About one out of every three dollars of state revenue comes from the federal government. But with a new Republican-controlled White House and Congress, the future of that funding is unclear. “There is some uncertainty there. We just don’t know what’s going to happen with federal funding,” said Delaware state Rep. Helene Keeley.

“It’s really too soon to tell,” said Brian Sigritz, director of state fiscal studies at the National Association of State Budget Officers. “But from a budgetary perspective, any kind of federal uncertainty can make it difficult for states to do their budget proposals.”

The possibility of a change in federal funding levels comes on top of a slow economic recovery that has impacted states’ bottom lines. “We expect to see continued slow revenue growth in 2017. We definitely experienced that at the tail end of 2016, when a lot of states saw revenues come up below projections,” said Sigritz.

“All of the state revenue sources have seen weak revenue growth and, in some areas, we’ve had declines, like with corporate income taxes,” said Sigritz. “A declining sales tax base is an issue and we’ve had very little inflation, almost deflation. The things that people are buying are the same price or in some cases, cost less than they did. So with the cost of goods stagnant, we’re seeing less growth in sales taxes.”

While the status of future federal funding may be unclear, instability from D.C. is not a new
phenomenon. For example, Congress hasn’t approved all 12 appropriations bills on time since 1996, and it has relied on the use of stopgap continuing resolutions, also known as CRs, and omnibus bills to provide federal appropriations. That makes it difficult for state and local governments to manage fiscal resources and plan strategically. “It’s been unstable,” said Keeley.

Coupled with fewer and more unpredictable federal dollars, states like Delaware have struggled keep essential services such as education going.

“We’ve plugged the holes,” said Keeley. “We’ve cut other places to make sure that funding is still there.”

“A lot of the states out there already have a bare-bones budget and Delaware is one of them. We are walking into a fiscal year where we already have a $350 million deficit and a bare budget,” she said.

In a weak recovery, raising taxes isn’t a preferable option, said Keeley, but if federal funding streams dry up, there may be no other choice.

“I don’t really see any alternatives,” Keeley said. “If that federal support isn’t there, then we will have no choice but to look at ways to raise more revenue.”

But there are some bright spots, Keeley said. “For example, President Trump has talked about a grand transportation funding project, which I think would be a good thing.”

“States have had a large amount of support from the federal government when it comes to transportation—building bridges, securing bridges and making sure that our roads and infrastructure were secure. But those funds have diminished,” said Keeley. “I’m hopeful that what President Trump has mentioned regarding this grand transportation project will come true. That could put a lot of people back to work.”

Public Employee Retirement

More than a decade ago, analysts were predicting the next big challenge for state governments: The mass retirement of baby boomers. Then the Great Recession hit and those same baby boomers stayed put. With a strengthened economy, baby boomers are resuming their retirement plans. This trend, coupled with less than stellar market returns for state public retirement systems and a nearly $1 trillion funding gap means that pensions will remain a significant area of concern for states in 2017.

Evidence-Based Decision Making

The slower than usual economic recovery has placed a strain on state budgets, making every dollar count. At the same time, state leaders are increasingly placing an emphasis on collecting and using good data to make decisions about where those dollars go and to set priorities. Using data to inform decision making can allow state governments to make more informed budget, policy and operational decisions that improve outcomes for their constituents and better steward taxpayer dollars.

Health Care Costs

Health care continues to be a growing and substantial part of state spending. Since the economic downturn, Medicaid has risen as a percentage of total state spending, from 20.5 percent in fiscal 2008 to an estimated 29 percent in fiscal 2016. With the fate of the Affordable Care Act up in the air, states may be facing a significant shift in how Medicaid is funded and will be tasked with prioritizing already
stretched budgets to deliver health care services to residents.

**Labor Markets**

While labor market measures such as the unemployment rate and median household income have seen gains, those gains have been moderate and vary significantly across states. That means states will continue looking for ways for the public, private and academic sectors to work together more efficiently to create and sustain high-paying jobs and foster an environment conducive to entrepreneurial investment. Workforce development strategies will increasingly include worker retraining and apprenticeship programs and leverage federal programs like the Workforce Innovation and Opportunity Act.

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