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- To improve the quality and effectiveness of state legislatures.
- To promote policy innovation and communication among state legislatures.
- To ensure state legislatures a strong, cohesive voice in the federal system.

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STATE BUDGET UPDATE: SPRING 2013

As the four-year anniversary of the official end of the Great Recession approaches, no strong indication exists that states are entering a robust recovery phase. Rather, states continue to move along the same path of slow and steady growth that gradually has brought them out of the economic nadir. The general outlook from state officials is one of stability, with a dose of uncertainty, as states continue to plod their way through an extended economic recovery.

There are some exceptions. A small, but increasing, number of states report moderate to strong fiscal conditions resulting in budget surplus projections. Only a few states find themselves on the other end of the fiscal spectrum, with continuing budget difficulties.

Even with this upbeat assessment of state fiscal conditions, uncertainty still hovers over state finances, as the impact of federal sequestration remains unclear. Some state officials are concerned about how federal fiscal policy could affect state revenues as federal government spending is reduced in both defense and non-defense program areas.

FY 2013 Revenue Performance
Stable revenue performance through the first eight months of fiscal year (FY) 2013 continues to be a key factor in the improved condition of state finances. To date, collections have met or exceeded expectations in most states and nearly all states remain optimistic that they will meet their revenue targets for the rest of the fiscal year.

This report is based on data collected in the spring of 2013 from legislative fiscal officers in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. It includes information on:

- State revenue performance;
- Areas of spending over budget;
- Impacts of sequestration on state budgets; and
- A summary of state fiscal situations.
While overall tax collections are positive, performance was uneven across the major tax categories. States reported strong personal income tax collections through February or March. However, because it is such an important month for personal income taxes, April collections will be a determining factor. In addition, several states noted that personal income tax performance may have been positively influenced by taxpayers pushing income into tax year 2012 because of uncertainty around the status of expiring tax cuts in 2013 and other federal fiscal policy changes. Real estate transfer taxes were also up, signaling a rebounding housing market. Sales tax collections, on the other hand, were not as strong.

The 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 6.¹

**Personal Income Taxes**

Personal income tax collections account for nearly 34 percent of state own-source revenues. Seven states 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.

- Twenty-three states and the District of Columbia reported that personal income tax collections exceeded the latest estimate (see figure 1). Eight of these states (California, Hawaii, Indiana, Montana, Oklahoma, Oregon, Utah and Wisconsin) and the District of Columbia saw collections surpass an estimate that had been revised upward. Maine, Massachusetts, Michigan, New York and Tennessee reported collections over a lowered estimate. Collections in nine states exceeded an unchanged forecast.
- Seventeen states saw personal income tax collections come in on target. Delaware, Illinois, Iowa, Mississippi, Nebraska, New Jersey, Ohio and South Carolina had all raised their estimates while Georgia had reduced its forecast.

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¹ Revenue performance data is not available for Rhode Island.

**Revenue Outlook for the Remainder of FY 2013**

Revenue performance is a key indicator of the state fiscal situation, so it is also important to get a sense of future revenue expectations. For most states, the general revenue outlook for the remainder of the fiscal year is stable as the majority of state officials expect revenues to meet the FY 2013 forecast. Only a handful of states expect that revenues will “likely exceed” or “unlikely meet” their projected targets through the remainder of FY 2013.

- Thirty-seven states and the District of Columbia reported that revenues are expected to meet FY 2013 revenue estimates.
- Fiscal directors in eight states indicated that revenues are likely to exceed projections.
- Revenues are unlikely to meet their forecasts in four states—Alaska, New Hampshire, New Jersey and West Virginia—as well as Puerto Rico and the U.S. Virgin Islands.
- This issue does not apply to New York because FY 2013 ended on March 31, 2013.
• Only Minnesota, Puerto Rico and the U.S. Virgin Islands reported personal income tax revenues below the latest target. In Minnesota, the estimate had been revised upward, in Puerto Rico it remained unchanged, and in the U.S. Virgin Islands, it had been revised downward.

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—and the U.S. Virgin Islands do not levy a state sales tax.

• Marking a change from this time last year when 23 states reported sales tax collections exceeding projections, only five states and the District of Columbia reported sales tax collections coming in over the latest estimate (see figure 2). Hawaii, Oklahoma, Utah and the District of Columbia were beating estimates that had been raised. Idaho and Minnesota reported collections over a forecast that had been revised downward.

• Twenty-seven states reported sales tax revenue coming in on target. However, in 13 of those states the target had been reduced. Five states—Florida, Iowa, Mississippi, North Dakota and South Dakota—were meeting targets that had been raised.

• In twelve states and Puerto Rico, sales tax revenues were failing to meet forecasts. In California the forecast had been raised, and in Indiana, Maine, Massachusetts and New York the forecasts had been lowered.

Corporate Income Taxes
On average, corporate income taxes account for about 5 percent of state own-source revenues. Alaska, Delaware 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.
- Nineteen states and the District of Columbia reported corporate income tax receipts above estimates (see figure 3). This includes Hawaii, Montana, New York, Oklahoma, Oregon, Utah, Wisconsin and the District of Columbia that had raised their forecasts. California, Massachusetts, New Mexico and Tennessee saw revenues coming in over a lower estimate.

- Sixteen states reported collections coming in on target. Of these, Illinois, Michigan, Nebraska and North Dakota had raised the forecast, while Connecticut, Florida, Georgia, Idaho, Iowa and New Jersey had lowered the forecast.

- Corporate tax receipts were coming in below expectations in eight states, Puerto Rico and the U.S. Virgin Islands. The forecast had been revised up in Minnesota and down in Delaware, Maine, Maryland, New Hampshire and the U.S. Virgin Islands.

**Other Taxes**
States also rely on a variety of other taxes. These include taxes on oil and gas production, real estate transfers, tobacco, meals and rooms, insurance premiums, gambling, estates and others.

- Reflecting lower oil and gas prices, severance taxes were below the latest estimate in seven states. Eleven states saw severance taxes coming in on target, and only Michigan and Texas reported severance taxes performing above estimate.

- On the other hand, real estate transfer tax collections were up, reflecting a modest rebound in the housing market. Ten states and the District of Columbia reported real estate transfer tax revenue above the latest target. Ten states were on target and New Jersey and the U.S. Virgin Islands reported real estate transfer taxes below the projected amount.

- Miscellaneous taxes were performing above estimate in six states. Seven states and the U.S. Virgin Islands reported them coming in on target, and eight states reported miscellaneous taxes on items such as tobacco, gaming, inheritance and estates were coming in below estimates.

**Significant Tax Reform Measures under Consideration in 2013**
Following a relatively quiet year for tax activity, 2013 emerged as “the year of tax reform” as many governors across the country kicked off the legislative sessions with major tax reform proposals. To date, only three states—Alaska, New Mexico and Virginia—have enacted tax reform measures, but another 31 and the District of Columbia report that significant tax reform measures are under consideration. In general, these tax reform proposals include personal and corporate income tax reductions, broadening the sales tax base by expanding into services and changes to transportation related taxes.
Areas of Spending Over Budget
Through March, 19 states and the District of Columbia and Puerto Rico reported that at least one category of spending—typically Medicaid, corrections or education—is significantly over budget for FY 2013. Some examples include:

- Ten states reported that Medicaid spending is over budget for FY 2013 (see figure 3). In Nevada, expenditures have exceeded budgeted levels because of higher than estimated caseloads and higher costs per recipient. North Carolina reported that Medicaid spending is projected to exceed FY 2013 budgeted levels by an estimated $100 million to $200 million. In Pennsylvania, the governor has requested a supplemental appropriation for Medicaid due to higher than anticipated costs, as opposed to caseload growth.

- Nine states reported that corrections programs are over budget. Officials in Idaho noted that a long standing lawsuit against the Dept. of Corrections was settled this year requiring some additional resources to meet the terms of the settlement, and to provide additional resources for housing and medical services. Tennessee reported that corrections is over budget due to an increase of state inmates housed in local jails.

- K-12 education spending is over budget in the District of Columbia, Maryland, Montana, New Hampshire and Puerto Rico. The District of Columbia and New Hampshire both noted they have spent more than anticipated on charter schools. In Maryland, both K-12 and higher education were over budget.

- Other programs over budget include social services programs in California, Connecticut and Maine; wildfire suppression in Alaska, Montana and Washington; and snow and ice removal in Massachusetts.

Federal Sequestration and State Budgets
Sequestration, which was established by Congress in the 2011 Budget Control Act and modified in January’s American Taxpayer Relief Act, went into effect on March 1, 2013. Sequestration includes $85 billion in federal spending cuts for FY 2013, split evenly between defense and non-defense spending. States can expect an estimated 5.9 percent across-the-board reduction of federal nondiscretionary funds in FY 2013, along with reductions of 7.3 percent for defense discretionary accounts.\(^2\) The uncertainty for states surrounding federal deficit reduction does not appear to have receded with the implementation of sequestration, prompting state officials into action over the changing federal funds landscape. Legislative fiscal officers were surveyed on actions taken in 2013 legislative sessions to offset the effects of sequestration, the impacts of defense related spending reductions and procedures to address further federal funding changes that would affect the enacted budget. The following summarizes the responses.

Actions Taken in 2013 Legislative Sessions to Offset the Effects of Sequestration
Policymakers in a few states have developed contingency plans and budgetary offsets to
mitigate the impacts of federal cutbacks. For example, lawmakers in Utah enacted “Financial
Ready Utah,” which requires revenue estimates to include changes in federal aid, federal
funding reductions to be included in calculations for rainy day fund deposits, and asks the
governor to include the estimated impacts of federal deficit reduction in the budget. In
Virginia, state officials have endorsed the actions of the Virginia Economic Development
Partnership to assist private firms that depend on federal contracts to find alternative
markets, both in Virginia and overseas. The District of Columbia and Maryland adjusted
their revenue forecasts downward based on the potential effects of sequestration. In Hawaii,
budget discussions have included potential general fund support to offset sequestration
related cuts. And in Vermont, the House made an appropriation of $4 million to be used as
a cushion against unanticipated federal fund reductions.

Impacts of Defense Related Spending Reductions
While sequestration affects nearly every category of state-federal discretionary programming,
it also includes reductions in defense spending. Though indirect, defense spending cuts are
likely to affect state economies, especially those that rely heavily on defense expenditures.
Overwhelmingly, states reported that defense related furloughs, layoffs and other personnel
issues cause the greatest concern because they are most likely to directly affect state revenues.
For example, Hawaii officials noted that wage reductions to defense and contract personnel
will result in a loss of business activity and related tax collections. Reductions to defense-
related industries and procurement is a significant issue for a number of states as well. In
Massachusetts, spending reductions affecting the defense industry stand to significantly affect
the state. Other potential impacts include the ability of the National Guard to mobilize in a
timely fashion (Mississippi and Pennsylvania) and that state own-source funds may be used
to offset reductions (Idaho and Montana).

Procedures to Address Further Federal Funding Changes
With the possibility of further federal funding changes occurring after states have enacted
their upcoming budgets, a number of states have created procedures to address changes post
enactment of the budget. In Maryland, Vermont and Virginia, officials have set aside funds
if unexpected reductions take place. North Carolina, Tennessee and Utah are requiring
agencies to develop contingency plans in the event of reductions in federal funding. In
Arkansas, expenditures for affected programs would be reduced if programs needs could not
be met by other available revenues. For most states though, any changes are likely to be
handled via standard budget management procedures (e.g., spending reductions,
supplemental appropriations), with the possibility of special sessions.

Summary of the State Fiscal Situation
Most legislative fiscal directors describe their state fiscal situation as “stable.” This reflects the
slow but steady recovery that most states are experiencing almost four years after the Great
Recession ended. Officials regularly referenced terms such as “relatively stable” and “stable
but cautious” to describe the current fiscal situation in their states. A few others indicated
that things were definitely improving using phrases as “cautiously optimistic” or “strong.” At the same time, there are still some states that are less positive with descriptions such as “extreme fiscal pressure” and “challenging.” Examples include:

- Officials in Arkansas and Colorado reported that a surplus at the close of FY 2013 is likely.
- In Alaska, due to lower oil prices and production, officials expect a deficit of about $350 million in FY 2013.
- California officials remarked that monthly cash receipts are significantly exceeding administration estimates made in January.
- Georgia will likely meet the latest forecast for the current fiscal year while continuing to build up its reserve fund.
- Iowa officials stated that revenues continue to exceed estimates but concerns exist about the uncertainty of federal fiscal policy, particularly effects from sequestration.
- Officials in Illinois and the U.S. Virgin Islands reported budget difficulties.
- New Jersey and North Dakota officials noted growing revenues but at a slower pace than anticipated.
- Officials in New Hampshire and South Dakota were cautiously optimistic in describing their state fiscal conditions.
- Montana and Texas officials expressed that the current fiscal situation is strong.
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