State Budgets in 2013 and 2014: Revenue and Spending Continue to Grow, while States Remain Cautious

By Brian Sigritz

Fiscal conditions for states continued to moderately improve in the 2013 fiscal year. Revenue collections exceeded projections for the vast majority of states and spending from both state funds and federal funds experienced stronger growth in comparison to the 2012 fiscal year. Additionally, the number of states making midyear budget cuts remained low and states have continued to replenish their rainy day funds and reserves. In the 2014 fiscal year, states are expected to have continued positive revenue and spending growth. Revenue and spending growth rates, however, are expected to be slower than last year. States are cautiously optimistic that fiscal conditions will continue to slowly improve in the 2015 fiscal year and beyond, although challenges remain.

Introduction

State fiscal conditions have continued to improve moderately over the past two years as states have more fully emerged from the impact of the Great Recession. In the 2013 fiscal year, both state revenue and spending experienced stronger growth compared to the 2012 fiscal year. State revenue collections in 2013 grew 5.7 percent, higher than 2012's growth rate of 2.9 percent. In addition, 2013 revenue collections were higher than projections in 37 states, on target in six states and lower than projections in only seven states. Several factors help explain why nearly three-fourths of states exceeded revenue projections, including conservative revenue forecasting, continued growth in the national economy and efforts to avoid potentially higher federal taxes set to rise under the federal fiscal cliff.[1]

State spending patterns for the most part mirrored revenue collection trends in the 2013 fiscal year. Spending from state funds—general funds and other state funds combined—increased 5.3 percent, more than 2012's growth level of 2.3 percent. Spending from federal funds also grew in 2013, increasing 2.3 percent. The growth in federal funds in 2013 was in stark contrast to 2012, when federal funds to states declined by 9.1 percent as most spending from the American Recovery and Reinvestment Act, or stimulus, ended. Overall, total state expenditures grew 4.6 percent in 2013, unlike 2012, when total state expenditures declined by 1.7 percent.[2]

In the 2014 fiscal year, both state revenue and spending are projected to continue to grow, although at lower levels than 2013. According to governors' enacted budgets, state revenues are projected to increase 0.8 percent in 2014, a significant slowdown from 2013's growth of 5.7 percent. General fund spending also is expected to grow more slowly in 2014 at 3.8 percent, compared to 4.3 percent in 2013. Even though general fund spending growth is projected to slow in 2014, 43 states enacted a 2014 budget with general fund spending levels above 2013 levels.[3]

Although general fund revenues and spending are projected to grow for the fourth straight year, in many ways states have not fully recovered from the impact of the recession. Revenues exceeded projections for the vast majority of states in the 2013 fiscal year; however, states are anticipating slower revenue growth in 2014. Overall revenue growth since the end of the recession has been weak by historical standards.[4] While general fund spending is expected to grow for the fourth straight year, in each of those years, spending growth has been below the historical average.[5] Additionally, in 19 states general fund spending remains below 2008 levels. Finally, while states have begun to replenish rainy day funds and reserves, total balances are not yet back to their prerecession peak.[6] Looking forward, it is likely that states will continue to budget cautiously as they monitor economic conditions, federal developments and changing spending demands.

The Current State Fiscal Condition

Revenues in the 2013 Fiscal Year

General fund revenue collections in the 2013 fiscal year easily outpaced projections, ending the year at $707 billion, or $14.2 billion above the states' enacted budgets. Revenue collections from all sources[7] were higher than projections in 37 states, on target in six states and lower than projections in only seven states.[8] Revenues exceeding projections in 2013 can be attributed to a number of factors, including conservative revenue forecasting, steady growth in the national economy and uncertainty surrounding the federal fiscal cliff. In total, general fund revenue collections increased 5.7 percent in 2013. Individually, sales taxes grew by 3.9 percent, personal income taxes by 9.6 percent, and corporate income taxes by 8.2 percent. In nominal dollars, sales tax revenue increased by $8.3 billion, personal income taxes by $27 billion and corporate income taxes by $3.5 billion. Total general fund revenue collections also surpassed prerecession highs for the first time in 2013. Aggregate revenues, however, were still 5.6 percent below 2008's prerecession peak after adjusting for inflation.[9]

Revenues in the 2014 Fiscal Year

Revenue growth rates are projected to slow considerably, from a 5.7 percent increase in 2013 to a projected 0.8 percent increase in 2014. The projected slowdown is partly attributable to states expecting the temporary growth due to federal tax changes will subside. Overall, general fund revenues are projected to grow by $5.7 billion, with sales taxes increasing by $9.9 billion (4.5 percent), personal income taxes declining by $1 billion (-0.3 percent), and corporate income taxes growing by $1.4 billion (3.1 percent).[10]

Through the first half of the 2014 fiscal year, revenue growth has been above forecast for many states. According to the Rockefeller Institute of Government, state revenues grew 6.1 percent for the July through September quarter, and grew 3 percent from October through December based on 49 reporting states.[11] One reason collections are coming in above projections is because many states made very conservative 2014 revenue forecasts. Additionally, although state tax collections continue to grow for most states, overall revenue growth since the end of the recession has been weak by historical standards compared to other post-recessionary periods.

Tax and Fee Changes in the 2014 Fiscal Year

States enacted $2.1 billion in net tax and fee decreases for the 2014 fiscal year, with 23 states enacting a net decrease and 12 states enacting a net increase. In 2013, states enacted a net increase of $6.9 billion. More states, however, enacted a net decrease than increase, with 20 states enacting a decrease and 11 states enacting an increase. States with the largest net tax and fee decreases in 2014 include Alaska, Arizona, Ohio, Pennsylvania, Texas and Wisconsin, while states with the largest net increases include Kansas, Massachusetts, Minnesota and Virginia.

In the 2014 fiscal year, personal income taxes saw the largest enacted decrease, reduced by $1.3 billion. Much of that decline came from actions taken by Ohio, Wisconsin and North Carolina. The second largest decline was in other taxes at $1.2 billion, with much of it attributed to Alaska, Texas and Pennsylvania. Additional revenue sources that experienced a net decrease include sales taxes, at a $161 million loss, and motor fuels, at a $49 million loss. Revenue sources that experienced a net increase include cigarettes and tobacco at $515 million, corporate income at $181 million, fees at $31 million, and alcohol at $6 million.[12]

State Spending in the 2013 Fiscal Year

State spending returned to more typical growth patterns in the 2013 fiscal year, in contrast to 2012. While spending from state funds—general funds and other state funds combined—rose 2.3 percent in 2012, federal funds to states declined 9.1 percent as most spending from the American Recovery and Reinvestment Act, or stimulus, ended. The combination of state funds slowly increasing and federal funds rapidly declining in 2012 led to a 1.7 percent reduction in total state expenditures, the first nominal decline in the 26-year history of the National Association of State Budget Officers' *State Expenditure Report*. In 2013, states more fully emerged from the recession. Unlike 2012, both state funds and federal funds grew in 2013, by 5.3 percent and 2.3 percent respectively, leading to a 4.6 percent increase in total state expenditures.

Additionally, in the 2013 fiscal year, the breakdown of total state spending began to return to more typical levels as the impact of the Recovery Act waned. In 2008, the last year before the federal stimulus, general funds accounted for 45.9 percent of total state spending, federal funds were 26.3 percent, other state funds were 25.5 percent, and bonds reflected 2.4 percent of the total. By 2010, general funds accounted for 38.1 percent of total state expenditures, federal funds 34.9 percent, other state funds 24.9, and bonds were 2.2 percent of the total. Due to the rapid decline in federal Recovery Act funds, however, general funds are growing again as a share of total state expenditures. In 2013, general funds were estimated to account for 40.3 percent of total state expenditures, federal funds 30.7 percent, other state funds 26.5 percent, and bonds 2.5 percent.[13]

Looking in greater detail at the 2013 fiscal year, total state expenditures—general funds, federal funds, other state funds and bonds combined—grew by an estimated 4.6 percent to $1.72 trillion.[14] Medicaid remained the largest component of total state spending, representing 24.4 percent. Other categories of total state expenditures include K–12 education at 19.8 percent, higher education at 10.3 percent, transportation at 7.9 percent, corrections at 3.1 percent, public assistance at 1.4 percent, and all other at 33.1 percent. As recently as 2008, elementary and secondary education represented a larger share of total state expenditures than Medicaid.[15]

General fund spending in 2013 was estimated to be $693.7 billion, a 4.4 percent increase from 2012. General funds typically come from broad-based state taxes, such as sales and personal income. All program areas saw at least minor general fund spending growth in 2013. Transportation, which receives few general fund dollars, grew fastest at 14.5 percent, followed by "all other" at 5.5 percent, K–12 education at 5.2 percent, public assistance at 4.2 percent, Medicaid at 2.8 percent, corrections at 2.2 percent, and higher education at 2 percent.[16]

Elementary and secondary education remained the largest category of general fund expenditures in the 2013 fiscal year, accounting for 35.1 percent of general fund spending. Medicaid represented 19 percent, and higher education accounted for 9.9 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 at 6.8 percent, public assistance at 1.5 percent, transportation at 0.6 percent, and all other at 27.2 percent.[17]

Federal fund spending was estimated to be $528.1 billion in the 2013 fiscal year, 2.3 percent more than 2012. K–12 education, higher education, public assistance, corrections and the "all other" category all experienced declines in 2013, while Medicaid and transportation saw increases. By far, Medicaid accounted for the largest share of state spending from federal funds at 45.2 percent, while elementary and secondary education at 10.4 percent and transportation at 8.6 percent represented the next largest shares.[18]

State Spending in the 2014 Fiscal Year

According to appropriated budgets, general fund expenditures are expected to increase by 3.8 percent in 2014, the fourth consecutive year of modest general fund spending growth following back-to-back declines in 2009 and 2010. Despite increases in 2014, spending growth is projected to remain below the 36-year historical average of 5.6 percent.[19] In total, general fund expenditures are estimated to be $721.8 billion in 2014, a $26.3 billion increase from the prior year. Forty-three states enacted a 2014 budget with general fund spending levels above 2013, with 26 states reporting general fund expenditure growth between 0 and 4.9 percent, and 17 states reporting growth greater than 5 percent. Although the vast majority of states enacted 2014 budgets with general fund spending growth, in 19 states general fund spending remains below 2008 levels.[20]

Budget Cuts

A clear indicator of the improvement in state fiscal conditions is that the amount of midyear budget cuts has sharply declined since the recession. During the midst of the economic downturn, 41 states made midyear cuts in the 2009 fiscal year totaling $31.3 billion. Thirty-nine states made midyear cuts in 2010 totaling $18.3 billion, demonstrating the widespread impact of the recession. The number of states making midyear cuts, however, began to decline in 2011, with 19 states making cuts of $7.4 billion and eight states making cuts of $1.7 billion in 2012. In 2013, the number of states making midyear budget cuts slightly increased to 11, although the net amount of midyear budget cuts declined to $1.3 billion.[21] In 2013, states most frequently made midyear budget cuts to Medicaid in 10 states, followed by K–12 education in eight states, public assistance in eight states, higher education in seven states, transportation in four states and corrections in three states.[22]

Through December 2013, only two states in the 2014 fiscal year had made net midyear budget cuts totaling $268.6 million.[23] If current trends hold, it is unlikely the number of states making budget cuts for the remainder of 2014 will increase sharply. As of December, 14 states were exceeding revenue projections, 23 states were on target and only seven states were seeing revenue coming in lower than projections. Not all states were able to provide preliminary 2014 fiscal year data.[24]

Balances

Total balances include both ending balances and the amounts in states' budget stabilization 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.[25] Total balances peaked in the 2006 fiscal year at $69 billion, or 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 2013 as revenues outpaced projections in many states, leading to budget surpluses and bringing total balances to $67 billion, or 9.6 percent of general fund expenditures. Total balance levels are projected to decline slightly in the 2014 fiscal year to $56.7 billion, or 8.2 percent of expenditures, as many states are not forecasting balances as large as those seen in 2013. While the 50-state average balance level of 8.2 percent in 2014 may seem like a significant cushion, two states—Alaska and Texas—represent 43.8 percent of total balance levels. When those two states are removed, total balances for the remaining states drop to 5 percent of expenditures. An informal rule-of-thumb cited by many is that balances should be at least 5 percent of expenditures. During the past 36 years, total balances have averaged 6.1 percent of general fund expenditures.[26]

Looking Ahead

State fiscal conditions have been somewhat mixed since the end of the recession. While revenues are likely to increase for the fourth straight year in 2014, overall revenue growth has been weak compared to other post-recessionary periods. And while 43 states enacted a 2014 budget with general fund spending growth, spending remains below 2008 levels in 19 states. Total balances as a percentage of expenditures are expected to be 8.2 percent in 2014, higher than the historical average of 6.1 percent, but below their 11.5 percent level in 2006.

Looking forward, states, for the most part, are cautiously optimistic that fiscal conditions will continue to slightly improve in the 2015 fiscal year due to several factors. The national economy has slowly but steadily grown over the past five years as the housing market has begun to recover, the unemployment rate has dropped and real gross domestic product has increased. If the national economy continues to grow near its current pace, states are likely to continue to see modest revenue increases. After shutting down for two weeks in October 2013, the federal government has reached several budget agreements bringing more short-term certainty to federal funding levels and removing the immediate risk of a debt ceiling crisis. States are hopeful that they will not experience significant federal program reductions over the next two years.

Even if the national economy continues to grow and states do not experience significant declines in federal funds in the near future, states still face a number of challenges in 2015 and beyond. Since state revenue is closely tied to economic conditions, it is unlikely that revenue collections will experience a rapid increase without stronger national economic growth. Additionally, long-term federal uncertainties—such as the national debt, health care and entitlement reform, transportation funds and possible changes to the federal tax code—pose potential challenges to states. Finally, states are expected to face increased spending demands in areas such as education, health care and infrastructure and will need to continue to address long-term liabilities such as pension funding. The combination of all of these factors means that states are likely to continue to put forth modest spending proposals that are sustainable in future years.

Notes

[1] National Association of State Budget Officers, *The Fiscal Survey of States* (December 2013), 40–41.

[2] National Association of State Budget Officers, *State Expenditure Report* (December 2013), 1–2.

[3] *The Fiscal Survey of States* (December 2013), 1.

[4] See note 1 above.

[5] *The Fiscal Survey of States* (December 2013), 2.

[6] *The Fiscal Survey of States* (December 2013), 52.

[7] "All Sources" includes revenues from sales, personal income, corporate income, gaming taxes, and all other taxes and fees.

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

[9] *The Fiscal Survey of States* (December 2013), 40.

[10] *The Fiscal Survey of States* (December 2013), 42–43.

[11] Nelson A. Rockefeller Institute of Government, *Data Alert*, (March 11, 2014), 3.
[12] *The Fiscal Survey of States* (December 2013), 44–45.
[13] *State Expenditure Report* (December 2013), 1.
[14] *State Expenditure Report* (December 2013), 7.
[15] *State Expenditure Report* (December 2013), 9.
[16] *State Expenditure Report* (December 2013), 6.
[17] See note 15 above.
[18] See note 15 above.
[19] See note 5 above.
[20] See note 3 above.
[21] *The Fiscal Survey of States* (December 2013), 8.
[22] *The Fiscal Survey of States* (June 2013), 10.
[23] See note 21 above.
[24] See note 8 above.
[25] National Association of State Budget Officers, *Budget Processes in the States*, (Summer 2008), 67–69.
[26] *The Fiscal Survey of States* (December 2013), 51–52.

About the Author

Brian Sigritz is the director of State Fiscal Studies at The National Association of State Budget Officers. He received his M.P.A. from the George Washington University and his bachelor's from St. Bonaventure University. Prior to working at NASBO, Sigritz worked for the Ohio Senate and the Ohio House of Representatives.