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The Forum for America's Ideas

State Budget Update: Summer 2011

(Condensed Free Version)

NCSL's latest fiscal survey finds that state budgets are recovering, but are far from being fully recovered from the effects of the Great Recession. The fiscal impact has been deep and prolonged, with fiscal year (FY) 2012 marking the fourth consecutive year that states faced significant mismatches between revenues and spending. To date, state lawmakers have faced—and largely addressed—budget gaps totaling $510.5 billion. And though additional budget gaps loom, the magnitude and number of states projecting them has fallen considerably.

This report is based on data collected from legislative fiscal officers in June and July 2011. It includes information on:

- Estimated FY 2011 year-end balances.
- Projected FY 2012 year-end balances.
- FY 2011 revenue and spending changes.
- FY 2012 revenue and appropriations changes
- Projected budget gaps in FY 2012, FY 2013 and FY 2014.

This report provides complete or partial information on all 50 states and Puerto Rico.

Better revenue performance is driving the turnaround in state finances. Collections are stabilizing or growing in nearly every state. Although it may take years for revenues to reach pre-recession levels, which is what some state officials are predicting, higher collections in the near term are easing some current budget pressures. The return to positive revenue growth that began in FY 2011 is expected to continue into FY 2012, albeit at a much lower rate.

Year-end balances—an important measure of state fiscal health—also are stabilizing and even rising from their trough in FY 2009. Balances are expected to hold steady in the 5 percent to 6 percent range for the next couple of years, which is a hopeful sign for lawmakers as they try to retain

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adequate budget reserves for the unexpected. It is important to note, however, that the aggregate balance is heavily influenced by the reserves in Alaska and Texas: The national average drops considerably when their year-end-balances are excluded from the tallies.

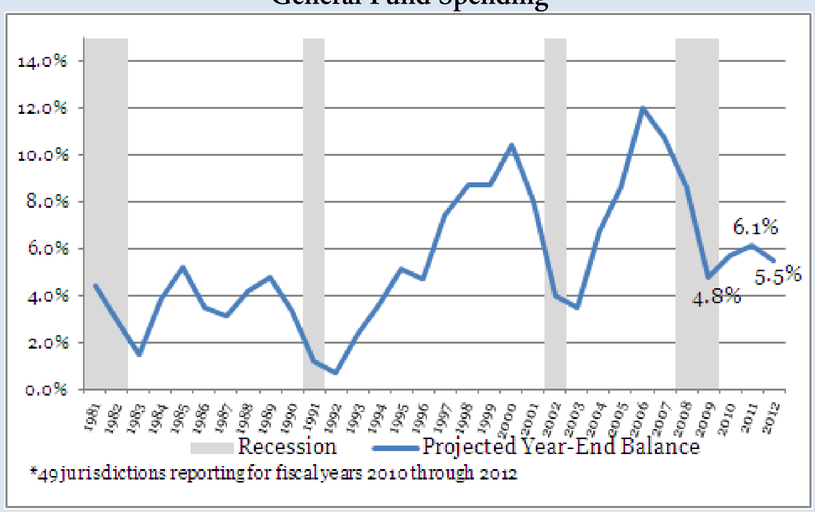
Despite the modest improvement in state finances, considerable challenges remain. Revenue growth is not expected to keep pace with anticipated increases in Medicaid and other health care costs. Additionally, public education demands and funding for other state programs will continue to present lawmakers with difficult budget choices. Potential federal policy changes also present uncertainties for state budgets. There are also widespread concerns about the strength of economic recovery, which many policymakers describe as fragile. They note that any significant disruptions to the recovery would stall or derail recent state fiscal improvements.

State Year-End Balances

Year-end balances, which combine general fund closing balances with rainy day fund balances, are important indicators of state fiscal conditions. They are discussed here as a percentage of general fund spending to allow for state comparisons. Wall Street analysts generally recommend that states hold reserves of 5 percent or more.

It has been difficult to evaluate and compare year-end balances since FY 2009 because of American Recovery and Reinvestment Act (ARRA) funds and their influence on state finances. In addition, two states–Alaska and Texas–substantially skew the national totals because together they hold nearly half of all state year-end balances. After reaching an aggregate balance of 12 percent in FY 2006, the national average dropped to 4.8 percent in FY 2009. More recently, balances have stabilized and even grown from the FY 2009 level (see figure 1).

Figure 1. State Year-End Balances as a Percentage of General Fund Spending



FY 2011 Estimated Year-End Balances

For the 48 reporting states and Puerto Rico, the estimated FY 2011 year-end balance is 6.1 percent of general fund expenditures.[1] This is slightly higher than the 5.7 percent balance at the end of FY 2010 for the same 49 jurisdictions. Table 1 provides additional details on year-end balances for FY 2011 and FY 2012.

[1] Massachusetts and Missouri are not included due to incomplete data.

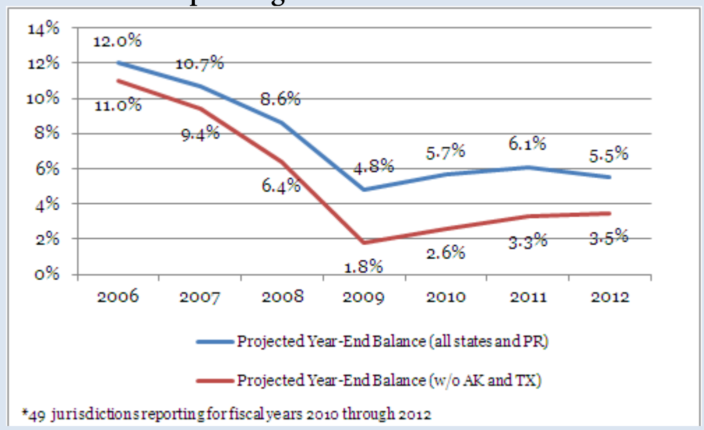
- When Alaska and Texas are excluded from the calculations, the aggregate year-end balance falls to 3.3 percent (see figure 2).

- Twenty states expected to finish FY 2011 with balances of 5 percent or more. Of these, 11 reported balances above 10 percent. Many of these states, like Alaska, Texas, and Wyoming, levy energy-related taxes that have helped boost their reserves.

- Alabama, New Hampshire and Puerto Rico expected to finish the fiscal year with zero balances. Four others reported balances below 1 percent of general fund spending.

- Three states expect to end FY 2011 with deficits. They are Arizona (-4 percent), California (-2.2 percent) and Washington (-0.6 percent). Officials in Arizona noted that better-than-expected collections in the closing months of the fiscal year could erase all or portions of the projected deficit.

Figure 2. State Year-End Balances as a Percentage of General Fund Spending with and without Alaska and Texas



Another way to view state fiscal health is to examine how year-end balances as a share of spending are changing from year to year.

- Twenty-seven states reported higher FY 2011 balances compared with FY 2010 levels. The largest percentage point increases were in Alaska (34.7 percentage points), West Virginia (9.6 percentage points) and South Carolina (9.3 percentage points).

- In 21 states, year-end balance fell in FY 2011. The largest percentage point declines were in Texas (-11.1 percentage points), Florida (-6.3 percentage points) and Montana (-5.6 percentage points).

- Puerto Rico projected no change.

Because FY 2011 will not be officially closed until later this year, these year-end estimates could change.

FY 2012 Projected Year-End Balances

Year-end balances are expected to decline slightly from FY 2011 levels. For the 48 states and Puerto Rico providing this information, the estimated FY 2012 year-end balance is 5.5 percent.[2] This is a decline from the projected 6.1 percent balance at the end of FY 2011 for the same 49 jurisdictions.

- Vast budget reserves in Alaska and Texas again skew the national figures. When they are excluded from calculations, the aggregate FY 2012 year-end balance falls to 3.5 percent (see figure 2).

[2] Massachusetts and Missouri are not included due to incomplete data.

- Nineteen states expect to end FY 2012 with balances greater than 5 percent. Of these, eight states forecast balances above 10 percent. The states with the largest year-end reserves once again tend to be those with natural resources.
- Alabama and Puerto Rico expect to end FY 2012 with zero balances. Six others project year-end balances below 1 percent.
- New Hampshire and Washington currently project deficits at the end of FY 2012, though in both cases FY 2012 marks the midpoint of the biennium.

By a wide margin, more states expect their balances to fall than to rise during FY 2012.

- As a percentage of general fund spending, 32 states expect their balances to drop by the end of FY 2012. The largest percentage point declines are expected in Alaska (28.7 percentage points), North Dakota (25.1 percentage points) and Texas (10.7 percentage points).
- Fourteen states expect their balances to rise by the end of FY 2012. The largest increases are projected in Florida (4.8 percentage points), Arizona (4.2 percentage points) and Colorado (4.2 percentage points).
- Alabama, Michigan and Puerto Rico expect no change in their FY 2012 year-end balances compared with FY 2011.

Revenue and Spending Changes

Changes in general fund revenue and spending may not be directly comparable across states due to different ways lawmakers accounted for ARRA funds. Overall, however, these data remain useful in understanding the general direction and magnitude of revenue and spending changes in the states. Table 2 provides additional revenue and spending details.

FY 2011 Revenue and Expenditure Changes

For most states, FY 2011 revenue and spending grew compared with FY 2010 levels.

- FY 2011 general fund revenues increased 6.1 percent above FY 2010 levels.
- Forty-three states reported year-over-year revenue growth in FY 2011. Among the states with increases greater than 10 percent were Alaska (23.7 percent), Illinois (18.6 percent), Texas (14.5 percent), Vermont (12.8 percent), Michigan (12.2 percent) and Tennessee (11.5 percent). Alaska attributes its revenue growth to high oil prices. Illinois raised personal and corporate income taxes. Vermont's increase is the result of a one-time estate tax payment.
- Seven states and Puerto Rico saw year-over-year revenue declines in FY 2011, with four jurisdictions experiencing drops greater than 5 percent: Puerto Rico (-9.7 percent), Louisiana (-9.6 percent), New Hampshire (-9.3 percent) and Wyoming (-7.2 percent). In Louisiana, some revenue sources that previously accrued to the general fund have been earmarked. Wyoming saw a drop in investment earnings.

General fund spending also increased in most states in FY 2011.

- FY 2011 general fund spending increased 4.6 percent compared with FY 2010 levels.

- Thirty-nine states reported year-over-year increases in FY 2011 spending. States with increases greater than 10 percent included Florida (13.3 percent), Massachusetts (12 percent), Tennessee (10.6 percent) and Nevada (10.4 percent). Florida's increase reflects a sizeable spending boost for education and human services. A portion of the Massachusetts increase is due to an accounting change. Nevada's spending growth is attributed to one-time expenditures.

- Eleven states and Puerto Rico reported lower year-over-year general fund spending in FY 2011, with the largest declines in Louisiana (-12.1 percent), Puerto Rico (-9.7 percent), Wyoming (-7.2 percent) and New Hampshire (-5 percent). Puerto Rico's decline is attributed to one-time expenditures in FY 2010 that boosted that year's base.

FY 2012 Revenue and Appropriations Changes

The most significant change for FY 2012 budgets was the absence of ARRA funds. Lawmakers had to develop general fund budgets based primarily on own-source revenues, unlike the past three fiscal years when federal stimulus funds helped support various state program expenditures.

Most states anticipate revenues to increase slightly in FY 2012 compared with FY 2011 (see figure 3).

Figure 3. Estimated Percent Changes in General Fund Revenues and Expenditures/Appropriations

	FY 2011	FY 2012
Revenues	6.1%	1.9%
Expenditures/ Appropriations	4.6%	2.7%

- FY 2012 general fund revenues are projected to increase 1.9 percent from FY 2011.

- Forty-one states and Puerto Rico project year-over-year revenue growth, with the largest increases expected in Illinois (12.9 percent), Hawaii (11.2 percent) and Iowa (9.9 percent). The Illinois increase reflects the first full-year impact of personal and corporate income tax increases. In Hawaii, a large one-time tax refund payment in FY 2011 artificially lowered that year's base; without that accounting effect forecasted revenue growth would be 6.5 percent. Iowa attributes its increase to a large growth in funding for its health and human service programs.

- Eight states anticipate revenues to decline in FY 2012. The largest decreases are expected in Nevada (-9.3 percent), North Dakota (-8.6 percent), New Hampshire (-7.6 percent) and California (-6.7 percent). Nevada's decline is the result of the room tax and some local property taxes being directed away from the state's general fund. In California, temporary increases in sales and use taxes and personal income taxes are expiring.

- Maine projects revenues to remain flat.

Most budgets were crafted in an environment of slowly increasing revenues, though FY 2012 also represents the first fiscal year in which ARRA funds are substantially exhausted. Some states reported large appropriations increases as they attempted to restore some of the spending previously supported by these federal stimulus funds.

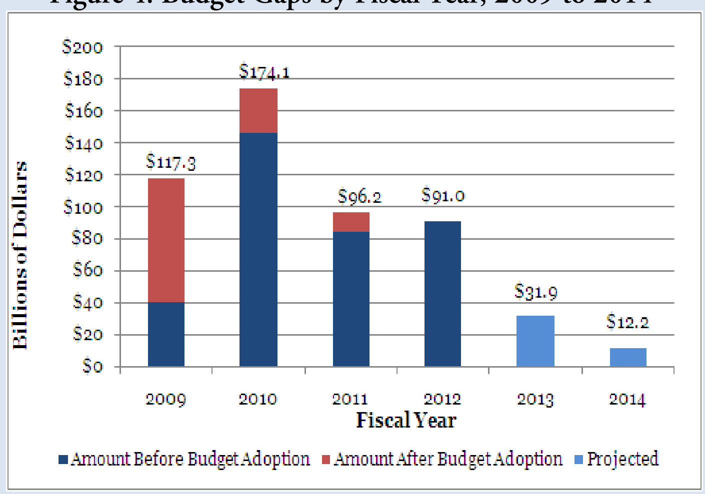
- FY 2012 appropriations are projected to increase 2.7 percent.
- Forty-three states and Puerto Rico increased spending for FY 2012. Six states estimate growth of more than 10 percent: Alaska (19.9 percent), North Dakota (19.3 percent), Iowa (12.1 percent), West Virginia (11.6 percent), Maryland (11.2 percent) and Hawaii (10.3 percent). Alaska significantly increased capital spending. North Dakota provided major increases for transportation, human services and K-12 education programs.
- Seven states expect year-over-year spending reductions in FY 2012, with the largest declines anticipated in Nevada (-8.0 percent), New Hampshire (-6.5 percent) and California (-6.1 percent). Nevada cited one-time spending in FY 2011 as contributing to the decline in FY 2012.

State Budget Gaps

With the exception of Massachusetts and Minnesota, all states enacted FY 2012 budgets by the beginning of the new fiscal year. Massachusetts passed a temporary budget to fund state operations; state government shut down in Minnesota. In addition, Alaska, Iowa, Texas and Washington extended their sessions or met in special sessions to deliberate further on their budgets.[3] Some of the budget delays were caused by disagreements on how to resolve budget imbalances. All states have since enacted FY 2012 budgets.

As shown in Figure 4, state budget gaps peaked in FY 2010 at $174.1 billion. They dropped substantially after that, but remained sizeable. If forecasts hold, they are expected to continue to decline.

Figure 4. Budget Gaps by Fiscal Year, 2009 to 2014



Estimated FY 2012 Budget Gaps

States faced a collective budget gap of about $91 billion as they were enacting their FY 2012 budgets. Table 4 provides more information on projected gaps by state.

- Thirty-eight states and Puerto Rico had FY 2012 budget gaps.
- Twenty-one states faced imbalances of 10 percent or more. The largest gaps were reported by Alabama (33.7 percent), Nevada (31 percent), and California (28

[3] For more information on the status of fiscal year 2012 budgets please see http://www.ncsl.org/default.aspx?tabid=23116

percent). In Alabama, the gap estimate was only for the state general fund and excluded the education trust fund.

- Seventeen states and Puerto Rico faced shortfalls between 1.1 percent (New Hampshire) and 9.7 percent (Vermont) of their general fund budgets.

Because fiscal conditions are still shaky in some states, new gaps could open before FY 2012 ends. Lawmakers in a few states are already bracing for that possibility.

Projected Budget Gaps in FY 2013 and FY 2014

Although some states are forecasting budget gaps in FY 2013 and FY 2014, the number of states and size of the imbalances are declining. Additional details on FY 2013 and FY 2014 budget gaps can be found in Tables 5 and 6, respectively.

- Twenty states originally projected an estimated $31.9 billion in budget gaps for FY 2013. Nine states have resolved those projected imbalances, largely through the enactment of biennial budgets. That leaves 11 states with unresolved imbalances totaling $15.9 billion.

- Nine states currently project budget gaps in FY 2014. The total estimate is $12.2 billion.

Compared with previous gaps, these projected shortfalls are significantly smaller. Much uncertainty continues to surround the trajectory of economic recovery, however, which threatens spending and revenue assumptions underlying these gap estimates.

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