State Budgets in 2014 and 2015: Spending and Revenue Growth Remains Limited, As States Experience Slow Growth

By Brian Sigritz

Fiscal conditions for states were somewhat mixed in the 2014 fiscal year as state general fund revenue growth declined due to the impact of the federal fiscal cliff, while total state spending growth accelerated due to increased federal Medicaid funds from the Affordable Care Act. The number of states making midyear budget cuts remained low and states maintained stable rainy day fund levels. In the 2015 fiscal year, states are expecting both revenue and spending to grow slowly, but below the historical rate of growth. It is likely that budget proposals for the 2016 fiscal year and beyond will remain mostly cautious with limited spending growth.

State fiscal conditions in the 2014 fiscal year were somewhat of a mixed bag.

On the one hand, states experienced much slower revenue growth than the prior year. State general fund revenues grew only 1.3 percent in the 2014 fiscal year, compared to 7.1 percent in 2013.[1] The main reason for the strong revenue growth in the 2013 fiscal year and the slow growth in 2014 was due to the impact of the federal "fiscal cliff." In 2013, states experienced temporary gains in revenues as taxpayers took actions to avoid scheduled higher federal taxes; in the 2014 fiscal year, states did not experience the same one-time gains.

While state general fund revenues experienced much slower growth in the 2014 fiscal year, total state expenditures—or spending from all fund sources—grew much more sharply. In 2014, total state spending—general funds, other state funds, bonds and federal funds combined—grew 5.7 percent, compared to 2.2 percent in 2013. The accelerated growth in total state spending largely was due to increased federal expenditures, as federal funds to states grew 7.6 percent in the 2014 fiscal year mainly as a result of the Medicaid expansion under the Affordable Care Act. In contrast, in both 2013 and 2012 federal funds to states declined by 1.8 percent and 9.8 percent respectively due to the wind down of spending from the American Recovery and Reinvestment Act, or stimulus.[2]

In the 2015 fiscal year, states are expected to return to their recent trend of slow but steady growth. State general fund revenues and general fund spending are both projected to grow at 3.1 percent. This would be the fifth consecutive year of modest general fund spending growth, following back-to-back declines in 2009 and 2010. However, all five years of spending increases have been below states' historical average of 5.5 percent.[3]

In examining other indicators of state fiscal health, it is likely state rainy day fund levels will remain healthy and around their totals of the past several years, and that the number of states making midyear budget cuts will remain well below the level experienced during the past economic downturn. While most states have experienced stable fiscal conditions so far in the 2015 fiscal year, some have experienced revenue difficulties, most notably oil-producing states due to a drop in worldwide oil prices. Looking forward, it is likely that spending plans for 2016 and beyond will remain mostly cautious, with limited growth and an emphasis on ensuring budgets are structurally balanced and sustainable in the future.

The Current State Fiscal Condition

Revenues in the 2014 Fiscal Year

Revenue growth slowed considerably in the 2014 fiscal year compared to the prior year. Whereas total state general fund revenues grew 7.1 percent in 2013, state revenues only grew 1.3 percent in 2014.[4] Additionally, 2014 saw 20 states with revenues coming in below original projections, five on target and 25 higher than projections.[5] This contrasts with 2013, when only seven states experienced revenues coming in below projections, six on target and 37 higher than projections.[6]

The primary reason for the slowdown in the 2014 fiscal year was related to the federal "fiscal cliff." In 2013, states experienced temporary gains in revenues as taxpayers took actions to avoid scheduled higher federal taxes; states did not experience the same one-time gains in 2014. Additionally, revenue collections may have been hampered by winter storms in early 2014. On a quarterly basis, the Rockefeller Institute of Government reported that state revenues grew 4.1 percent in first quarter of the 2014 fiscal year (July–September 2013), increased 2.1 percent in the second quarter, declined 0.9 percent in the third quarter and decreased 2.1 percent in the fourth quarter.[7]

The impact of the federal fiscal cliff also was seen when examining individual revenue sources. Income taxes experienced the most severe slowdowns in 2014, with personal income taxes growing only 0.9 percent and corporate income taxes increasing 0.7 percent. Sales taxes, on the other hand, grew 4.9 percent.[8] Overall state revenues increased $9.7 billion in 2014, from $716.4 billion to $725.9 billion.[9]

Revenues in the 2015 Fiscal Year

Revenue growth is projected to increase in the 2015 fiscal year, but remain slow and below the historical average. Total state general fund revenues are projected to grow 3.1 percent, the same percentage as total state general fund spending growth.[10] Since 1979, general fund revenues have increased 5.5 percent on average according to the National Association of State Budget Officers' *Fiscal Survey of States*. Overall, general fund revenues are projected to grow by $22.2 billion in 2015, from $725.9 billion to $748.3 billion, with sales taxes increasing by $9.2 billion (4.0 percent), personal income taxes growing by $14.6 billion (4.7 percent), and corporate income taxes increasing by $778 million (1.7 percent).[11]

Through the first half of 2015, revenue growth has been near projections for most states. According to the Rockefeller Institute of Government, state revenues grew 2.8 percent during the first quarter of the 2015 fiscal year (July–September 2014), and preliminary figures show 6.4 percent growth in the second quarter of 2015 (October–December 2014).[12] According to data collected by National Association of State Budget Officers—also known as NASBO—in the fall of 2014, 26 states were seeing revenues coming in on target for 2015, with 10 lower and seven higher—not all states were able to report data.[13] While most states have seen stable revenue growth so far in 2015, some have experienced significant revenue difficulties, most notably oil-producing states due to a drop in worldwide oil prices.

Tax and Fee Changes in the 2015 Fiscal Year

States enacted $2.3 billion in net tax and fee decreases for the 2015 fiscal year, with 21 states enacting a net decrease and 10 states enacting net increases. Similar to 2015, in 2014 states enacted $2.1 billion in net tax and fee decreases, with 23 states enacting decreases and 12 enacting increases. Emerging from the economic downturn, states have now enacted net tax and fee decreases in four out of the past five years. States with the largest net tax and fee decreases in 2015 include, in order of largest to smallest decrease, Texas, New York, Florida, Minnesota, Wisconsin, Arkansas and Indiana, while states with the largest net increases include, in order of the increase, Oregon, Delaware, New Hampshire and Colorado. It should be noted that while states enacted a large number of tax and fee decreases in 2015, the net decrease only represents 0.3 percent of overall general fund revenue.

In the 2015 fiscal year, personal income taxes saw the largest enacted decrease, reduced by $747 million. Much of that decline came from actions taken, in order of decrease, by Minnesota and Wisconsin. The second largest decline was in "other taxes" at $698 million, with much of it attributed to Texas. Additional revenue sources that experienced a net decrease include fees (-$427 million); sales taxes (-$248 million); corporate income (-$207 million); and alcohol (-$200,000). Revenue sources that experienced a net increase include motor fuels ($33 million), and cigarettes and tobacco ($8 million).[14]

State Spending in 2014

Total state spending,[15] or expenditures from all fund sources, grew by 5.7 percent in the 2014 fiscal year, compared to 2.2 percent growth in 2013. The accelerated growth in total state spending largely was due to increased federal expenditures, as federal funds to states grew 7.6 percent in 2014 mainly as a result of Medicaid expansion under the Affordable Care Act. In contrast, in both 2013 and 2012 federal funds to states declined by 1.8 percent and 9.8 percent respectively due to the wind down of spending from the American Recovery and Reinvestment Act, or stimulus. In fact, the reduction in federal funds in 2012 was so significant that total state spending declined for the first time in the 27-year history of NASBO's *State Expenditure Report*. State funds[16] growth has been much steadier over the past three years, increasing 3.8 percent in 2012, 4.1 percent in 2013, and 4.8 percent in 2014.[17]

The recovery act and the Affordable Care Act also contributed to shifts in the distribution of funding sources for state expenditures. Over a two-year period from fiscal years 2008 and 2010, general funds shrank from representing 45.9 percent of total state expenditures to 38.1 percent, while federal funds rose from 26.3 percent to 34.9 percent. However, due to the expiration of recovery act funds, general funds started to once again make up a larger component of total state expenditures. By 2013, general funds accounted for 40.9 percent of total state expenditures, federal funds 29.8 percent, other state funds 27.3 percent, and bonds 2.1 percent. In 2014, it is estimated that federal funds will grow to 30.3 percent of total state spending, while general funds will decline slightly to 40.5 percent. The increase in federal funds in 2014 was almost solely due to additional Medicaid dollars.[18]

Looking in greater detail at the 2014 fiscal year, total state expenditures—general funds, federal funds, other state funds and bonds combined—grew by an estimated 5.7 percent to $1.79 trillion.[19] Medicaid remained the largest category of total state spending in 2014, representing 25.8 percent. Other categories of total state expenditures include elementary and secondary education (19.5 percent), higher education (10.1 percent), transportation (7.7 percent), corrections (3.1 percent), public assistance (1.4 percent), and "all other" (32.4 percent). As recently as 2008, elementary and secondary education represented a larger share of total state expenditures than Medicaid.[20]

General fund spending is estimated to be $723.8 billion in the 2014 fiscal year, a 4.8 percent increase from 2013. General funds typically receive their revenue from broad-based state taxes, such as sales and personal income. All program areas saw at least some general fund spending growth in 2014, with the exception of public assistance, which declined 2.6 percent. Transportation, which receives few general fund dollars, grew fastest at 33.4 percent, followed by Medicaid (5.8 percent), K–12 (5.0 percent), higher education (4.7 percent), corrections (4.1 percent), and all other (3.8 percent).[21]

Elementary and secondary education remained the largest category of general fund expenditures in the 2014 fiscal year, accounting for 35 percent. Medicaid represented 19.1 percent and higher education accounted for 9.4 percent. Combined, education (both K–12 and higher education) and Medicaid comprised 64 percent of total state general fund spending. Other categories of general fund spending included corrections (6.8 percent), public assistance (1.4 percent), transportation (0.9 percent), and all other (27.4 percent).[22]

Federal fund spending is estimated to be $541.2 billion in 2014, amounting to 7.6 percent more than the 2013 fiscal year. While federal Medicaid funds to states increased $41.8 billion, or 17.8 percent, in 2014, all other federal funds to states are estimated to have declined $3.4 billion, or 1.3 percent.[23] By far, Medicaid accounted for the largest share of state spending from federal funds at 51.0 percent in 2014, with elementary and secondary education at 9.9 percent and transportation at 7.7 percent, representing the next largest shares.[24]

State Spending in 2015

According to appropriated budgets, general fund expenditures are expected to increase by 3.1 percent in the 2015 fiscal year, the fifth consecutive year of modest general fund spending growth following back-to-back declines in 2009 and 2010. Despite increases in 2015, general fund spending growth is projected to once again remain below the 37-year historical average of 5.5 percent.[25] In total, general fund expenditures are estimated to be $751.6 billion in 2015, a $22.7 billion increase from the prior year. Forty-three states enacted a 2015 budget with general fund spending levels above 2014, with 29 states reporting general fund expenditure growth between 0 and 4.9 percent, and 14 states reporting growth greater than 5 percent. Although the vast majority of states enacted 2015 budgets with general fund spending growth, in 11 states general fund spending levels remain below 2008.[26]

Budget Cuts

A clear indicator of the current improvement in state fiscal conditions is that the amount of midyear budget cuts has sharply declined since the Great Recession. During the midst of the economic downturn, 41 states made net midyear cuts in 2009 totaling $31.3 billion, and 39 states made midyear cuts in 2010 totaling $18.3 billion, demonstrating the widespread impact of the recession. However, the number of states making net midyear cuts began to decline in 2011, with 19 states making cuts of $7.4 billion, eight states making cuts of $1.7 billion in 2012, 11 states making cuts of $1.3 billion in 2013, and eight states making cuts of $1.0 billion in 2014. The largest program areas of net mid-year cuts in the 2014 fiscal year include K–12 (nine states), public assistance (seven states), Medicaid (seven states), and corrections (seven states).[27]

Through December 2014, seven states had made net midyear budget cuts in 2015 totaling $852 million. The largest cuts to date were seen in Missouri

($512 million), Indiana ($129 million), and Maryland ($79 million).[28]

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 unforeseen circumstances after budget obligations have been met. Forty-eight states have either a budget stabilization fund or a rainy day fund, with about three-fifths of the states having limits on the size of these funds.[29] Total balances peaked in the 2006 fiscal year at $69 billion—11.5 percent of general fund expenditures—and had declined to $32.5 billion, or 5.2 percent of expenditures, by 2010.

States have begun to replenish their reserves, although they have not returned to pre-recession levels. Total balance levels greatly increased in the 2013 fiscal year as revenues outpaced projections in many states due partly to the impact of the federal fiscal cliff, leading to budget surpluses and bringing total balances to $67 billion—or 9.6 percent of general fund expenditures. In 2014, total balances declined slightly to $62.7 billion, or 8.9 percent of expenditures; and in 2015, it is projected that total balances will once again decline to $53.1 billion, or 7.3 percent of expenditures. While total balances are projected to decline for the second consecutive year, it is largely because states are forecasting smaller ending balances. States' rainy day fund levels have remained relatively consistent during the past three years at $40.0 billion in 2013, $43.8 billion in 2014, and $42.5 billion in 2015.[30]

Looking Ahead

Most states have experienced significant economic improvements since the end of the Great Recession, including business expansions, lower unemployment and some increased consumer spending. The overall improvement in state economies has led to more stable fiscal conditions, with most budgets including modest revenue growth, moderate increases in state spending and rainy day fund levels at or near historical averages.

However, state spending has been constrained as a result of such factors as slow revenue growth, the decline in the price of oil, federal uncertainty, continued pressures from long-term obligations, and efforts to limit the size of state government. It is expected that in the 2016 fiscal year and beyond, much of the additional state spending will be directed toward core services such as education, health care, corrections and transportation, while other areas of the budget will in many instances see flat spending growth or spending reductions. Looking forward, it is likely that budget proposals will remain mostly cautious, with limited spending growth and an emphasis on ensuring that budgets are structurally balanced and sustainable in the future.

Notes

[1] National Association of State Budget Officers, *The Fiscal Survey of States* (December 2014), 41.

[2] National Association of State Budget Officers, *Summary: NASBO State Expenditure Report*, (November 20, 2014), 1.

[3] *The Fiscal Survey of States* (December 2014), 7, 41.

[4] See note 1 above.

[5] *The Fiscal Survey of States* (December 2014), 42.

[6] *The Fiscal Survey of States* (December 2013), 41.

[7] Nelson A. Rockefeller Institute of Government, *State Revenue Report*, (February 2015), 5.

[8] *The Fiscal Survey of States* (December 2014), 45.

[9] *The Fiscal Survey of States* (December 2014), 5–6.

[10] See note 3 above.

[11] *The Fiscal Survey of States* (December 2014), 44–45.

[12] Nelson A. Rockefeller Institute of Government, *State Revenue Report*, (February 2015), 1, 5.

[13] *The Fiscal Survey of States* (December 2014), 42.

[14] *The Fiscal Survey of States* (December 2014), 46–49.

[15] Total state spending consists of general funds, other state funds, bonds, and federal funds combined.

[16] State funds are general funds and other state funds combined, excluding bonds.

[17] See note 2 above.

[18] *Summary: NASBO State Expenditure Report*, (November 20, 2014), 2.

[19] National Association of State Budget Officers, *State Expenditure Report* (November 2014), 8.

[20] *State Expenditure Report* (November 2014), 10–11.

[21] *State Expenditure Report* (November 2014), 7–8.

[22] *State Expenditure Report* (November 2014), 11.

[23] *State Expenditure Report* (November 2014), 1.

[24] See note 22 above.

[25] *The Fiscal Survey of States* (December 2014), 2.

[26] *The Fiscal Survey of States* (December 2014), 1, 3.

[27] *The Fiscal Survey of States* (June 2014), 8–10.

[28] *The Fiscal Survey of States* (December 2014), 8.

[29] National Association of State Budget Officers, *Budget Processes in the States*, (Summer 2008), 67–69.

[30] *The Fiscal Survey of States* (December 2014), 58–59.

About the Author

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