State Budgets in 2010 and 2011:

Difficult Decisions Remain for States as Slow Growth Follows Unprecedented Declines

By Brian Sigritz

The 2010 fiscal year was another difficult year for states. State revenue collections continued to fall, while general fund spending declined for the second year in a row, marking the first time state spending has declined in back-to-back years. Additionally, 39 states were forced to make midyear budget cuts. Fiscal conditions have improved somewhat for states thus far in the 2011 fiscal year. The number of states making budget cuts has declined and both revenue collections and spending have grown. However, states remain well below pre-recession levels even with the recent increases. States will have to continue to make difficult decisions in the 2012 fiscal year and beyond as Recovery Act funds wind down, spending demands remain high and revenues are slow to recover.

Introduction

The 2010 fiscal year was one of the most challenging for state budgets since the Great Depression. After a revenue decline of 8 percent in the 2009 fiscal year, revenues declined an additional 2.5 percent in 2010.[1] State general fund spending also remained negative, with spending declining an unprecedented 7.3 percent. This followed a 3.8 percent decline in general fund spending in 2009, marking the first time in the 33 year history of the National Association of State Budget Officers' Fiscal Survey of States that general fund spending declined two years in a row.[2] Perhaps not surprisingly, the number of states making midyear budget cuts also remained high, with 39 states making cuts totaling $18.3 billion in the 2010 fiscal year.[3]

Fiscal conditions for states have improved somewhat in 2011. Following two straight years of revenue declines, state revenues are expected to increase 4.4 percent in the 2011 fiscal year according to governors' enacted budgets. Likewise, general fund expenditures are expected to increase by 5.3 percent according to appropriated budgets. For the 2010 fiscal year, 45 states had general fund expenditures below the 2009 levels. In the 2011 fiscal year, 35 states enacted a budget with general fund spending levels above those of 2010.[4]

States will still face a difficult budgetary environment for several years to come even with the recent improvements in fiscal conditions. Revenues, spending and balances all remain well below prerecession levels. Total state general fund revenues in the 2011 fiscal year are forecast to be $44 billion, or 6.5 percent below general fund revenue collections in 2008. Similarly, state general fund spending remains nearly $42 billion, or 6.2 percent below its 2008 level. Total state balance levels have declined from a high of $69 billion in the 2006 fiscal year to $36 billion in 2011. Furthermore, in the 2012 fiscal year, states will have to contend with the $66 billion dropoff of temporary federal aid provided through the American Recovery and Reinvestment Act of 2009.[5] States are also facing increased spending demands in areas such as Medicaid and public assistance due to the recession and are being asked to maintain adequate funding levels in areas such as education. As a result of all these factors, states will be forced to make painful budgetary decisions in 2012 and beyond.

The Current State Fiscal Condition

Revenues in the 2010 Fiscal Year

The 2010 fiscal year marked a continuation of the revenue declines that began in 2009. After growing 4 percent in the 2008 fiscal year,[6] revenues declined sharply by 8 percent in 2009 and an additional 2.5 percent in 2010.[7] To put it another way, over a two-year period between the 2008 and 2010 fiscal years, state revenues declined more than 10 percent. Sales, personal income and corporate income tax revenues all continued to decline in the 2010 fiscal year. Individually, sales tax collections decreased 0.6 percent, personal income tax collections declined 3.8 percent, and corporate income tax collections were 6.9 percent lower than their 2009 fiscal year levels. In actual dollar terms, sales tax revenues declined by $1.1 billion, personal income tax revenues shrank by $9.2 billion, and corporate income tax collections decreased by $2.9 billion.[8]

Another indication of the severity of the revenue strain states faced in 2010 is that revenue collections from all sources[9] were lower than anticipated in 36 states, on target in another two states, and were higher than budgeted amounts in only 12 states. These totals would have been even worse had state revenues not seen a slight uptick at the end of 2010. As recently as the spring of 2010, 46 states were reporting their revenue collections were below their original forecast.[10]

Revenues in the 2011 Fiscal Year

The revenue outlook for states has brightened somewhat in the 2011 fiscal year. Following two straight years of revenue declines, state revenues are expected to increase 4.4 percent in 2011 according to governors' enacted budgets.[11] Sales, personal income and corporate income taxes are all projected to increase by 4.5 percent, 4.8 percent and 8.5 percent respectively.[12] The latest data from the Nelson A. Rockefeller Institute of Government indicates state revenues are growing as expected. According to the Rockefeller Institute, state tax revenues grew by 4.5 percent in the first quarter of the 2011 fiscal year (third quarter of calendar year 2010) compared to the same quarter of the 2010 fiscal year. Additionally, preliminary figures for the second quarter of the 2011 fiscal year show state revenues growing by 6.9 percent compared to 2010.[13]

While encouraging, the revenue growth figures do not tell the entire story. Even if revenues grow 4.4 percent in the 2011 fiscal year as projected, state revenues will still be 6.5 percent below 2008. In actual dollar terms, revenues are projected to be $636.3 billion in the 2011 fiscal year, compared to $680.2 billion in 2008, a decline of nearly $44 billion. Revenues in the 2011 fiscal year will even be nearly $19 billion less than 2007 levels.[14] To find revenue totals similar to the 2011 fiscal year, you have to go back five years to 2006.

Tax and Fee Changes in the 2011 Fiscal Year

In reaction to significant reductions in revenue, states enacted $23.9 billion in tax and fee changes in the 2010 fiscal year. This marked the highest dollar amount since NASBO's Fiscal Survey of the States began tracking tax and fee changes in 1979. In total, 29 states enacted net increases, while nine states enacted net decreases. States continued to enact tax and fee increases in the 2011 fiscal year, although at a lower level. Through December 2010, states had enacted $6.2 billion in tax and fee increases, with 23 states enacting net increases and six states enacting net decreases.[15]

Although sales, personal income and corporate income tax collections comprise approximately 80 percent of state revenue, a large share of the tax increases in the 2011 fiscal year came from outside these three major sources. For example, 17 states enacted fee increases in their 2011 budgets for a net increase of $1.1 billion. Additionally, seven states enacted cigarette tax increases for a net increase of $472 million, and 10 states enacted tax increases in other, smaller tax sources for an increase of $1.1 billion.

States also enacted $2.5 billion in motor fuel taxes, but this was due almost entirely to a tax shift in California in which motor fuel taxes were increased while at the same time sales taxes were decreased. The shift in California also led to states enacting a net decrease in sales tax revenue of $613 million. Personal income taxes experienced a net increase of $424 million, with eight states enacting increases. Corporate taxes increased by $1.1 billion, with seven states enacting increases.[16]

State Spending in the 2010 Fiscal Year

The recent economic downturn has created a unique and, in some ways, unprecedented situation for state expenditures. Spending from state funds (general funds and other state funds combined) declined in both the 2009 fiscal year and estimated 2010 fiscal year, marking the first occurrence in the 23-year history of NASBO's State Expenditure Report. The decline in spending from state funds was precipitated by a rapid reduction in state revenue. However, not all components of state expenditures declined during this period. Federal funds increased sharply in both the 2009 and 2010 fiscal years due to the Recovery Act. This large increase in temporary federal aid, targeted to help states weather the recession, caused total state expenditures to grow modestly in both 2009 and 2010.[17]

Looking in greater detail at the 2010 fiscal year, general fund spending is estimated to be $618.2 billion, a 5.9 percent decline from 2009. General funds typically receive their revenue from broad-based state taxes—such as sales and personal income taxes—and serve as the primary source for financing state operations. All areas of general fund spending, with the exception of transportation, experienced a decline in the 2010 fiscal year.[18] Elementary and secondary education remained the largest category of general fund expenditures in the 2010 fiscal year, accounting for 35.7 percent of all general fund expenditures. Medicaid represented 15.4 percent, and higher education accounted for 12.1 percent. Combined, Medicaid and education comprised more than 63 percent of total state general fund spending. Other categories of general fund spending included corrections at 7.2 percent, public assistance at 1.9 percent, transportation at 0.8 percent, and all other spending[19] at 27 percent.[20]

While general fund spending was declining by nearly 6 percent in the 2010 fiscal year, federal funds increased by 23.4 percent due to the Recovery Act. Federal fund spending went from $457 billion in the 2009 fiscal year to an estimated $563.7 billion in 2010.[21] In contrast to general funds, all spending categories of federal funds increased in the 2010 fiscal year. Medicaid accounted for the largest share of state spending from federal funds at 39.5 percent. Elementary and secondary education at 13.1 percent and transportation at 8 percent represented the next largest shares.[22]

The drastic increase in federal funds from the Recovery Act led to an overall increase in total state expenditures, even after accounting for the aforementioned sharp dropoff in general fund spending. Total state expenditures grew by an estimated 5 percent in the 2010 fiscal year to $1.62 trillion.[23] Additionally, Medicaid surpassed elementary and secondary education as the largest component of total state spending for the first time since 2006, based on estimated 2010 fiscal year spending data. Medicaid expenditures increased sharply due both to Recovery Act funds and a significant increase in Medicaid enrollment brought on by the national recession. In the 2010 fiscal year, Medicaid is estimated to represent 21.8 percent of total state expenditures, with elementary and secondary education close behind at 20.8 percent. Other categories of total state expenditures include higher education at 10.1 percent, transportation at 8.1 percent, corrections at 3.1 percent, public assistance at 1.7 percent, and all other spending at 34.4 percent.[24]

Finally, the Recovery Act, passed in February 2009, produced a shift in the funding sources for state expenditures. Federal funds grew from 26.3 percent of total state expenditures in the 2008 fiscal year to 34.7 percent in the estimated 2010 fiscal year, while general funds shrank from representing 45.9 percent of total state spending in 2008 to 38.1 percent in 2010.[25]

State Spending in the 2011 Fiscal Year

According to appropriated budgets, general fund expenditures are expected to increase by 5.3 percent in the 2011 fiscal year. This would mark the first year that general fund spending has increased since 2008.[26] General fund spending is estimated to be $645.1 billion in the 2011 fiscal year, a $32.5 billion increase from 2010. Not surprisingly, the number of states assuming general fund spending growth greatly increased in the 2011 fiscal year. Thirty-five states enacted a 2011 fiscal year budget with general fund spending levels greater than 2010. By comparison, 45 states in the 2010 fiscal year had general fund expenditures less than 2009 levels.[27]

It should be noted that the 2011 fiscal year general fund spending is expected to remain well below prerecession levels, even after assuming 5.3 percent growth. General fund spending remains nearly $42 billion, or 6.2 percent, below its 2008 fiscal year level. Furthermore, 2011 spending is roughly $10 billion less than even 2007 levels.[28]

Budget Cuts

The number of states forced to make midyear budget cuts remained high in the 2010 fiscal year, with 39 states making cuts totaling $18.3 billion. This was only slightly lower than the 2009 fiscal year, when 41 states made midyear budget cuts.[29] States made budget cuts in a wide range of areas in the 2010 fiscal year. Thirty-five states made cuts in K–12, 32 cut higher education, 31 reduced corrections spending and 28 made cuts to Medicaid. Twenty states also made cuts in public assistance, while 15 cut transportation spending and 37 made cuts in other areas of the budget.[30]

So far in the 2011 fiscal year, the number of states making budget cuts has decreased. Fourteen states have made $4 billion in cuts through December 2010.[31] The reason the number of budget cuts has decreased can likely be traced to the fact that a number of states are meeting or exceeding their revenue projections. Through December, 14 states were exceeding revenue projections, while 20 were on target and 13 were seeing revenues coming in lower than projected.[32] However, states will likely face an additional round of budget cuts in the 2012 fiscal year as Recovery Act funding winds down and state revenues remain below prerecession levels.

Balances

Total balances include both ending balances as well as the amounts in states' budget stabilization funds, which are funds states may use to respond to unforeseen circumstances such as revenues coming in below projections. 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.[33]

Balances have fallen since the start of the recession as states have turned to them in response to declining revenue levels. In the 2010 fiscal year, balances were 6.4 percent of expenditures ($39.2 billion), considerably less than 2008 when balances were 8.6 percent of expenditures ($59.1 billion). As recently as the 2006 fiscal year, balances were at record high levels of 11.5 percent of expenditures ($69 billion). The informal rule-of-thumb is that balances should be at least 5 percent of expenditures.

While the 2010 50-state average balance level of 6.4 percent may seem like a significant cushion, two states—Alaska and Texas—represent 65 percent of the total balance. When those two states are removed, total balance levels drop to 2.4 percent of expenditures. In the 2011 fiscal year, balance levels are projected to fall even further to 5.6 percent of expenditures ($36.2 billion) from 6.4 percent in 2010. Over the last 33 years, balances have averaged 5.8 percent of general fund expenditures.[34]

Looking Ahead

States are likely to continue to face tight fiscal conditions for a number of years to come. While revenues have begun to rise for many states in the 2011 fiscal year, overall state revenues remain $44 billion, or 6.5 percent, less than prerecession levels. Typically, state tax revenues remain weak for several years after a recession ends. For example, it took state revenues at least five years to fully recover after the last two recessions.[35]

Similar to revenue, state general fund spending remains nearly $42 billion, or 6.2 percent, less than the 2008 fiscal year. This is even after factoring in the 5.3 percent growth of fiscal year 2011. At the same time that state spending remains below prerecession levels, states are facing increased spending demands in areas such as Medicaid and public assistance due to the recession and are being asked to maintain adequate funding levels in areas such as education. States also will have to soon contend with the rapid winding down of Recovery Act funds. They are projected to receive roughly $66 billion less in temporary federal aid in the 2012 fiscal year than they received in 2011.[36]

Looking forward, states will be forced to contend with a number of issues, such as the uncertain impact of federal health care legislation, the continued rise in Medicaid costs and enrollment, the need for additional funds for infrastructure maintenance and the desire to reform pension and retiree health benefits. These factors mean states will have to continue to make difficult decisions regarding funding levels, priorities, and the roles and responsibilities of state government. Although states face a challenging road ahead, they will continue to balance their budgets and meet their obligations as they historically have done in the past.

Notes

[1] National Association of State Budget Officers, *The Fiscal Survey of States*, (December 2010), 4, 5.

[2] *The Fiscal Survey of States*, (December 2010), 2.

[3] *The Fiscal Survey of States*, (December 2010), 8.

[4] *The Fiscal Survey of States*, (December 2010), 6.

[5] National Association of State Budget Officers, *Preliminary Summary NGA/NASBO Fall 2010 Fiscal Survey of States*, (November 2010), 1–4.

[6] *The Fiscal Survey of States*, (December 2009), 31.

[7] See note 1 above.

[8] *The Fiscal Survey of States*, (December 2010), 42.

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

[10] *The Fiscal Survey of States*, (December 2010), 39.

[11] Ibid.

[12] *The Fiscal Survey of States*, (December 2010), 43.

[13] Nelson A. Rockefeller Institute of Government, *State Revenue Report*, (February 2011), 1.

[14] See note 5 above.

[15] Ibid.

[16] *The Fiscal Survey of States*, (December 2010), 44–46.

[17] National Association of State Budget Officers, *2009 State Expenditure Report*, (Fall 2010), 2.

[18] Ibid.

[19] "All Other" spending in states includes the State Children's Health Insurance Program (SCHIP), institutional and community care for the mentally ill and developmentally disabled, public health programs, employer contributions to pensions and health benefits, economic development, environmental projects, state police, parks and recreation, housing, and general aid to local governments.

[20] *2009 State Expenditure Report*, (Fall 2010), 8.

[21] *2009 State Expenditure Report*, (Fall 2010), 6.

[22] See note 20 above.

[23] See note 21 above.

[24] See note 20 above.

[25] See note 17 above.

[26] See note 2 above.

[27] *The Fiscal Survey of States*, (December 2010), 1.

[28] *Preliminary Summary NGA/NASBO Fall 2010 Fiscal Survey of States*, (November 2010), 1.

[29] See note 3 above.

[30] *The Fiscal Survey of States*, (December 2010), 11.

[31] See note 3 above.

[32] *The Fiscal Survey of States*, (December 2010), 40.

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

[34] *The Fiscal Survey of States*, (December 2010), 50.

[35] Nelson A. Rockefeller Institute of Government, *Fiscal Features: What Will Happen to State Budgets When the Money Runs Out?*, (February 2009), 2.

[36] See note 5 above.

About the Author

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