Overall, state fiscal conditions weakened in fiscal year 2016 compared to the prior year. Both revenue growth and total state spending experienced a slowdown due to numerous factors. In addition, the number of states making mid-year budget cuts was historically high outside of a recessionary period. In fiscal 2017, it is projected that both state general fund spending and revenue will grow moderately. However, since the start of the fiscal year, over half the states have had to revise their revenue projections downward due to weaker-than-anticipated tax collections. Looking forward, states are not only contending with slow revenue growth and constrained spending, but also federal uncertainty in a number of areas.

About the Author

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Introduction

By most measures, state fiscal conditions weakened in fiscal year 2016 compared to the prior year. Revenue growth slowed in fiscal 2016, growing just 1.8 percent compared to 5 percent in fiscal 2015. Several factors contributed to the slower growth in fiscal 2016, including the weak stock market performance in calendar year 2015, slow growth in the national economy, low inflation, and continued declines in energy-producing states. Total state spending (including general funds, other state funds, bonds and federal funds) also experienced a slowdown, increasing 4 percent in fiscal 2016, compared to a relatively sharp increase of 6.9 percent in fiscal 2015. Spending from both states’ own funds and federal funds experienced substantially less growth than the prior year, with the more modest increase in spending from states’ own funds largely driven by a decline in revenue growth, and the decreased growth rate in federal funds to states attributed to Medicaid spending beginning to slow, partly due to Medicaid enrollment levels decelerating as states entered into the second full-year of Medicaid expansion under the Affordable Care Act, or ACA. Additionally, weaker-than-anticipated revenue collections and resulting budget gaps in fiscal 2016 led 19 states to cut spending during the year, a historically high number of states outside of a recessionary period. One positive indicator was that many states continued to work to increase their reserves. In nominal dollar terms, 29 states...
increased rainy-day fund balance levels in fiscal 2016.

In fiscal 2017, it is projected that both state general fund spending and revenue will increase for the seventh consecutive year, although the growth is expected to be modest. Total state general fund revenues are projected to increase 3.6 percent in fiscal 2017, an increase from fiscal 2016, but well below the historical average of 5.5 percent. According to appropriated budgets, general fund expenditures are expected to increase 4.3 percent in fiscal 2017. However, it is likely that this growth rate will decline before the year is over, due to weaker-than-expected revenue collections in many states that may necessitate mid-year budget reductions. States also enacted an aggregate net increase of $1.3 billion in taxes and fees. Overall, 11 states enacted net tax and fee increases while 20 states enacted net decreases in fiscal 2017. Sales taxes experienced the largest net increase while personal income taxes experienced the largest enacted decrease. Additionally, total balances are projected to slightly decrease in fiscal 2017, mostly due to lower ending balances at the conclusion of fiscal 2016. Although the budget environment for most states indicates modest growth in fiscal 2017, states are facing rising spending demands and long-term budget pressures in areas including health care, education and infrastructure. At the same time, states are currently contending with slow growth in revenue collections and federal uncertainty in a number of areas.

The Current State Fiscal Condition

Revenues in Fiscal 2016

Revenue growth slowed in fiscal 2016, growing just 1.8 percent compared to 5 percent growth in fiscal 2015. Several factors contributed to the slower growth in fiscal 2016, including the weak stock market performance in calendar year 2015, slow growth in the national economy, low inflation, and the continued decline in oil and natural gas prices, as well as coal production, which impacted energy-producing states. The revenue slowdown was widespread with sales, personal income and corporate income all experiencing slower growth in fiscal 2016 than the prior year. Sales taxes grew 2.7 percent in fiscal 2016, compared to 5 percent in fiscal 2015, while personal income taxes increased 3.1 percent, compared to 7.1 percent in fiscal 2015. Corporate income taxes experienced an outright decline of 4.3 percent, in contrast to 6.2 percent growth the prior year. Twelve states saw general fund revenues decline in fiscal 2016, while 30 states experienced growth between 0 and 5 percent, seven states had growth between 5 and 10 percent, and one state had growth greater than 10 percent. In addition, 25 states reported that fiscal 2016 revenue collections ended the fiscal year lower than originally forecasted, while 20 states reported that revenues were above forecast, and five states said that revenue collections were on target. Overall, state general fund revenue collections totaled $780.6 billion in fiscal 2016, up from $766.6 billion in fiscal 2015.

Revenues in Fiscal 2017

Total state general fund revenues are projected to grow 3.6 percent in fiscal 2017, increasing from $780.6 billion in fiscal 2016 to $808.6 billion. Although revenues are forecasted to grow for the seventh consecutive year in fiscal 2017, the 3.6 percent growth level remains well below the historical average of 5.5 percent. Sales taxes are forecasted to increase by $12.7 billion (5.1 percent), personal income taxes are projected to grow by $15.4 billion (4.5 percent), and corporate income taxes are expected to see gains of $2.6 billion (5.5 percent). Other general revenue sources, particularly severance taxes, are expected to grow more slowly, which explains why the projected growth rate of general fund revenues from all sources is lower than the rates of the three major tax types.

Through the first half of fiscal 2017, revenue growth has been below forecast for many states. At least 29 states have revised their revenue forecast downward at some point during the fiscal year. The downward revisions have resulted from overly optimistic economic forecasts of gross domestic product and income, declines in the price of tangible goods, weaknesses in energy states, and other
factors. According to the Rockefeller Institute of Government, preliminary figures show state revenues growing 1.2 percent during the first quarter of fiscal 2017 (July–September 2016), and 0.4 percent during the second quarter of fiscal 2017 (October–December 2016). Additionally, according to National Association of State Budget Officers, or NASBO, data collected in the fall of 2016, 24 states were seeing revenues come in below projections for fiscal 2017, with 16 states on target and only four states reporting higher revenues (not all states were able to report data). At this time, it appears likely that that the overall revenue growth level for fiscal 2017 will be below the 3.6 percent originally forecasted.

**Tax and Fee Changes in Fiscal 2017**

Eleven states enacted net tax and fee increases in fiscal 2017, while 20 states enacted net decreases in fiscal 2017, resulting in an aggregate net increase of $1.3 billion. In both fiscal 2016 and 2017 states enacted small net increases in taxes and fees, while in fiscal 2014 and 2015 states enacted small net decreases. The largest net increases in taxes and fees in fiscal 2017 include Louisiana’s sales tax rate hike and elimination of several exemptions, California’s replacement of its managed care organization tax with a new enrollment tax, a cigarette tax increase in Pennsylvania, and Michigan’s gas tax increase. It should be noted that while states enacted more than $1.3 billion in net tax and fee increases in fiscal 2017, the overall net increase only represents 0.16 percent of total general fund revenue.

In fiscal 2017, personal income taxes saw the largest enacted decrease, reduced by $2.3 billion; much of the decline in personal income taxes came from actions taken in Maine, Massachusetts, North Carolina and Ohio. The second largest decline was in corporate income taxes at $489 million, with the majority attributed to decreases enacted by California and North Carolina. Sales taxes experienced the largest net increase at $1.9 billion led by Louisiana. A number of other revenue sources saw net increases, including cigarette and tobacco taxes ($812 million), fees ($791 million), motor fuel ($337 million), other taxes ($270 million), and alcohol ($19 million).

**State Spending in 2016**

Total state spending grew by an estimated 4 percent in fiscal 2016, a significantly slower rate than the relatively sharp increase of 6.9 percent in fiscal 2015. Fiscal 2016 spending from states’ own fund sources and federal funds both experienced substantially less growth than the prior year. The more modest increase in spending from states’ own funds was largely driven by a decline in revenue growth. Additionally, the growth rate of federal funds to states decreased as Medicaid spending began to slow, partly due to Medicaid enrollment levels beginning to decelerate as states entered the second full-year of Medicaid expansion under ACA. Although total state spending growth began to slow in fiscal 2016, all program areas saw at least a small increase in spending.

In fiscal 2015, federal funds to states rose 10.4 percent during the first full year of the optional Medicaid expansion under the ACA, and in fiscal 2016 it is estimated that federal funds increased 5.8 percent. While the level of federal funding to states has seen sharp increases over the past several years almost entirely due to additional Medicaid dollars, spending growth from states’ own revenue sources has been more moderate. Spending from state funds (including general funds and other state funds, but not federal funds or bonds) increased 5.5 percent in fiscal 2015, and an estimated 3.1 percent in fiscal 2016. In fiscal 2015, spending from state funds was partly bolstered by strong growth in personal income tax collections. In fiscal 2016 it is estimated that personal income and sales taxes experienced slower year-over-year growth while corporate income tax receipts significantly declined.

Looking in greater detail at fiscal 2016, total state expenditures (general funds, federal funds, other state funds and bonds combined) grew from $1.85 trillion in fiscal 2015 to $1.93 trillion in fiscal 2016. Medicaid remained the largest category of total state spending in fiscal 2016, representing 29 percent. Other categories of total state expenditures include elementary and secondary education
(19.4 percent), higher education (10.2 percent), transportation (7.9 percent), corrections (3 percent),
public assistance (1.4 percent), and “all other” (29.2 percent). All of these categories experienced
total state spending increases in fiscal 2016, with Medicaid experiencing the largest gains at 6.9
percent, followed closely by transportation at 6.3 percent. Total spending growth in other program
areas include higher education (4.8 percent), elementary and secondary education (3.6 percent),
public assistance (2 percent), corrections (2 percent), and all other (0.9 percent).

All of these categories experienced
total state spending increases in fiscal 2016, with Medicaid experiencing the largest gains at 6.9
percent, followed closely by transportation at 6.3 percent. Total spending growth in other program
areas include higher education (4.8 percent), elementary and secondary education (3.6 percent),
public assistance (2 percent), corrections (2 percent), and all other (0.9 percent).

General fund spending is estimated to be $779.4 billion in fiscal 2016, a 3.7 percent increase from
fiscal 2015. General funds typically receive their revenue from broad-based state taxes such as sales
and personal income taxes. As with total state spending, all program areas saw at least some general
fund spending growth in fiscal 2016, with transportation spending leading the way. Transportation,
which receives the vast majority of its funding from non-general fund sources, grew fastest by far at
17.5 percent, followed by Medicaid (6.5 percent), K-12 (3.6 percent), all other (2.8 percent), higher
education (1.7 percent), corrections (1.6 percent), and public assistance (0.2 percent). Elementary
and secondary education remained the largest category of general fund expenditures in fiscal 2016,
accounting for 35.1 percent. Medicaid represented 20.3 percent and higher education accounted for
9.7 percent. Combined, education (both K-12 and higher education) and Medicaid comprised nearly
two-thirds of general fund spending. Other categories of general fund spending included corrections
(6.6 percent), public assistance (1.2 percent), transportation (0.9 percent), and all other (26.2
percent).

State Spending in 2017
According to appropriated budgets, general fund expenditures are expected to increase by 4.3
percent in fiscal 2017, the seventh consecutive year of modest general fund spending growth
following back-to-back declines in fiscal 2009 and 2010. This growth rate may decline before the
year is over, however, due to weak revenue performance in some states that may necessitate mid-
year budget reductions. In total, general fund expenditures are estimated to be $819.8 billion in fiscal
2017, a $34 billion increase from the prior year. Forty-one states enacted a fiscal 2017 budget with
general fund spending levels above fiscal 2016, with 26 states reporting general fund expenditure
growth between 0.1 and 4.9 percent, and 15 states reporting growth greater than 5 percent.

Although the vast majority of states enacted fiscal 2017 budgets with general fund spending growth,
in eight states nominal general fund spending levels remain below their fiscal 2008 levels, with
several of these states facing negative budgetary impacts associated with declining energy prices.

Budget Cuts
Weaker-than-anticipated revenue collections and resulting budget gaps in fiscal 2016 helped lead 19
states to cut spending during the year, totaling $2.8 billion. The number of states with net mid-year
budget reductions in fiscal 2016 is historically high outside of a recessionary period. However, the
number is less than half of what was seen during and immediately following the Great Recession,
when 41 states made mid-year budget cuts in fiscal 2009 and 39 states in fiscal 2010. In addition,
while the number of states with net mid-year budget cuts in fiscal 2016 is higher than has been
observed in recent years, most of these reductions were relatively small in value. Also, these
reductions do not always reflect fiscal stress or even true spending cuts, but sometimes are the result
of technical or accounting changes. The largest program areas of net mid-year cuts in fiscal 2016
include K-12 (17 states), higher education (14 states), corrections (14 states) and Medicaid (13
states).

Although overall general fund spending is projected to increase in fiscal 2017 for the seventh
consecutive year, many states did enact fiscal 2017 budget cuts in various areas, including
transportation (12 states), corrections (11 states), Medicaid (10 states), public assistance (9 states),
higher education (9 states), and K-12 (8 states). It is also likely that a relatively high number of states
will once again enact mid-year budget cuts in fiscal 2017 as revenue growth has been slower than forecasted for many states.\textsuperscript{11}

**Balances**

Total balances include both ending balances as well as the amounts in states’ budget stabilization (or rainy-day) funds. Combined, these reserves reflect the funds states may use to respond to budget gaps or unforeseen circumstances. Forty-eight states have a budget stabilization or rainy-day fund, with about three-fifths of the states having limits on the size of these funds.\textsuperscript{32}

Total balances reached a recent low in fiscal 2010 due to the severe decline in revenues and rise in expenditure demands tied to the recession, falling to $32.5 billion, or 5.2 percent of general fund expenditures. By fiscal 2016, total balance levels rebounded to $73.3 billion, or 9.4 percent of expenditures. Total balances are projected to decrease to $65 billion in fiscal 2017, mostly due to lower ending balances at the conclusion of fiscal 2016. Rainy-day funds tend to be more stable than total balance levels, as ending balances fluctuate from year to year due to a variety of factors. Rainy-day funds are also a reflection of deliberate state policy chosen by elected officials. Most states have focused on strengthening their rainy-day funds in recent years; at the conclusion of fiscal 2016, 40 states had increased their rainy-day fund levels since fiscal 2010 in nominal terms. Additionally, the median state rainy-day fund balance was 5.1 percent of general fund expenditures in fiscal 2016—above the pre-recession peak median level in fiscal 2008 of 4.9 percent.\textsuperscript{33}

**Looking Ahead**

For most states, fiscal 2018 revenue projections are assuming continued slow growth in tax collections, although some are projecting slightly higher levels than the current year. As a result, budget proposals for fiscal 2018 have remained cautious with most governors calling for another year of modest spending growth. Some preliminary themes from fiscal 2018 budgets show a continued emphasis on early learning, a re-examination of school funding proposals, a call for increased infrastructure spending, the need for workforce development, restructuring of child welfare services, possible pension reforms, and new initiatives to help address the opioid crisis. Additionally, a number of governors have called for improving structural balances, rainy-day fund increases, and increased efficiency and the consolidation of government services. As states enact budgets for fiscal 2018, they are not only contending with slow revenue growth and constrained spending, but also federal uncertainty in several areas including possible health care changes, the consideration of federal tax reform, and discussions regarding various infrastructure proposals. These factors combined will require states to make difficult decisions moving forward.

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**Notes**

1 National Association of State Budget Officers, The Fiscal Survey of States (December 2016), 45.
3 The Fiscal Survey of States (December 2016), 11.
4 The Fiscal Survey of States (December 2016), 60.
5 See note 1 above.
6 The Fiscal Survey of States (December 2016), 3.
7 The Fiscal Survey of States (December 2016), 56.
8 The Fiscal Survey of States (December 2016), 67.
9 See note 1 above.
10 The Fiscal Survey of States (December 2016), 51.
11 The Fiscal Survey of States (December 2016), 46.
12 The Fiscal Survey of States (December 2016), 48.
14 The Fiscal Survey of States (December 2016), 7–8.
15 See note 1 above.
16 The Fiscal Survey of States (December 2016), 50–51.
18 The Fiscal Survey of States (December 2016), 48.
19 Total state spending consists of general funds, other state funds, bonds and federal funds combined.
21 State Expenditure Report (November 2016), 8.
25 Transportation spending mostly comes from “other state funds” and federal funds, while general funds only comprise 3.9 percent of total state transportation expenditures.
26 State Expenditure Report (November 2016), 11.
27 The Fiscal Survey of States (December 2016), 3.
28 The Fiscal Survey of States (December 2016), 5.
29 The Fiscal Survey of States (December 2016), 2.
31 The Fiscal Survey of States (December 2016), 15.
32 National Association of State Budget Officers, Budget Processes in the States, (Spring 2015), 75–79.
33 The Fiscal Survey of States (December 2016), 61–62.

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