reported in the Spring 2021 Fiscal Survey, based on governors’ budget proposals, which predated passage of the American Rescue Plan Act. (See Figure 7.)

Governors in 30 States Recommend Net Tax Reductions in Fiscal 2023

According to governors’ budgets, governors in 30 states are proposing net decreases in taxes and fees while just three are proposing net increases, resulting in a projected net revenue decline in fiscal 2023 of $15.0 billion for all state funds. Looking only at the impact on general fund revenue, these changes would reduce revenue on net by $14.1 billion, representing 1.3 percent of forecasted general fund revenues in fiscal 2023 governors’ budgets. It is worth noting that, if enacted, a $15.0 billion reduction in revenues from proposed tax changes would be the largest decline on record in the history of the Fiscal Survey of States. Measured as a share of general fund revenue, the percentage decrease would be similar to the reductions recorded in the late 1990s and early 2000s.

The scale and scope of tax reductions proposed by governors for fiscal 2023 reflect strong fiscal conditions. They also mark a departure from one year ago, when governors proposed revenue actions that would have resulted in a net increase in revenue of $6.5 billion. Proposed tax cuts in governors’
fiscal 2023 budgets ranged from targeted, one-time tax relief measures to permanent, broad-based rate reductions – often phased-in over a series of years. (See Figure 8.)

State Balance Levels Remain High After Steep Increase in Fiscal 2021

Before the COVID-19 crisis hit, state rainy day funds and total balances were at an all-time high, after a decade of rebuilding reserves following the Great Recession. As they coped with weakening revenue projections and increased spending demands early in the pandemic, some states turned to their rainy day funds, other reserves, and prior-year balances as a tool to help manage their budgets, resulting in declines in both rainy day funds and total balances in fiscal 2020. Due to revenues exceeding budget projections as well as other one-time factors, states reported substantial increases in balance levels in fiscal 2021, with both rainy day funds and total balances reaching new record levels. At the end of fiscal 2021, rainy day fund balances totaled $124.5 billion or 13.5 percent as a share of general fund expenditures, while total balances (including rainy day funds) reached $234.7 billion or 25.4 percent of spending. According to current estimates for fiscal 2022, these year-end balances as a share of general fund expenditures are expected to come down slightly – which is a reflection on rising spending levels as opposed to declining balance levels. (See Figure 9.) In dollar terms, both rainy day funds and total balances are estimated to continue growing in fiscal 2022. While balance levels vary by state, growth has been

### Summary of Proposed State Revenue Changes, Fiscal 2023

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<thead>
<tr>
<th>Revenue Type</th>
<th>Sales Tax</th>
<th>Personal Income Tax</th>
<th>Corporate Income Tax</th>
<th>Cigarette/Tobacco Tax</th>
<th>Motor Fuel Tax</th>
<th>Alcohol Tax</th>
<th>Gaming/Lottery Revenue</th>
<th>Other Tax</th>
<th>Fees</th>
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<td>1</td>
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<td>0</td>
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<tr>
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<td>0</td>
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<td>Net Change ($ in Millions)</td>
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<td>-$936</td>
<td>$0</td>
<td>+$7</td>
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<td>Net Change – General Fund Only ($ in Millions)</td>
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<td>-$3</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>-$1,154</td>
<td>+$85</td>
</tr>
</tbody>
</table>

**Figure 8.** Summary of Proposed State Revenue Changes, Fiscal 2023
widespread, with 28 states reporting rainy day fund balances greater than 10 percent of their general fund spending and 47 states reporting total balances greater than 10 percent in fiscal 2022. In governors’ budgets, most states are planning to spend down some of their cash balances – largely on one-time investments, with 34 states forecasting total balance declines; meanwhile, a majority of states (37) plan to maintain or increase their rainy day fund balances in fiscal 2023.

Medicaid Spending Growth Projected to Slow in Fiscal 2023 with Expected Expiration of Enhanced Federal Match

Medicaid spending figures reported in this survey for fiscal 2021 through fiscal 2023 reflect the impact of the COVID-19 pandemic and ensuing economic fallout affecting Medicaid enrollment and spending, as well as the effects of enhanced federal aid for Medicaid. Medicaid spending from all fund sources is estimated to grow 11.1 percent in fiscal 2022 compared to fiscal 2021 levels (median growth of 10.6 percent). Looking only at state fund sources, spending is estimated to increase 11.3 percent in fiscal 2022 after an increase of 2.9 percent in fiscal 2021. Medicaid spending from federal funds, bolstered by the enhanced Federal Medical Assistance Percentage (FMAP) provided in the Families First Coronavirus Response Act that was passed in March 2020, is on track to grow 11.0 percent for fiscal 2022 after increasing 13.8 percent in fiscal 2021. (See Figure 10.)

Looking ahead, Medicaid spending is forecasted to grow at a much slower rate in fiscal 2023 based on governors’ proposed budgets. Total Medicaid spending is projected to grow 2.8 percent for fiscal 2023. Spending from state fund sources is projected to grow 15.6 percent, while federal fund spending is expected to decline 3.6 percent in fiscal 2023. Almost all states assumed in governors’ budgets that the increased FMAP would no longer be available during fiscal 2023, with the majority of states assuming an end date of either March 31, 2022 or June 30, 2022. However, the increased FMAP, which is tied to the public health emergency, now remains in effect until at least September 30, 2022.

States also reported on Medicaid expansion expenditures. As of May 2021, 38 states and the District of Columbia have adopted Medicaid expansion. In this survey, one additional state that has not yet adopted expansion included spending projections from the governor’s budget for fiscal 2023, while one expansion state was unable to provide data. In fiscal 2021, 35 states reported total spending for Medicaid expansion of $119.9 billion, $13.6 billion in state funds, and $106.3 billion in federal funds. In fiscal 2022, 37 states are estimated to spend $139.0 billion in all funds, $15.9 billion in state funds, and $123.0 billion in federal funds. In 38 recommended budgets for fiscal 2023, projected spending for Medicaid expansion totaled $142.8 billion, with $16.4 billion in state funds, and $126.4 billion in federal funds. The median state share for Medicaid expansion on a fiscal year basis is 10 percent for all three fiscal years covered in this survey (fiscal 2021, fiscal 2022 and fiscal 2023).

Additionally, states reported changes to their Medicaid programs in fiscal 2022 and recommended changes for fiscal 2023, both to contain costs and enhance their programs. States’ most common strategies to contain costs included enhanced

Figure 10.
Percentage Change In Medicaid Spending (By Fund Source)
program integrity efforts, policies to cut prescription drug costs, changes to managed care capitation rates reflecting decreased utilization, and delivery system changes. The program enhancements states have made or are planning to make reflect the impact of the pandemic, especially increased provider payments for vulnerable providers, expansion of behavioral services, expanding or restoring benefits, and telehealth.

State Budget Outlook: Slower Pace Ahead After Two Years of Robust Growth and Revenue Surpluses

As states prepare to enter fiscal 2023, they continue to be in a strong fiscal position after two consecutive years of robust growth and widespread revenue surpluses. These surplus funds have helped states invest in capital projects, pay down debt, make supplemental pension payments, bolster reserves and provide inflation relief to consumers and taxpayers. States also continue to leverage federal aid from the American Rescue Plan Act to support residents and businesses affected by the pandemic and make strategic one-time investments that will strengthen the resilience of their economies and communities. Meanwhile, states’ rainy day fund and total balance levels are at record levels, leaving them with a substantial budgetary cushion as the face some uncertainty about the economic outlook. For now, state revenues are projected to continue increasing, but the pace of growth is expected to slow considerably compared to what states have experienced over the past two years.

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