STATE BUDGET UPDATE: FALL 2012

NATIONAL CONFERENCE of STATE LEGISLATURES

The Forum for America's Ideas

Fiscal Affairs Program
National Conference of State Legislatures
William T. Pound, Executive Director

7700 East First Place
Denver, CO 80230
(303) 364-7700

444 North Capitol Street, N.W., Suite 515
Washington, D.C. 20001
(202) 624-5400

www.ncsl.org

The National Conference of State Legislatures is the bipartisan organization that serves the legislators and staffs of the states, commonwealths and territories.

NCSL provides research, technical assistance and opportunities for policymakers to exchange ideas on the most pressing state issues and is an effective and respected advocate for the interests of the states in the American federal system.

NCSL has three objectives:

- 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.

The Conference operates from offices in Denver, Colorado, and Washington, D.C.

Printed on recycled paper

Item #121812PDF

Contents

STATE BUDGET UPDATE: FALL 2012

State budgets continue their slow to moderate rate of recovery. A fall 2012 survey of state legislative fiscal officers found solid revenue performance in most states, although a few reported underperformance in individual tax categories. Generally, it appears that state budgets are in line with budgeted estimates through the first few months of fiscal year (FY) 2013. The slowly improving economic situation across the states has led most officials to describe their current fiscal situation as stable.

This report is based on data collected in the fall of 2012 from legislative fiscal officers in all 50 states and the District of Columbia and includes information on:

- State revenue performance;
- Revenue outlook for the remainder of the fiscal year;
- Areas of spending over budget;
- A summary of state fiscal situations;
- Return to peak revenue collections; and
- A historical comparison of the recovery of state general fund revenues.

Despite these positive fiscal trends, federal deficit reduction actions, increasing program pressures, international debt crises, and the impact from recent storms will continue to challenge lawmakers as they begin their new legislative sessions.

While there are signs of improvement, the turnaround has been uneven across the nation. Although half of the states expect to return to peak revenue levels by the close of this fiscal year, several others are still awaiting a return to peak levels. Some states are uncertain when that will occur.

Three and a half years following the official end of the recession, state officials face the prospect that slow and steady growth may be the "new normal." With the unpredictability of recent fiscal years, stable is not necessarily a bad position for states but enough uncertainty lingers on the horizon to create a fragile situation for state budgets.

FY 2013 Revenue Performance

Revenue performance remained solid for most states through the first quarter of FY 2013. More states reported strength rather than weakness in the three major taxes—personal income, sales and corporate income. The majority of states report that they expect to meet or exceed general fund revenue targets. Only Idaho, Maine and New Jersey reported all three tax categories are performing below forecast.

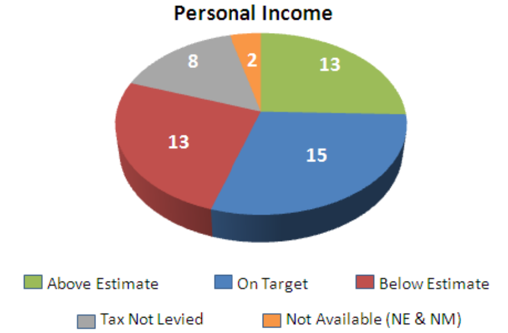
The rest of this section provides a snapshot of recent state revenue performance for personal income, sales and corporate income taxes. Information on the performance of other taxes is included for those states that provided it.[1]

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.[2]

- Twelve states and the District of Columbia reported that personal income tax collections exceeded the latest estimate (see figure 1). Ten of these states had not revised their forecasts. Iowa and the District of Columbia raised the target and still saw collections surpass estimates. Hawaii reported collections above a lowered estimate.
- Fifteen states saw collections come in on target, even though Delaware, Maryland, Mississippi, North Dakota, Oregon and Rhode Island had raised their estimates. California reduced its estimate since the beginning of FY 2013.
- Thirteen states saw personal income tax collections below target. Arizona, Idaho and Kansas were failing to meet projections that had been revised downward.

Figure 1.FY 2013 Tax Performance: Personal Income

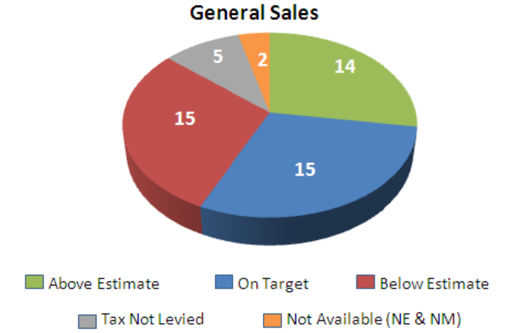


General Sales Taxes

General sales and use taxes represent about 31 percent of state own-source revenues. Five states—Alaska, Delaware, Montana, New Hampshire and Oregon—do not levy a state sales tax.

- Thirteen states and the District of Columbia saw general sales tax collections exceed the revenue estimate (see figure 2). In 11 of these states, the forecast had not been revised. Iowa and the District of Columbia were exceeding increased estimates. Hawaii was exceeding lowered estimates.

Figure 2.FY 2013 Tax Performance: General Sales



[1] Revenue performance data is not available for Nebraska and New Mexico.

[2] 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 did provide information on the performance of the personal income tax.

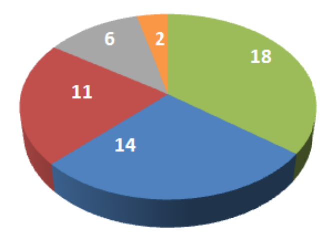
- Fifteen states saw collections coming in on target. California, Maryland, Mississippi, North Dakota and Wyoming were meeting targets that had been revised upward. Arizona, Rhode Island and Washington were meeting reduced estimates.
- In 15 states, sales tax revenues were coming in below estimate. Idaho was failing to meet a target that had been raised, while Connecticut and New York reported revenues were below a reduced forecast.

Corporate Income Taxes

On average, corporate income taxes account for about 5 percent of 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.

- Eighteen states saw corporate income tax receipts above estimate, including Iowa, Kansas, Maryland and West Virginia, which raised their forecasts. Hawaii reported revenues above a lowered forecast (see Figure 3).
- Fourteen states saw collections coming in on target. Delaware, North Dakota, Oregon, Rhode Island and South Carolina were meeting targets that had been revised upward, while California had reduced its estimate.
- Corporate income tax collections were below the latest target in 10 states and the District of Columbia. Idaho was failing to meet a target that had been raised and Arizona, Connecticut and the District of Columbia were below a reduced estimate.

Figure 3.FY 2013 Tax Performance: Corporate Income



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.

- Two states reported severance taxes performing above estimate. Eight states saw severance taxes coming in on target, and in nine states these taxes were coming in below the latest estimate.
- Seventeen states and the District of Columbia reported real estate transfer taxes coming in on target or above expectations. Only four states—Hawaii, Maine, New Jersey and Pennsylvania—reported transfer taxes below the current forecast.
- Seven states saw other miscellaneous taxes performing above estimate. Examples include gaming taxes in Nevada and the franchise tax in Texas.

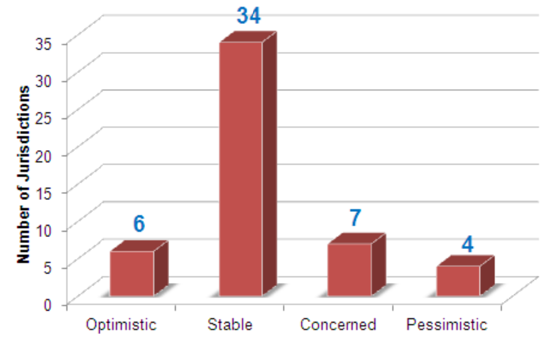
- In five states, other tax sources were coming in on target, while 10 states reported that collections were below the latest target.

Revenue Outlook for the Remainder of FY 2013

Revenue performance is a key indicator of the state fiscal situation, so it is important to get a sense of future expectations. For most states, revenues continue their slow climb out of the trough of the recession, and the outlook for the remainder of the budget year indicates continued improvement. However, in a change from last year when no states reported pessimism, a handful of state officials believe they are unlikely to meet the revenue forecast in FY 2013.

- Thirty-three states and the District of Columbia reported that revenues are **stable** and are likely to meet FY 2013 revenue estimates (See figure 4).
- Officials in seven states are **concerned** about meeting their projections.
- Fiscal directors in six states described their revenue outlook as **optimistic** for the remainder of the fiscal year. Their optimism is based on collections that are exceeding projections.
- Officials in four states—Alaska, Maine, New Jersey and New York—are **pessimistic** about the revenue outlook.

Figure 4. Revenue Outlook for the Remainder of the Fiscal Year



Areas of Spending Over Budget

Generally state spending is in line with budgeted estimates, though more states appear to be facing spending overruns than at this time last year. Eighteen states reported that at least one area of spending is significantly over budget in FY 2013 compared to 11 states in FY 2012. Twenty-two states reported that no areas of the budget are overspent at this time, and 11 states indicated that it is unknown if any program areas are over budget for FY 2013. Some examples of spending areas over budget include:

- Medicaid and other health care programs are over budget in 10 states, compared to six at this time last year. Texas notes that when balancing the 2012-13 biennial budget, Medicaid was underfunded by approximately $4.3 billion. West Virginia estimates that Medicaid is $180 million over budget in FY 2013, and Maine notes that despite declining caseloads, Medicaid spending continues to increase. California, Connecticut, Georgia, Iowa, Maryland, Nevada, and Virginia also report overspending on Medicaid or other health care benefits.
- Education spending, either K-12 or higher, is over budget in five states. Kansas reported that additional funding will be needed to maintain the current level of base state aid per pupil expenditures, and New Hampshire indicated that charter school appropriations are estimated to exceed budgeted appropriations by 58 percent.

California, Maryland and Montana also indicated that education spending was over budget.

- Idaho, Maryland, Mississippi, and Vermont reported that corrections programs were over budget thus far in FY 2013.
- The western states of California, Montana and Wyoming indicated that fire suppression costs were over budget due largely to wildfires this past summer.

Summary of the State Fiscal Situation

The slowly improving economic situation in the states has caused legislative fiscal directors to describe their fiscal situation as being generally stable. Officials frequently used terms such as "improving" and "stable growth" to describe the current fiscal situation in their states. Also, a small but increasing number of officials used more positive descriptions such as "strong" and "cautiously optimistic" to describe their states. At the same time, a few officials used less optimistic terms such as "precarious" and "underperforming" to describe their fiscal situation and the use of the term "budget gap" has crept back into the lexicon. Examples from officials in a few states include:

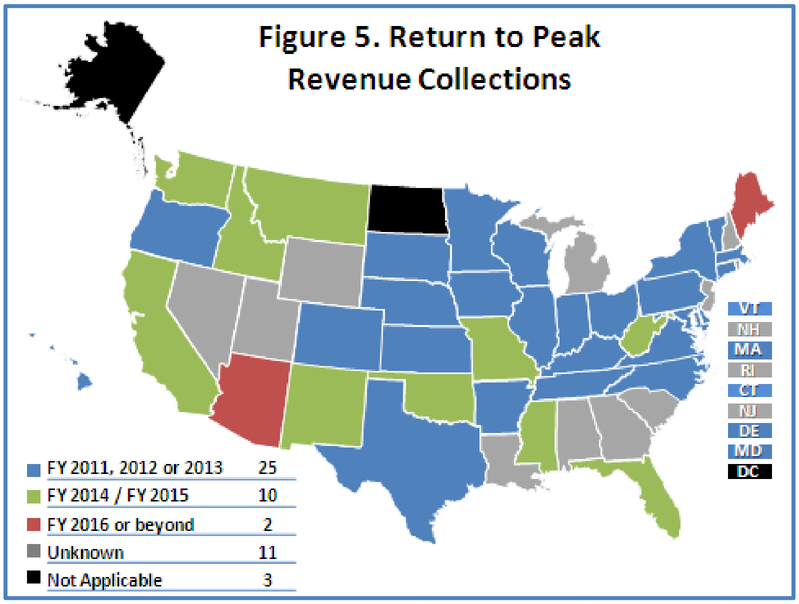
- Alaska officials reported that they may have their first deficit since FY 2005.
- In California, the situation is stable, with projected operating surpluses in the out-years, a notable change from the state's recent multi-billion gap situation.
- Officials in Hawaii describe their fiscal situation as "razor's edge" because the projected general fund balance and reserves are inadequate and susceptible to any unanticipated economic or fiscal shocks.
- Officials in Delaware, New Hampshire, Ohio, and Oregon are cautiously optimistic regarding their respective fiscal situations.
- In Kansas, officials noted that the state economy is showing consistent, but slow growth.
- Officials in Maine describe their fiscal situation as precarious with little on the horizon that would result in an improvement.
- North Carolina officials reported that revenues have stabilized and are returning to long-term growth trends.
- Officials in Oklahoma noted that their fiscal situation is stable with a sense of optimism for continued improvement and stability.

Projected Return to Peak Revenue Collections

One way to view the health of state finances is to consider when revenues are expected to return to their previous peak levels. This is a pretty simple and straightforward comparison: When did nominal state revenue collections peak and when are they expected to reach or exceed that previous level? There are some obvious limitations to this assessment since it does not adjust for base or rate changes nor account for the effects of inflation. But from a policymaker's point of view, it can be helpful to know when collections are projected to reach pre-recession levels.

FY 2008 marked the peak year of nominal revenue collections in all but a handful of states. After year-over-year declines in FY 2009 and FY 2010,state revenue collections slowly began to recover and by the close of FY 2013 at least half of the states will have returned to peak collections. While this is certainly good news, it is tempered by the fact that for the other half of the states a return to peak is not projected until at least FY 2014 or beyond (see figure 5).[3]

The following highlights provide information about the return or projected return to peak revenue collections.



- Twenty-five states have or are projected to return to peak revenue collections by the close of FY 2013. Six states returned to peak in FY 2011, 13 in FY 2012 and six additional states anticipate a return in the current fiscal year.
- Six states expect a return to peak collections in FY 2014, while another four project a return in FY 2015.
- Officials in Maine and Arizona do not project a return to peak collections until FY 2016 and FY 2018, respectively. Officials in Maine note that the return to peak revenue levels was delayed by significant income and estate tax reductions passed in 2011 and implemented in FY 2013.
- Eleven states currently do not have predictions for when tax collections will return to peak levels. In Louisiana and Utah, for example, a return to peak is not on the current forecast horizon. In Michigan, FY 2014 revenue is forecasted to be 13.3 percent below the previous peak of FY 2000.
- In Alaska, the District of Columbia and North Dakota, a return to peak is not applicable. In the District of Columbia and North Dakota, revenues never fell on a year-over-year basis, while officials in Alaska noted that the state is unlikely to ever see the revenue levels experienced in FY 2008 when oil prices were very high and production was higher on a downward trend line.

---

[3] It is important to note that the predictions are based on current economic forecasts and existing tax law, which are subject to change.

State General Fund Revenue Recovery: A Historical Comparison.

It has been repeated time and time again: The Great Recession was the longest and worst economic downturn since the Great Depression. But what about the recovery after the recession? Unlike previous recoveries—where it was common to see a robust upturn—the post-Great Recession period feels more like malaise than a recovery for states. One way to demonstrate how different the current recovery has been from the past is to look at state general fund revenue collections both in the length of time to return to peak (cumulatively) and by comparing the percentage growth rates by state to those of previous recoveries.[4]

Cumulative State General Fund Revenues Return to Peak

While the individual state expectations for return to peak revenue collections provide valuable insight on the wide variations of recovery across the U.S., looking at the cumulative return to peak allows for historical comparisons.

- *The recession of July 1990 to March 1991:* State general fund revenue collections peaked at the end of FY 1990 and as the country entered the recession, cumulative state general fund revenues fell on a year-over-year basis before returning to peak in just one fiscal year, FY 1992.
- *The recession of March to November 2001:* General fund revenue collections reached their then peak in FY 2001, fell in FY 2002, and returned to peak two years later in FY 2004.
- *The recession of December 2007 to June 2009:* As previously mentioned, FY 2008 marked the peak year of nominal revenue collections, then—in contrast to previous recessions—state general fund collections experienced two consecutive years of year-over-year declines in FY 2009 and FY 2010. Despite steady growth in FY 2011 and FY 2012, state general fund revenues had only inched closer to their pre-recession peak. FY 2013 cumulative general fund revenue collections are projected to finally return to the FY 2008 peak—five years since state revenues began their precipitous decline.

General Fund Revenue Recovery Growth Rates

Legislative fiscal officers were asked how the rate of general fund revenue growth since the end of the Great Recession compares to previous economic recoveries. In many cases this analysis is complicated due to tax rate/base changes; however, this information is still useful in demonstrating the historical significance of the Great Recession.

- Officials in 27 states reported that general fund revenue growth rates are lower than growth rates from previous recoveries (see figure 6).

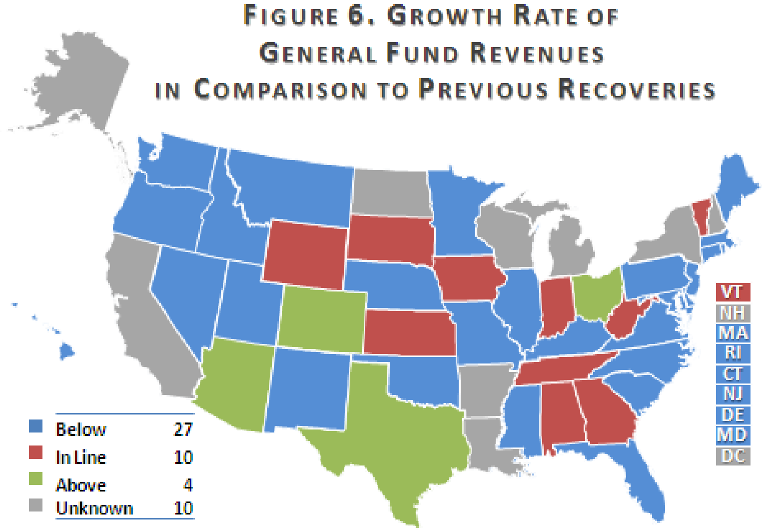
---

[4] Additional information on state general fund revenues, economic downturns and recoveries will be available in a forthcoming brief.

- Current recovery growth rates are in-line with historic norms in 10 states.
- Officials in four states noted that revenue recovery is above historic norms.
- In nine states and the District of Columbia state officials could not make the comparison or it was not applicable—most often due to tax policy changes.

However, these numbers understate the tepid recovery experienced by the states. For example, in Arizona, while statistically the current recovery is stronger than previous recoveries, the depth of the Great Recession makes it easier to generate higher recovery growth rates. In California, New Hampshire and New York a comparison is not possible due to tax policy changes.

FIGURE 6. GROWTH RATE OF GENERAL FUND REVENUES IN COMPARISON TO PREVIOUS RECOVERIES



The devastating impact of the Great Recession and subsequent protracted recovery is not one that will remain fond in memories of state lawmakers; and, unfortunately, it is not one that will be easy to erase.

NCSL

NATIONAL CONFERENCE OF STATE LEGISLATURES

William T. Pound, Executive Director

Denver Office
7700 East First Place
Denver, CO 80230
(303) 364-7700
(303) 364-7800

Washington Office
444 North Capitol Street, N.W., Suite 515
Washington, DC 20001
(202) 624-5400
(202) 737-1069

www.ncsl.org