

SUMMARY: NASBO STATE EXPENDITURE REPORT

November 19, 2015

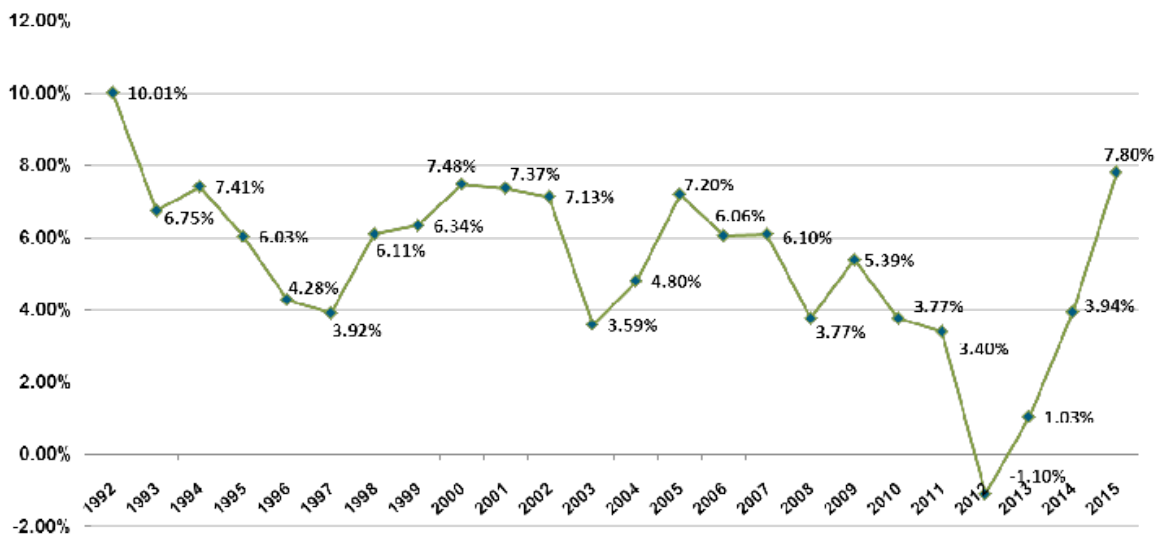
Overview: Total State Spending in Fiscal 2015 Increased at Its Fastest Rate Since 1992, Driven by Federal Medicaid Growth

Estimated total state spending (including general funds, other state funds, bonds, and federal funds) sharply increased in fiscal 2015. The year-over-year percentage growth rate of 7.8 percent was the highest rate since fiscal 1992. The rise in total state spending resulted from a combination of a rapid increase in federal funds to states, and modest growth in states' own fund sources. The acceleration of federal funds to states in fiscal 2015 was almost solely due to states receiving significantly more federal Medicaid dollars as part of the first full-year of Medicaid expansion under the *Affordable Care Act* (ACA).

Total state spending in fiscal 2014 increased at a slower rate than in fiscal 2015, growing 3.9 percent. Both federal funds to states and spending from states' own fund sources experienced modest growth in fiscal 2014. The slower growth in federal funds to states in fiscal 2014 was related to the Medicaid expansion only being implemented during the second half of the fiscal year, while the moderate increase in spending from states' own funds was partly attributable to slow revenue growth. Looking forward, it is likely that spending from states' own fund sources will continue its recent pattern of modest growth as revenue collections increase, while the increase in federal funds to states will likely slow as the growth in Medicaid enrollment is expected to decelerate in future years after states have implemented the ACA.

Increases in Total State Spending

Year-Over-Year Percentage Increases in Total State Expenditures*



*Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states



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Spending from States' Own Funds Moderately Grows in Fiscal 2015, While Federal Funds Rapidly Increase

Over the past several years, spending growth from states' own fund sources has moderately grown as states' revenues have slowly rebounded from the most recent recession and the national economy has gradually improved. Spending from state funds (including general funds and other state funds, but not federal funds or bonds) increased 4.6 percent in fiscal 2011, 3.8 percent in fiscal 2012, 2.6 percent in fiscal 2013, 4.0 percent in fiscal 2014, and an estimated 5.9 percent in fiscal 2015. In fiscal 2015, spending from state funds was partly bolstered by strong growth in personal income tax collections.

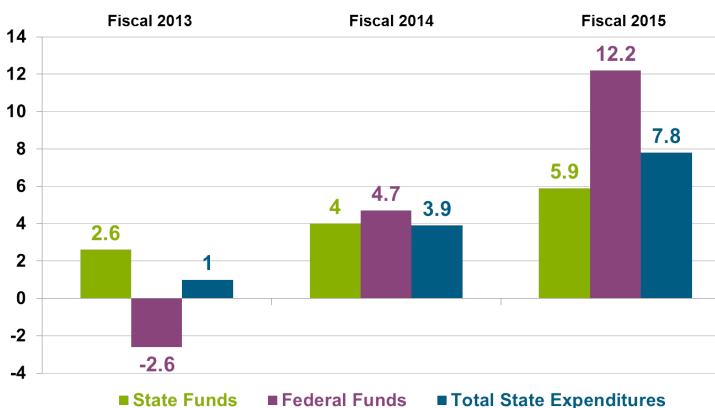
While the level of spending growth from state funds has been relatively stable in recent years, the level of growth in federal funds to states has fluctuated. Due to the wind-down of funds from the *American Recovery and Reinvestment Act of 2009* (ARRA), also known as the Recovery Act or stimulus, federal funds to states only grew 1.0 percent in fiscal 2011, declined 9.8 percent in fiscal 2012 and decreased an additional 2.6 percent in fiscal 2013. However, federal funds rose by 4.7 percent in fiscal 2014 as some states began to receive additional Medicaid funds through the ACA in January 2014. In fiscal 2015, it

is estimated that federal funds to states rose 12.2 percent during the first full year of the optional Medicaid expansion under the ACA. It should also be noted that while federal funds to states rose sharply in fiscal 2015, the increase was almost solely due to increased Medicaid dollars. Federal Medicaid funds to states increased 22.5 percent in fiscal 2015, while all other federal funds to states only grew 2.0 percent.

Medicaid Represents Over Half of All Federal Funds to States in Fiscal 2015

Medicaid is estimated to represent 54.3 percent of all federal funds to states in fiscal 2015, with the next highest program areas being elementary and secondary education at 9.9 percent, and transportation at 7.2 percent. By comparison, in fiscal 2014 Medicaid represented 49.6 percent of all federal funds to states. Medicaid also represents 27.4 percent of total state spending (including all state and federal funds) in fiscal 2015, up from 25.6 percent in fiscal 2014, and 15.8 percent of spending from state-only funds, a slight increase from 15.7 percent in fiscal 2014.

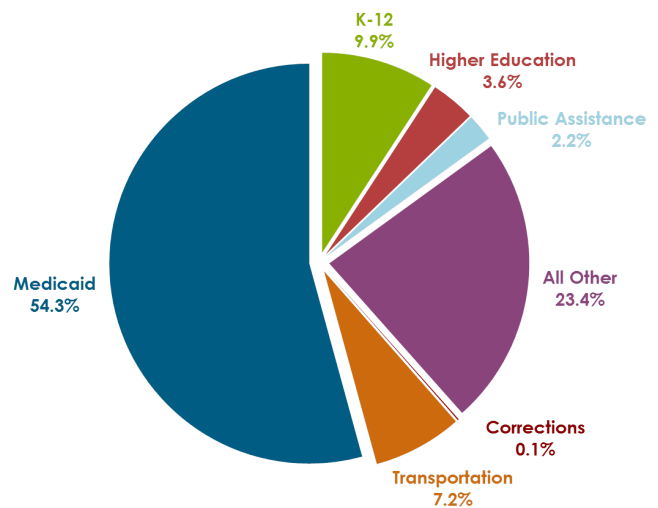
Year-Over-Year Percentage Spending Growth by Fund Source



State funds are general funds and other state funds combined, excluding bonds.
Total state expenditures are all federal and state funds.

Federal Funds Expenditures by Function

(Estimated Fiscal 2015)



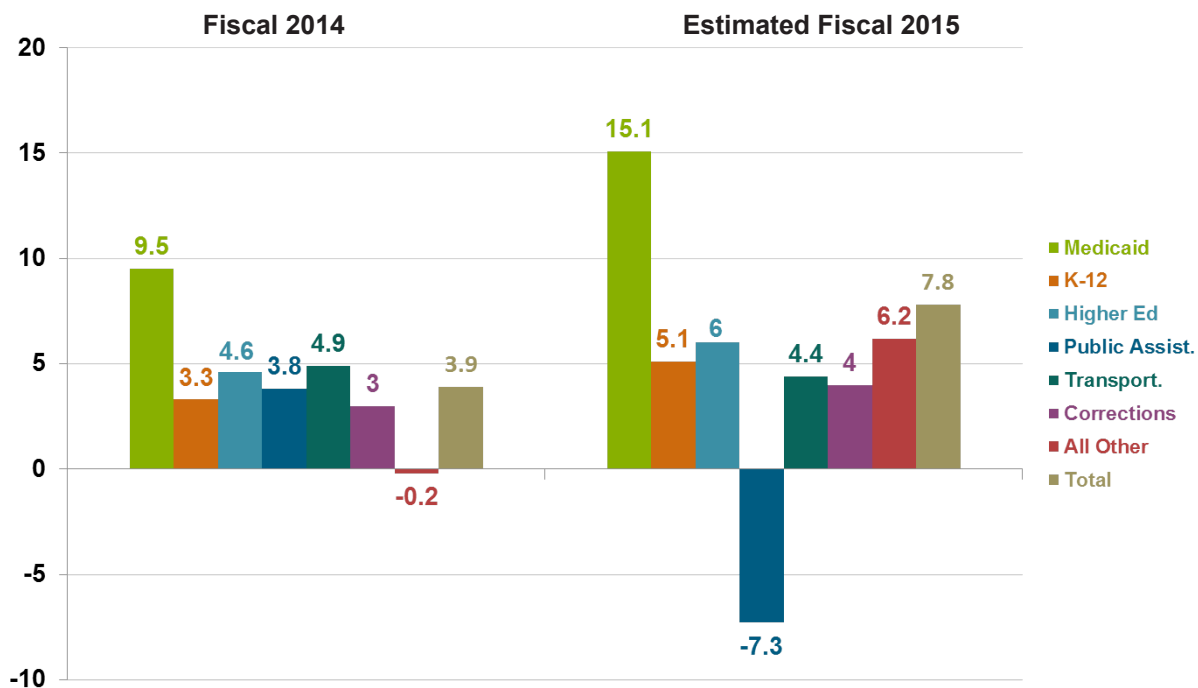
Spending in Most Program Areas Has Recently Increased

Nearly all program areas of total state spending (including all state and federal funds) grew in both fiscal 2014 and estimated fiscal 2015 with only the “all other” category slightly declining in fiscal 2014, and public assistance declining in fiscal 2015. Additionally all areas of spending from states’ own funds increased in both fiscal 2014 and estimated fiscal 2015, with the exception of public assistance declining in fiscal 2015.

Additional state expenditure details and trends include:

- When looking only at general fund spending, **elementary and secondary education** remains the largest category in estimated fiscal 2015, representing 35.2 percent of general fund expenditures, with **Medicaid** second at 19.3 percent. Those two categories, combined with **higher education** at 10.0 percent, account for nearly two-thirds of general fund spending.
- **Elementary and secondary education** total expenditures increased by 3.3 percent in fiscal 2014 and increased by 5.1 percent in estimated fiscal 2015. While state funds increased by 4.1 percent in fiscal 2014, federal funds grew only 0.1 percent. In fiscal 2015, state funds increased 5.4 percent while federal funds grew 3.7 percent.
- Total expenditures for **higher education** increased by 4.6 percent in fiscal 2014 and are estimated to have increased by 6.0 percent in fiscal 2015. State funds for higher education increased by 6.0 percent in fiscal 2014 and are estimated to have increased by 6.9 percent in fiscal 2015, while federal funds declined 1.4 percent in fiscal 2014 and declined by an estimated 1.6 percent in fiscal 2015. As opposed to prior years when much of the growth in state funds for higher education was coming from other state funds (which includes tuition and fees in most states), and not general funds, general fund spending on higher education experienced strong gains in both fiscal 2014 and fiscal 2015, growing 5.2 percent and 7.7 percent respectively.

Total State Expenditures Percentage Spending Growth by Program Area

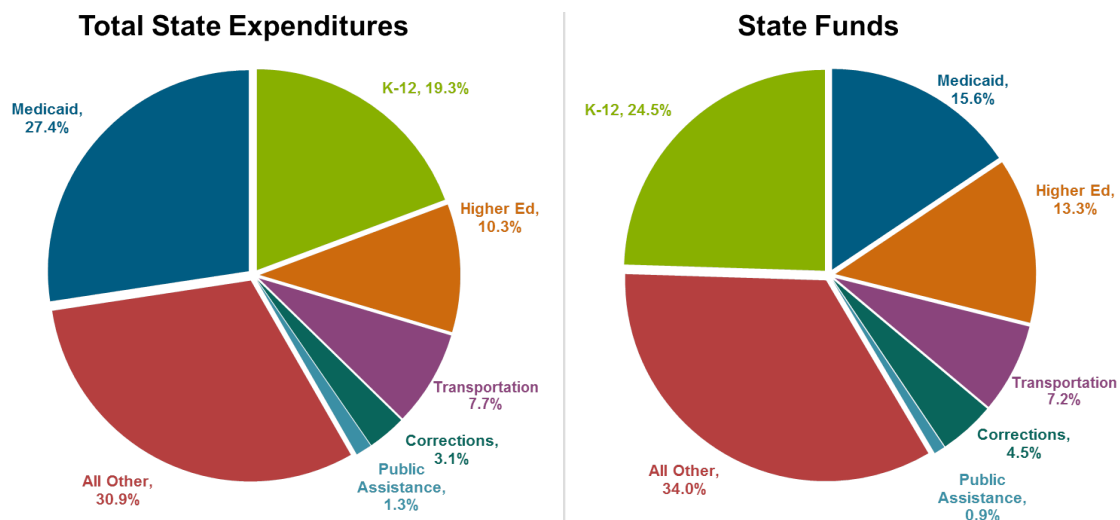


*Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states

- Total **public assistance** increased by 3.8 percent in fiscal 2014 and declined by 7.3 percent in estimated fiscal 2015. Public assistance represented 1.5 percent of total state expenditures in fiscal 2014. The public assistance information in the State Expenditure Report only contains data on cash assistance programs such as the Temporary Assistance for Needy Families (TANF) program, and does not include other supportive services.
- In fiscal 2014, total **Medicaid** state expenditures increased 9.8 percent, with state funds growing a relatively modest 4.4 percent and federal funds increasing 13.5 percent. In fiscal 2015, it is estimated that total Medicaid state expenditures increased 15.1 percent, with state funds growing 4.8 percent and federal funds increasing 15.1 percent due to increased Medicaid dollars provided through the *Affordable Care Act*. Additionally, in fiscal 2015, federal funds made up 61.9 percent of total state Medicaid spending, up from 58.2 percent in fiscal 2014.
- Total **corrections** expenditures increased by only 3.0 percent in fiscal 2014 with state funds increasing 3.4 percent and federal funds declining 5.2 percent. In recent years, states have begun efforts to control costs through reducing recidivism rates, implementing changes to parole and probation systems, enhancing community supervision, offering increased treatment to address mental health and substance abuse disorders, and enacting sentencing reforms. State funds comprised 97.9 percent of total corrections spending in fiscal 2014. Corrections accounted for 3.2 percent of total state expenditures in fiscal 2014 and 6.9 percent of general funds. In fiscal 2015 it is estimated that total corrections spending will increase 4.0 percent, with state funds growing 3.8 percent and federal funds increasing 10.4 percent.
- Total **transportation** spending, representing 7.9 percent of total state expenditures, increased by 4.9 percent in fiscal 2014 and is estimated to increase by 4.4 percent in fiscal 2015. In both fiscal 2014 and fiscal 2015, the growth in transportation spending was largely driven by an increase in state funds. State funds for transportation grew 10.5 percent in fiscal 2014 and an estimated 9.1 percent in fiscal 2015, while federal funds for transportation grew only 1.5 percent in fiscal 2014 and declined by 2.0 percent in fiscal 2015. Other state funds, which are typically earmarked revenue sources such as gasoline taxes, comprised 56.2 percent of total transportation spending in fiscal 2014, with federal funds at 31.1 percent, bonds at 8.7 percent, and general funds only accounting for 4.0 percent. States and the federal government are concerned that in the long term, gas tax revenue will not be sufficient to meet transportation needs and have begun exploring other funding options.

Expenditures by Function

(Estimated Fiscal 2015)



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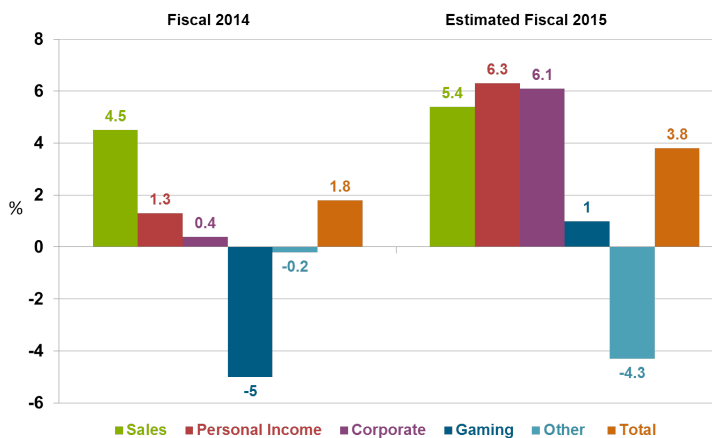
Revenue Growth Accelerated in Fiscal 2015, Although It Was Hampered Somewhat by the Decline in Oil Prices

In total, general fund revenues increased 1.8 percent in fiscal 2014, a much slower rate than fiscal 2013 when revenues increased 7.3 percent. The main reason for both the large increase in fiscal 2013 and the more modest increase in fiscal 2014 was due to the impact of the federal “fiscal cliff,” in which many taxpayers shifted capital gains and other income to calendar year 2012 to avoid higher scheduled federal tax rates. When examining the various sources that comprise general fund revenues, sales taxes experienced the largest increase in fiscal 2014 at 4.5 percent, while

personal income taxes grew 1.3 percent and corporate income taxes increased 0.4 percent. Both “other taxes and fees” and gaming taxes experienced declines in fiscal 2014, decreasing 0.2 percent and 5.0 percent respectively. In fiscal 2015, it is estimated that general fund revenues grew at a faster pace than fiscal 2014, increasing 3.8 percent. Personal income taxes experienced the largest gain in fiscal 2015, increasing 6.3 percent, while corporate income taxes (6.1 percent), sales taxes (5.4 percent), and gaming taxes (1.0 percent) also experienced growth. “Other taxes and fees” are estimated to have declined 4.3 percent in fiscal 2015, likely due largely to the recent decline in oil prices impacting severance taxes, which are included in the other taxes and fees category. For example, Alaska experienced an estimated 62 percent decline in other taxes and fees in fiscal 2015.

Revenue Growth by Percentage

(State General Funds)



Outlook

Looking forward, it is likely that spending from states’ own fund sources will continue its recent pattern of modest growth as revenue collections increase, while the increase in federal funds to states will likely slow as the growth in Medicaid enrollment is expected to decelerate in future years after states have implemented the ACA. States remain concerned about both the short- and long-term outlook due to increased spending demands, continued pressures from long-term obligations, recent volatility in states revenues, and uncertainty surrounding future federal fiscal policies. However, it is expected that state fiscal conditions will continue to slowly improve in tandem with growth in the national economy.

Since its inception in 1987, the State Expenditure Report has developed into a definitive baseline for the analysis of state spending. This edition of the report includes data from actual fiscal 2013, actual fiscal 2014, and estimated fiscal 2015. The report details the seven main functional categories of state spending: elementary and secondary education, higher education, public assistance, Medicaid, corrections, transportation, and “all other.”

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