# Summary:
# Fall 2016 Fiscal Survey of States

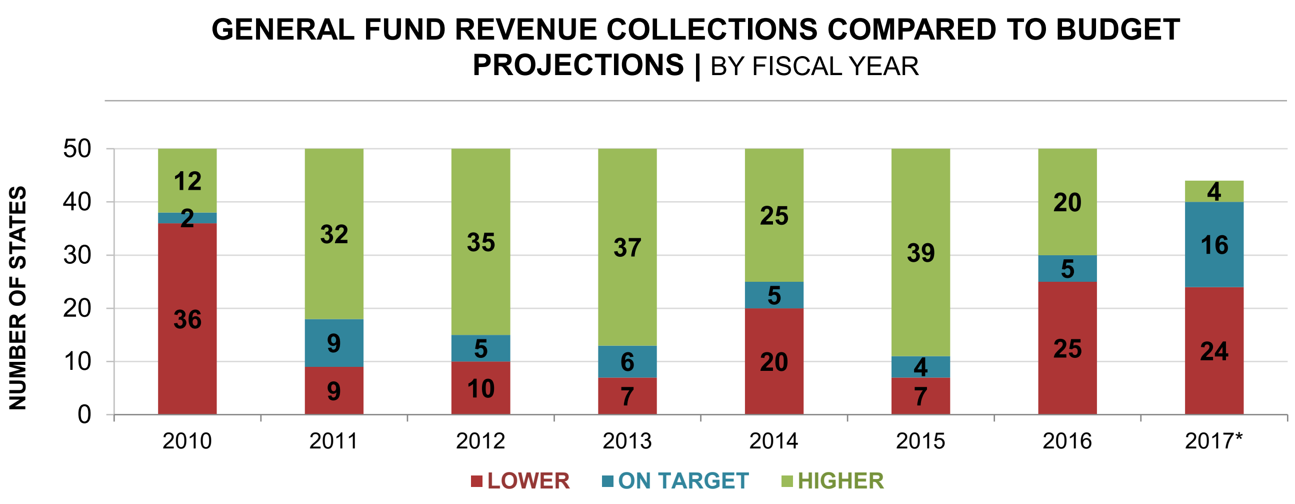
December 13, 2016

## State General Fund Budgets Grow for Seventh Consecutive Year in Fiscal 2017, while Revenue Slowdown Continues

State general fund spending is on track to grow moderately for the seventh consecutive year in fiscal 2017, according to enacted budgets. However, progress since the Great Recession has been slow, and 32 states still spent less in fiscal 2016 than the pre-recession peak in fiscal 2008, after accounting for inflation. Fiscal improvement has also been uneven across states. For example, while 11 states increased general fund spending by six percent or more in fiscal 2017, eight states enacted budgets that call for less spending in fiscal 2017 than in the prior year. This variation is due to a number of factors, such as the negative impact of declining oil and gas prices on energy-producing states, differing tax and spending policies, regional economic disparities, and varied changes in population and other demographics.

There is evidence that many states are seeing softening state tax collections. General fund revenue growth slowed considerably in fiscal 2016, after fairly robust growth in fiscal 2015, necessitating mid-year budget reductions in some states. Revenues came in less than budgeted in 25 states in fiscal 2016 – the most since the Great Recession – and many states are seeing these weaker revenue conditions carrying into fiscal 2017 (See **Figure 1**). At the time of data collection, 24 states reported general fund revenues for fiscal 2017 were coming in below forecast – the highest number of states expecting revenue shortfalls at this time in the fiscal year since fiscal 2010. States also face rising spending demands and long-term budget pressures in areas including health

**Figure 1.**




Source: NASBO *Fiscal Survey of States.*
*Fiscal 2017 figures are based on data collected early in fiscal year. Not all states were able to report for fiscal 2017.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care, education, infrastructure and pensions. Despite these budgetary challenges, most states continue to strengthen their rainy day funds, with 29 states making deposits into these funds in fiscal 2016, and 25 states projecting increases for the current fiscal year.

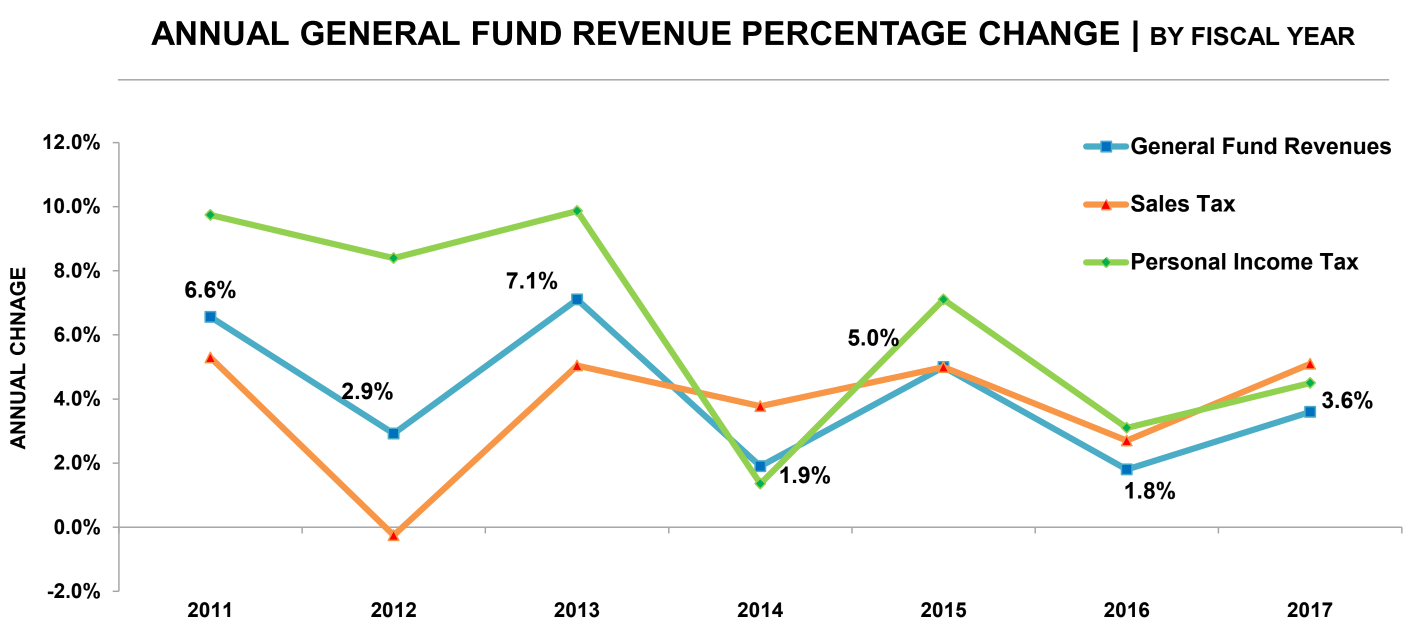
## Revenue Growth Slowed Considerably in Fiscal 2016, and Many States are Below Revenue Targets for Fiscal 2017

State general fund revenue growth slowed considerably in fiscal 2016, increasing just 1.8 percent to $781 billion, after rising 5.0 percent in fiscal 2015. Twenty-five states reported fiscal 2016 preliminary actual revenues came in below original budget projections, while 20 states had revenues come in above forecast and five states were on target.

Enacted budgets for fiscal 2017 project general fund revenues will total $809 billion, a 3.6 percent increase over fiscal 2016. At this time, it seems likely that overall actual revenue totals will be lower than these original projections, with general fund collections coming in below forecast in 24 states, on target in 16 states, and above forecast in just four states at the time of data collection, based on those states able to report for fiscal 2017.

The recent revenue slowdown has been driven by a number of factors. All three of the largest sources of general fund revenue had a lackluster performance in fiscal 2016. Personal income tax collections were negatively affected by the weak stock market gains in calendar year 2015, and corporate income tax collections outright declined. Sales tax growth was also weak, tempered by low inflation and slower growth in consumption of taxable goods and services. The continued decline in oil and gas prices and coal production, and the negative impact on energy-producing states has also contributed to the general fund revenue slowdown. The significant drop in severance tax revenues explains, at least in part, why overall general fund revenue growth has been slower than the gains in personal income taxes and sales taxes over the past couple of years, as shown in **Figure 2**.

**Figure 2.**




*Sources: NASBO *Fiscal Survey of States* for General Fund Revenues (all years), Sales Tax (fiscal 2015-2017), and Personal Income Tax (fiscal 2015-2017). NASBO *State Expenditure Report* for Sales Tax (fiscal 2008-2014) and Personal Income Tax (fiscal 2008-2014).

## Weaker Fiscal 2016 Revenue Performance Contributed to Modest Rise in Mid-Year Budget Cuts

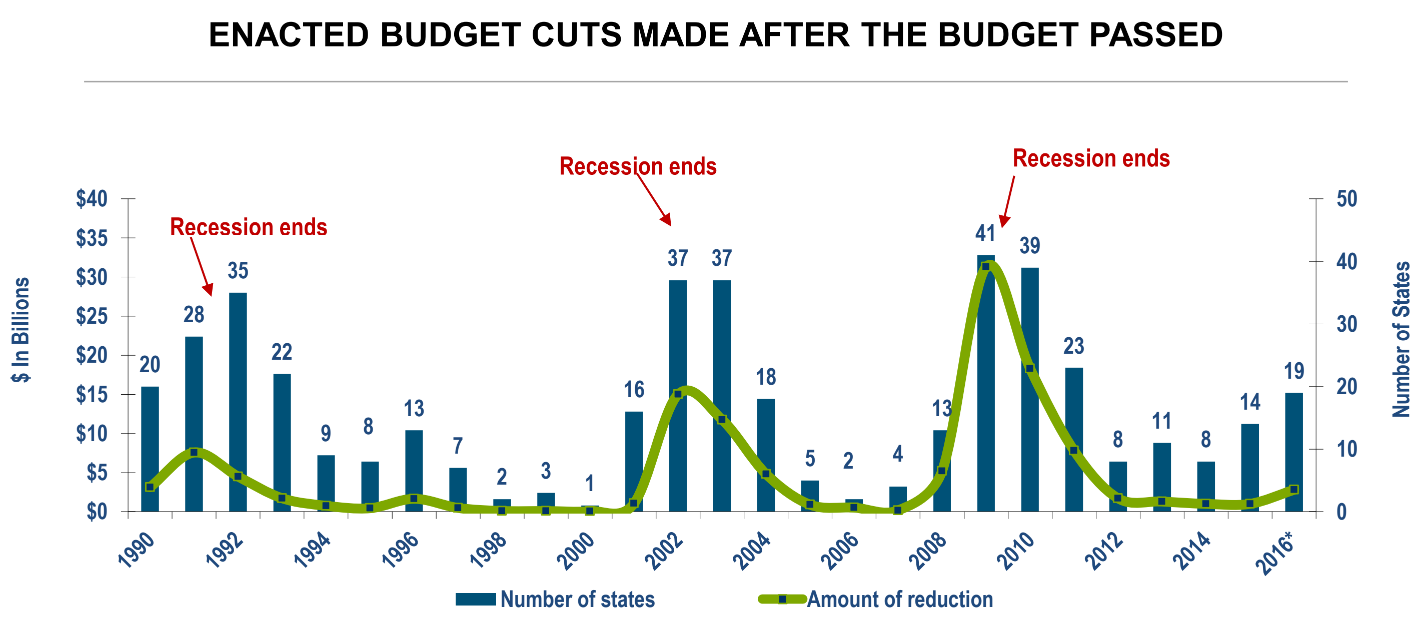
Weaker-than-anticipated revenue collections and resulting budget gaps in fiscal 2016 led some states to cut spending during the year. Nineteen states reported net mid-year budget decreases in fiscal 2016 totaling $2.8 billion. As shown in **Figure 3**, the number of states with net mid-year budget reductions in fiscal 2016 is historically high outside of a recessionary period. However, in a few states, the mid-year reductions were not due to the presence of a budget gap, but rather resulted from adjustments due to lower than expected costs, timing of transfers or other technical changes, or creating resources for an upcoming fiscal year. Still, there is a correlation between mid-year budget reductions and fiscal conditions; among the 19 states that enacted net mid-year budget cuts in fiscal 2016, 14 states also reported revenue collections for the year came in below forecast and most also reported having a fiscal 2016 budget gap to close.

## Enacted Budgets Show States Increase General Fund Spending by 4.3 Percent in Fiscal 2017

Enacted fiscal 2017 budgets show aggregate general fund expenditures reaching $820 billion, an increase of 4.3 percent over fiscal 2016. 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. After seven years of budget growth, most states have surpassed their pre-recession spending levels in nominal terms, although eight states enacted fiscal 2017 budgets below fiscal 2008 levels (without adjusting for inflation); several of these states are facing negative budgetary impacts associated with the declining price in oil.

State general fund spending reached $786 billion in fiscal 2016, a 3.7 percent increase over fiscal 2015. NASBO's *Spring 2016 Fiscal Survey of States* previously reported that estimated fiscal 2016 spending (and revenues) had exceeded pre-recession fiscal 2008 levels in real terms. However, this is no longer the case, as actual spending and revenue amounts came in

**Figure 3.**

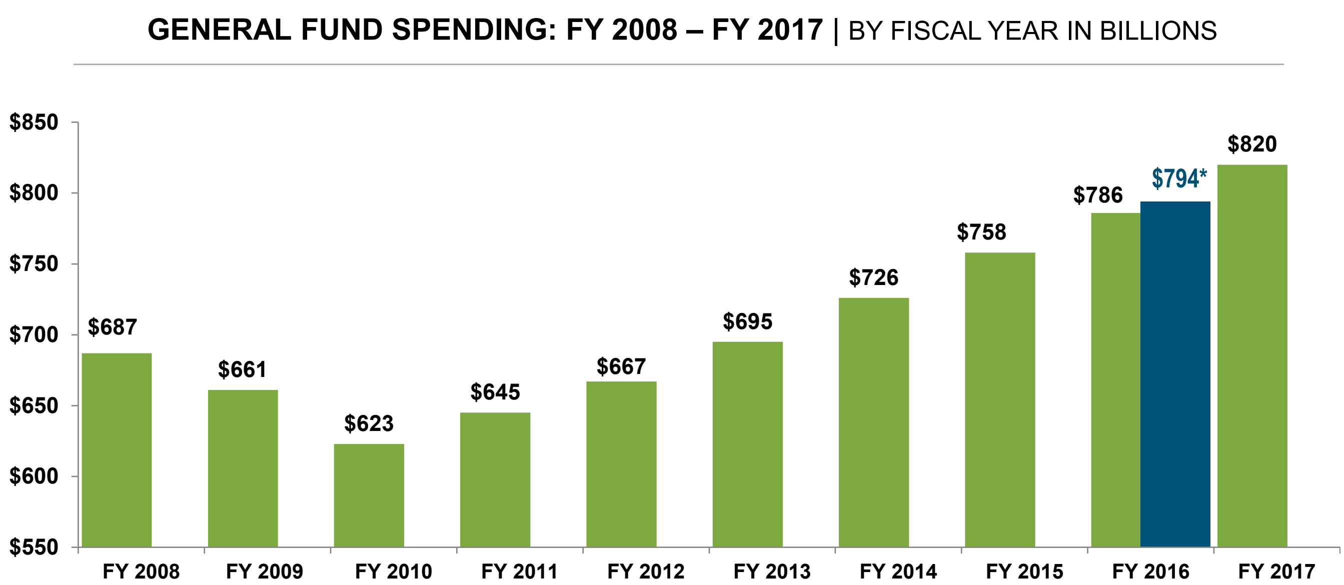



Source: NASBO *Fiscal Survey of States*

below prior estimates – in part due to these mid-year budget reductions. The inflation rate for fiscal 2016 also increased since the spring report was released, causing the threshold to exceed the fiscal 2008 real spending level to increase. (See **Figure 4**)

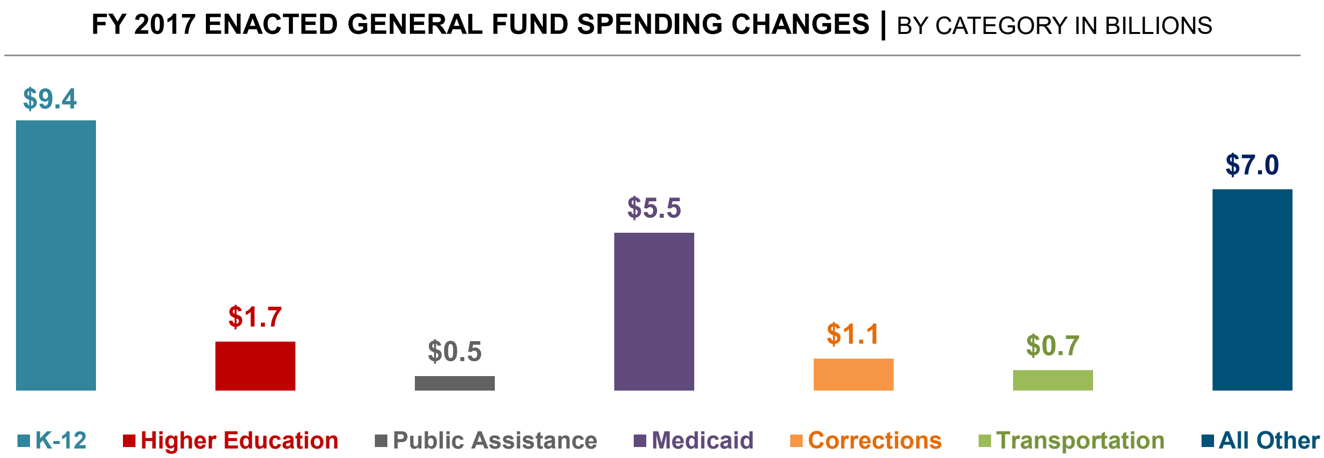
For fiscal 2017, states approved general fund appropriation increases totaling $26 billion, mainly directing additional funds to K-12 education and Medicaid – the two largest portions of state general fund spending. Thirty-nine states enacted spending increases for K-12, while eight states enacted decreases, and for Medicaid, 34 states enacted increases while 10 states enacted decreases. States also enacted net increases in general fund spending on all other program areas tracked in this report, including higher education, corrections, transportation and public assistance, as shown in **Figure 5**.

## Figure 4.




Source: NASBO *Fiscal Survey of States;* Fiscal 2017 figure is based on states' enacted budgets.
*Aggregate spending level would need to total $794 billion in fiscal 2016 to be equivalent with real 2008 spending level.

## Figure 5.




Source: NASBO *Fall 2016 Fiscal Survey of States*


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**Figure 6.**

**SUMMARY OF ENACTED STATE REVENUE CHANGES | FISCAL 2017**

| | SALES TAX | PERSONAL INCOME TAX | CORPORATE INCOME TAX | TOBACCO/ CIGARETTE TAX | MOTOR FUEL TAX | ALCOHOL TAX | OTHER TAX | FEES |
|---|---|---|---|---|---|---|---|---|
| # OF STATES ENACTING INCREASES | 8 | 2 | 3 | 4 | 3 | 1 | 5 | 7 |
| # OF STATES ENACTING DECREASES | 11 | 15 | 12 | 0 | 0 | 1 | 8 | 2 |
| NET CHANGE ($ IN MILLIONS) | +$1,878 | -$2,284 | -$489 | +$812 | +$337 | +$19 | +$270 | +$791 |

Source: NASBO *Fall 2016 Fiscal Survey of States*

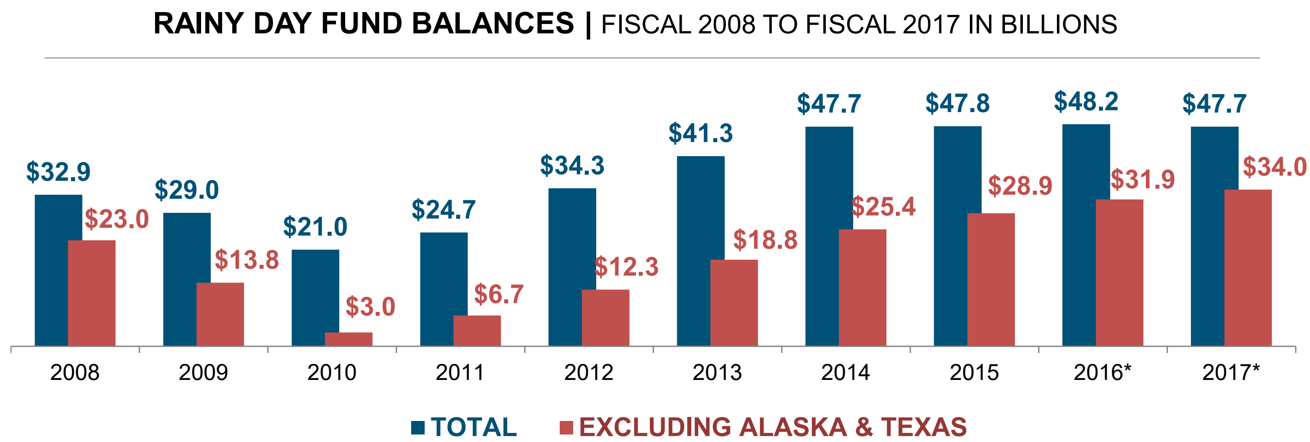
## States Enact a Mix of Tax Increases and Decreases in Fiscal 2017

Similar to last year, states enacted a mix of tax increases and decreases in their fiscal 2017 budgets, summarized in **Figure 6**. Eleven states enacted net tax and fee increases, while 20 states enacted net decreases, resulting in a net increase of $1.3 billion – representing less than 0.2 percent of forecasted general fund revenue for fiscal 2017. This net increase is primarily driven by a substantial sales tax hike in Louisiana, as well as tax and fee changes in California, Pennsylvania, and Michigan. Meanwhile, Ohio's continued phase-in of personal income tax cuts accounted for the largest tax decrease. As seen in previous years, tax increases were more commonly enacted on general sales and cigarettes, while taxes on personal and corporate income reflected most of the reductions.

## Despite Slower Revenue Growth and Other Budget Challenges, Most States Continue to Bolster Rainy Day Funds

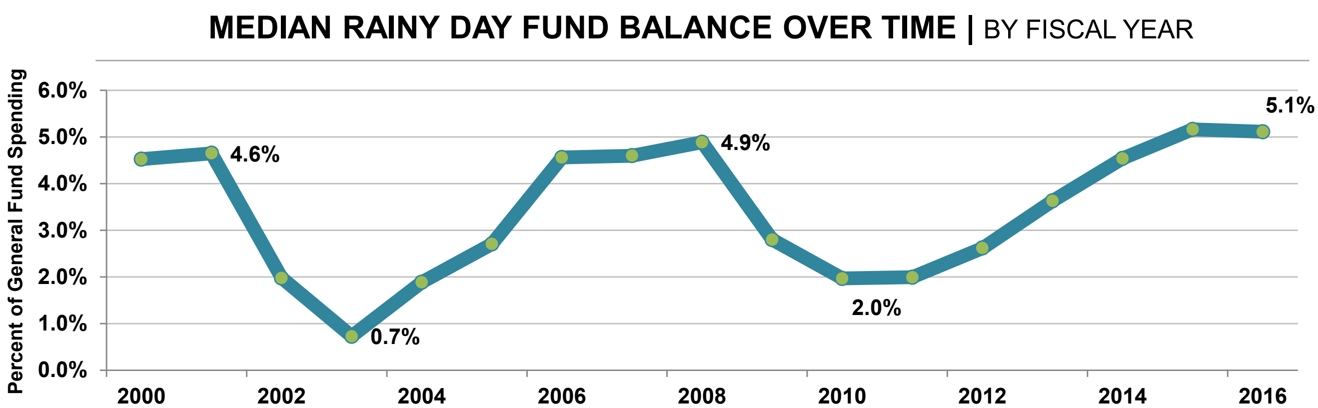
Most states have focused on strengthening their rainy day funds, though some states – particularly energy-producing ones – have had to tap their reserves to help address budget shortfalls. Twenty-nine states increased their rainy day fund balances in fiscal 2016, and 25 states project increases in fiscal 2017. Since aggregate rainy day fund levels hit a recent low in fiscal 2010, 40 states had increased their amounts as of the end of fiscal 2016, at least in nominal terms. Since Alaska and Texas have historically held a disproportionate amount of rainy day fund dollars, and Alaska's reserves have also declined dramatically over the last several years in response to budget challenges caused by the steep drop in energy prices, it can be helpful to look at the trend over time excluding these two states. (See **Figure 7**) Looking at the median fund balance can also help avoid a few outlier states from dominating the trend line. The median state's 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. (See **Figure 8**)

**Figure 7.**




Source: NASBO *Fall 2016 Fiscal Survey of States*
*Fiscal 2016 totals exclude Georgia; FY 2017 totals exclude Georgia and Oklahoma

**Figure 8.**




Source: NASBO *Fall 2016 Fiscal Survey of States*

## Outlook: Many States Face Tighter Fiscal Conditions Ahead Due to Softening Revenue Collections

A number of states are already seeing general fund revenues coming in below original budget projections for fiscal 2017, and some states will need to turn to mid-year spending reductions to address these shortfalls. Slower revenue growth in fiscal 2016 and fiscal 2017 is also likely to translate into tighter state budgets for fiscal 2018, currently under development in most states (17 states are preparing biennial budgets that will also include fiscal 2019). At the time of data collection, 11 states were forecasting shortfalls for fiscal 2018 that will require budget management actions. States will also have to contend with rising spending demands in areas such as health care and education, long-term pressures such as pensions and infrastructure, and increasing federal uncertainty, particularly concerning the prospects of tax reform and health care policy. In this environment, states are likely to be cautious in their spending and revenue forecasts, as they continue to focus on ensuring structurally balanced budgets.

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