STATE BUDGET UPDATE: SPRING 2012

(Condensed Free Version)

NATIONAL CONFERENCE of STATE LEGISLATURES

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State Budget Update: Spring 2012

State fiscal conditions continue to improve at a slow and steady pace. A spring 2012 survey of state legislative fiscal officers found revenue performance remains positive and expenditures in most states are stable. And for the first time since before the Great Recession, a number of states are projecting to end the fiscal year with small unobligated balances.

> This report is based on data collected from legislative fiscal officers in March and April 2012. It includes information on:
>
> - FY 2012 tax performance;
> - Projected return to peak revenues
> - Spending overruns in FY 2012;
> - New FY 2012 budget gaps and projected FY 2013 budget gaps;
> - Projected FY 2012 unobligated balances; and
> - Summary of the state fiscal situation.
>
> This report provides information on all 50 states and the District of Columbia.

In another sign of improving fiscal conditions, few states have faced mid-year budget shortfalls in fiscal year (FY) 2012. This is good news for state lawmakers who have closed more than $500 billion in budget gaps over the previous four fiscal years. In addition, fewer budget gaps are projected for FY 2013 compared with recent years.

Despite this encouraging news, a degree of uncertainty still lingers over state budgets. Concerns about unemployment levels, potential federal deficit reduction actions, spending pressures and global economic events, are contributing to a cautious state budget outlook.

FY 2012 Tax Performance

Revenue performance through the first eight months of FY 2012 has been a key factor in the improved condition of state finances. To date, collections have met or exceeded expectations in most states. Officials expressed cautious optimism about the fiscal situation, reflecting the slow, but steady, improvement in revenue performance.

Performance in the major tax categories exceeded or met expectations in most states. However, performance was uneven across tax categories. Sales taxes and corporate income taxes generally performed better than personal income taxes. In addition, many analysts note that original forecasts were conservative, which explains, in part, why collections are exceeding estimates. Yet, revenues continue to grow, which is welcome news for states.

This rest of this section provides a snapshot of recent performance for state personal income, sales and corporate income taxes. Information on the performance of other taxes is included for those states that provided it. More details can be found in Tables 1 through 6.

Personal Income Taxes

Personal income tax collections account for nearly 34 percent of state own-source revenues. Nine states do not levy a broad-based personal income tax.[1]

- Twelve states and the District of Columbia reported that personal income tax collections exceeded the latest estimate. Nine of these states had not revised their forecasts. Hawaii, Minnesota and the District of Columbia saw collections surpass an estimate that had been revised upward. Idaho reported collections over a lowered estimate.
- Sixteen states saw collections come in on target. Colorado, Delaware, Iowa, Kansas, Mississippi and South Carolina had raised their estimates while Maine, Oregon and Wisconsin had reduced theirs.
- Fourteen states reported that personal income tax revenues were below the latest target. Massachusetts and Michigan were both failing to meet an estimate that had been revised upward. Collections in Alabama, Connecticut Louisiana, Maryland and Utah were coming in below an estimate that had been reduced, although in most of these states, revenues were underperforming only slightly.

Table 1 contains more information on personal income tax performance.

Return to Peak Revenue Collections

For most states, FY 2008 marked the peak year of nominal revenue collections. The expectations for return to peak collections vary widely. One-third of the states expect a return to peak during the current fiscal year, though many others do not expect a return for at least three years or longer. Some states do not have a projection. For those that do, however, it is important to note that the predictions are based on current economic forecasts and existing tax law, which obviously could change.

- FY 2012: Fifteen states expect revenue collections to reach previous peak levels during the current fiscal year.
- FY 2013: Minnesota, Montana, Ohio, Pennsylvania, Tennessee and Vermont.
- FY 2014: Colorado, New Jersey, Rhode Island, Washington and West Virginia.
- FY 2015: Florida, Idaho and Mississippi.
- FY 2016: Arizona, Georgia, Maine and South Carolina.
- FY 2017: California,
- FY 2018: Michigan.
- Fourteen states report that a return to peak revenue collections is currently unknown or not in the forecast horizon.
- North Dakota is the only state where tax collections never fell on a year-over-year basis.

Table 7 contains more information about when states expect to return to peak revenue collections.

[1] Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not levy a personal income tax. New Hampshire and Tennessee do not levy a personal income tax, but tax interest income and dividends. Tennessee provided information on the performance of its tax on interest and dividends.

General Sales Taxes

General sales and use taxes represent about 32 percent of state own-source revenues. Five states—Alaska, Delaware, Montana, New Hampshire and Oregon—do not levy a state sales tax.

- Twenty-three states and the District of Columbia saw general sales tax collections coming in over the revenue estimate. In 12 of those states, the forecast had not been revised. Alabama, Connecticut, Massachusetts, Michigan, South Carolina, South Dakota, Texas and the District of Columbia exceeding increased estimates, while Idaho, Kentucky and Minnesota were exceeding lowered estimates.
- Sixteen states reported that collections were coming in on target. Colorado, Iowa, Kansas and Minnesota were meeting targets that had been revised upward. Maine, New Jersey and Wisconsin were meeting reduced estimates.
- In six states, sales tax revenues were failing to meet forecasts. Hawaii and Utah reported collections below estimates that had been raised.

Table 2 contains more information on general sales tax performance.

Corporate Income Taxes

On average, corporate income taxes account for about 5 percent of all state tax collections. Alaska and New Hampshire, however, depend on them for more than 10 percent of collections. Six states—Nevada, Ohio, South Dakota, Texas, Washington and Wyoming—do not levy a corporate income tax.

- Twenty-two states reported corporate income tax receipts above estimates. This includes Alabama, Hawaii, Iowa, Kentucky, Maryland, Massachusetts, Michigan, Minnesota and South Carolina that had raised their forecasts. Idaho, Maine and Utah saw revenues coming in over a lower estimate.
- Fifteen states reported collections coming in on target. Of these, Colorado, Kansas, Mississippi and New Jersey had raised the forecast, while Delaware, Oregon and Wisconsin had lowered the forecast.
- Seven states and the District of Columbia saw corporate tax receipts coming in below expectations. The forecast had been revised downward in the District of Columbia.

Table 3 contains more information on corporate income tax performance.

Other Taxes

States also rely on a variety of miscellaneous taxes for revenue. These include taxes on oil and gas production, real estate transfers, tobacco, meals and rooms, insurance premiums, gambling, estates and others.

- Ten states reported severances taxes performing above estimate, which had been raised in both South Dakota and Texas. Eight states saw collections coming in on target, and four states reported severance tax collections coming in below estimates.

Several states commented on the negative impact low natural gas prices were having on severance tax collections.

- Eighteen states reported real estate transfer taxes coming in on target or above. Four states reported transfer taxes slightly below the current forecasts.
- Miscellaneous taxes were performing above estimate in six states. Eleven states reported them coming in on target, and 10 states reported miscellaneous taxes such as insurance and gambling coming in below estimates.

Tables 4, 5 and 6 contain more information on these other taxes.

Spending Overruns in FY 2012

The number of states reporting spending overruns in FY 2012 has grown since fall 2011. Through March, 21 states and the District of Columbia reported spending overruns. Four months ago 11 states had reported spending overruns. At this time last year, the number of states reporting spending overruns stood at 23.

- Medicaid or other health care programs are over budget in 10 states, compared with 20 states last year. In California, court orders and delayed federal approval of reductions in several health and human services have increased costs by nearly $2 billion. Florida has spent $47.3 million in nonrecurring general revenue funds to cover a deficit in its Medicaid program. Maryland's governor has submitted general fund deficiency requests for FY 2012 that include $78.1 million to support reimbursements for Medicaid providers and mental hygiene fee-for-service expenses. New Jersey officials noted that Medicaid costs are above budget due to a failure to obtain federal approval for waivers.
- Five states, California, Maine, Maryland, New York and Oregon, reported that public welfare or human service programs are over budget. In Maryland, officials reported that they had not received anticipated federal funds for Temporary Cash Assistance, resulting in a $25.8 million deficiency. Officials in Oregon reported that caseloads are over budget in Temporary Assistance for Needy Families and Supplemental Nutrition Assistance Program.
- Iowa, Maryland, Tennessee and Texas indicated that corrections programs are over budget. Iowa reported that a $7.5 million was needed to bring its program within budget.
- The District of Columbia, Kansas and Maryland reported spending more on K-12 education than was budgeted for in FY 2012. Washington, D.C.'s public schools are $25 million (4 percent) over budget primarily because of food service costs exceeding the reimbursement rate from the U.S. Department of Agriculture.
- Other programs over budget include homeless shelter programs in Massachusetts, disaster assistance in Missouri, Nebraska and Texas, and local jail payments in Tennessee and West Virginia.

Table 8 contains more information on state spending overruns.

New FY 2012 Budget Gaps

The lack of new (gaps that have opened since July 1, 2011, the start of FY 2012 for most states) budget gaps is welcome news to state officials. For the first time in four years, most lawmakers did not spend the early part of their legislative sessions addressing current budget shortfalls. For the few states facing new FY 2012 budget gaps they are relatively small in comparison to previous years. Here are the details.

- Nine states have experienced gaps since the beginning of FY 2012, totaling $6.8 billion.
- Two states have FY 2012 gaps greater than 5 percent of their general fund budgets—Alabama (10.6 percent) and Washington (5.3 percent).
- Three states have budget gaps between 1 percent and 5 percent: California (4.8 percent), Louisiana (3 percent) and Pennsylvania (2.7 percent).
- In four states—Connecticut, Maine, Missouri and New York—the budget gaps amount to less than 1 percent of their general fund budgets.
- Five states already have closed all or a portion of their budget gaps. New York, for instance, resolved its gap through spending restraints.

More information on FY 2012 budget gaps can be found in Table 9.

FY 2013 Budget Gaps

The number of states with budget gaps and size of the projected imbalances are declining. Sixteen states and the District of Columbia project new FY 2013 gaps of $16.2 billion.

- When combined with the FY 2013 budget gaps resolved during 2011 legislative sessions, the cumulative shortfall for FY 2013 is $32.2 billion (see *State Budget Update: Summer 2011* for more information).
- Seven states reported gaps of 5 percent or more of their general fund budgets. The largest shortfalls are projected in Alabama (17 percent) and Louisiana (9.6 percent).
- Eight states and the District of Columbia currently have gaps between 0.3 percent (Maine) and 4 percent (Rhode Island).
- Massachusetts has a projected gap of between $800 million and $1 billion.

Table 10 provides more information on projected FY 2013 budget gaps.

Projected FY 2012 Unobligated Balances

Throughout the Great Recession, spending estimates often proved to be too low and revenue estimates too high, resulting in substantial state budget gaps. The fiscal environment, however, is beginning to stabilize. Spending requirements have been relatively stable, and revenues continue to grow, and in some cases have returned to pre-recession levels. More than half of the states project to end the fiscal year with unobligated balances—albeit very modest amounts. These balances represent revenues above what was originally budgeted. Here are the details.

- Twenty-nine states and the District of Columbia project FY 2012 revenues to exceed budgeted obligations by $9.1 billion, but the aggregate amount is a equal to a mere 1.4 percent of FY 2012 general fund appropriations.[2]
- Four states are projecting unobligated balances in greater than 10 percent of their general fund budgets: Alaska (21.6 percent), Indiana (12.9 percent), Montana (10.8 percent) and Wyoming (10 percent). Officials in Alaska noted that their projection is from fall 2011, but high oil prices have since increased the estimate.
- Arizona, Iowa, Michigan and South Dakota are projecting positive ending balances between 5 percent and 9.9 percent.
- Unobligated revenues in 16 states and the District of Columbia range from 0.002 percent (Rhode Island) to 4.6 percent (Idaho) of their general fund budgets.
- While officials in five states expect an unobligated balance for FY 2012, the amount is unknown.
- Officials in Georgia, Virginia and West Virginia do not yet know if revenues will exceed budgeted obligations in FY 2012.

More information can be found in Table 11.

Use of Projected FY 2012 Unobligated Balances

Most states anticipate using any excess funds to rebuild budget stabilization funds (rainy day funds) and to carry forward into FY 2013. Other states plan to use a portion to reduce debt or to fund capital projects.

- *Deposit into the Budget Stabilization Fund:* Twenty-one states plan to deposit all or portions of their ending balances into a budget stabilization fund. In many cases this is due to constitutional or statutory requirements for deposits that are triggered when state revenues or economic growth exceed specified levels. Minnesota, for example, is required to deposit excess revenues into the budget stabilization fund until it reaches $653 million. In West Virginia, at least half of any unanticipated funds must be deposited into the revenue shortfall fund.
- *Carry Forward into FY 2013:* Nineteen states expect to tap excess resources to support FY 2013 budgets. In Michigan, the governor proposes using an estimated ending balance of $500 to fund FY 2013 appropriations. South Dakota officials approved $27.8 million in excess funds for FY 2013 needs. In Oregon, any positive balance from the first half of the biennium automatically rolls forward into the second half.
- *Debt Reduction:* Two states—Arizona and Indiana—plan to use a portion of projected resources for debt reduction. In Indiana, revenues are being directed toward state employee pension funds.

[2] State appropriations totaled $670.9 billion in FY 2012. NCSL survey of legislative fiscal offices, summer 2011.

- *Other:* Eleven states and Washington, D.C. are considering using unexpected revenues for capital projects, or for relieving spending pressures. In Mississippi, a portion of the ending balance will go the Capital Expense Fund and will be available for repair and rehabilitation of state-owned buildings. The District of Columbia will use extra revenues to address agency spending pressures, while in Alaska some of the funds will be used to increase capital spending.

More information on the use of projected FY 2012 unobligated balances can be found in Table 12.

Summary of the State Fiscal Situation

The tenor from legislative fiscal directors is one of cautious optimism as state budgets slowly but steadily improve. Officials frequently used terms such as“cautiously optimistic” and “stable” to describe the current fiscal situation in their states. The instances in which officials used summary less optimistic terms such as “precarious” or “cautious” were fewer than at any point in recent surveys. Examples from officials in a few states include:

- Officials in Alabama are reporting slow revenue growth and a gradual improvement in the fiscal situation, but the loss of one-time revenues creates an unstable general fund budget.
- Fiscal indicators in Arizona are generally positive but uncertainty regarding federal health care reform and budget reform makes the outlook beyond FY 2013 uncertain.
- California lawmakers continue to cope with the state’s multi-billion gap between projected revenues and anticipated expenditures.
- Officials in Arkansas, Connecticut, Idaho, Iowa, New Hampshire, Nevada, Ohio, and South Dakota are cautiously optimistic regarding their respective fiscal situations.
- Officials in New Jersey describe short-term fiscal conditions as relatively stable, but long-term structural issues remain a concern.
- North Dakota officials report revenues from energy-related activities continue to increase while other areas of the budget are fairly stable.
- The growth in sales tax collections in Tennessee is an indicator of an improving economy.
- Texas officials reported that revenues are tracking well above estimate and will be used to offset a Medicaid budget shortfall.
- Officials in Wyoming describe their fiscal situation as precarious because of falling natural gas prices.

Table 13 provides summary information on the current state fiscal situation.

As noted throughout this report, state finances are showing signs of recovery. At the same time, however, the improvements are modest, and officials in many states are still concerned about the strength of economic growth.

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