

SUMMARY: NASBO STATE EXPENDITURE REPORT

November 17, 2016

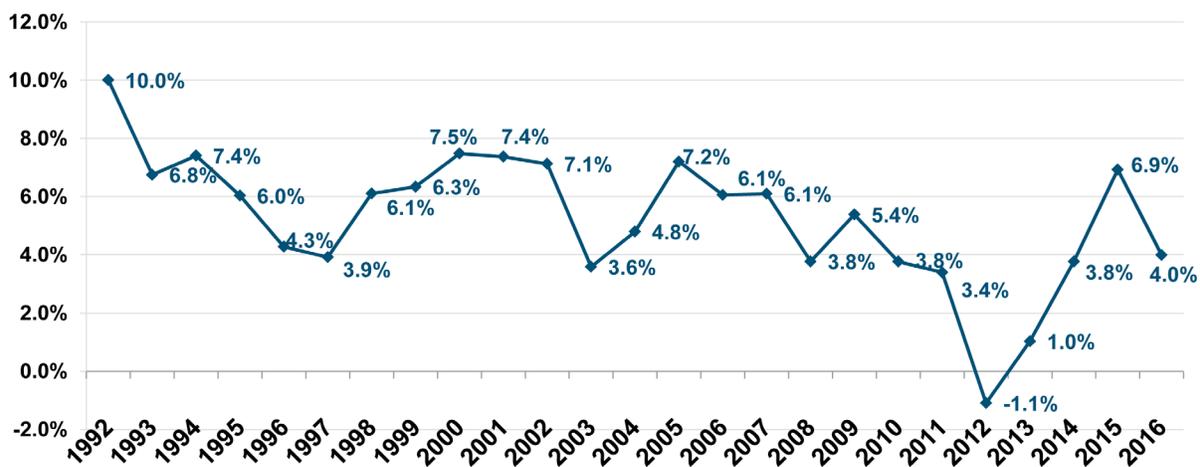
Total State Spending Growth Rate Slowed in Fiscal 2016, Following a 10-Year High in Fiscal 2015

According to NASBO's latest *State Expenditure Report*, total state spending (including general funds, other state funds, bonds, and federal funds) grew by an estimated 4.0 percent in fiscal 2016, a significantly slower rate than the relatively sharp increase of 6.9 percent in fiscal 2015. Fiscal 2016 spending from states' own fund sources (general funds and other state funds combined) and federal funds both experienced substantially less growth than the prior year. The more modest increase in spending from states' own funds was largely driven by a decline in revenue growth. The two largest sources of state tax collections (personal income and sales taxes) saw slower year-over-year growth in fiscal 2016, while corporate income taxes saw a significant decline. Additionally, the growth rate of federal funds to states decreased as Medicaid

spending began to slow, partly due to Medicaid enrollment levels beginning to decelerate as states entered into the second full-year of Medicaid expansion under the *Affordable Care Act* (ACA). Although total state spending growth began to slow in fiscal 2016, all program areas saw at least a small increase in spending.

In contrast to the moderate growth in total state spending in fiscal 2016, total state spending in fiscal 2015 increased at its fastest rate since fiscal 2005 due primarily to a substantial increase in federal funds to states. As state revenue collections continued to slowly rebound from the national recession, states were able to increase funding to nearly all program areas in fiscal 2015. While spending from states' own funds moderately grew in fiscal 2015, federal funds to states greatly accelerated as states received significantly more federal Medicaid dollars as part of the first full-year of Medicaid expansion under the ACA.

YEAR-OVER-YEAR PERCENTAGE INCREASES IN TOTAL STATE EXPENDITURES*



*Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states



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Both Federal and State Funds Experienced Less Growth in Fiscal 2016 than the Prior Year

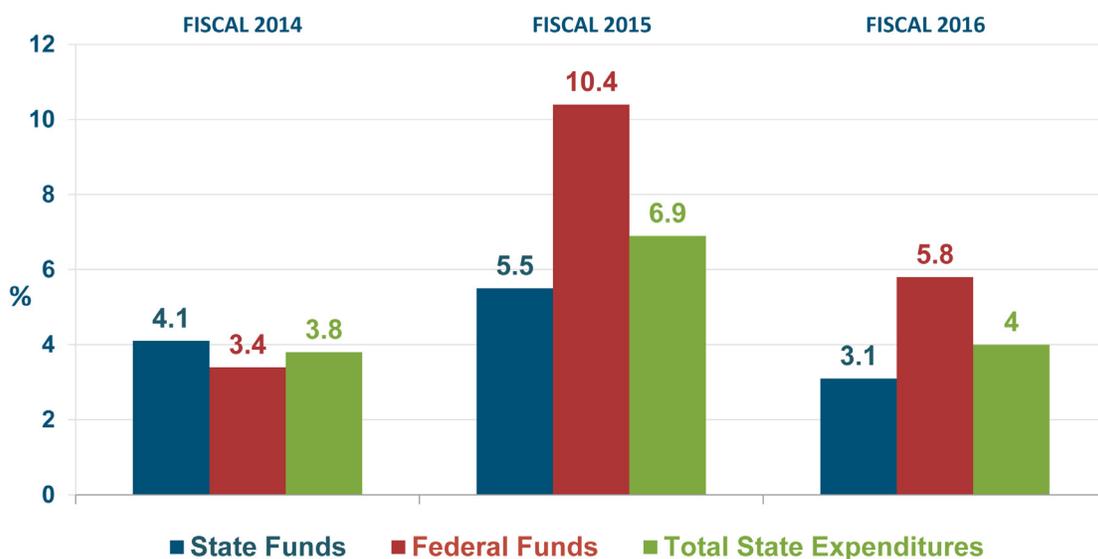
The level of federal funds to states has seen numerous shifts during the most recent recession and subsequent recovery. After growing a relatively modest 2.9 percent in fiscal 2007 and 2.4 percent in fiscal 2008, federal fund spending increased 19.3 percent in fiscal 2009 and 21.4 percent in fiscal 2010. This unusual increase in federal funds to states was due to the infusion of spending from the *American Recovery and Reinvestment Act of 2009* (ARRA), also known as the Recovery Act or stimulus. The swift wind down of ARRA funds led federal fund spending to grow only 1.0 percent in fiscal 2011, decline 9.8 percent in fiscal 2012 and decrease an additional 2.6 percent in fiscal 2013. However, federal funds rose by 3.4 percent in fiscal 2014 as some states began to receive additional Medicaid funds through the ACA in January 2014. In fiscal 2015, federal funds to states rose 10.4 percent during the first full year of the optional Medicaid expansion under the ACA, and in fiscal 2016, it is estimated that federal funds increased 5.8 percent.

While the level of federal funding to states has fluctuated over the past several years, spending growth from states' own revenue sources has been more stable as the national economy has gradually improved and states' revenues have slowly rebounded from the national recession. Spending from state funds (including general funds and other state funds, but not federal funds or bonds) increased 4.6 percent in fiscal 2011, 3.8 percent in fiscal 2012, 2.6 percent in fiscal 2013, 4.1 percent in fiscal 2014, 5.5 percent in fiscal 2015, and an estimated 3.1 percent in fiscal 2016.

Medicaid Continued to Increase as a Share of Total State Spending, While K-12 Remained the Largest Category from State Funds

Since the beginning of the recent economic downturn, Medicaid has risen as a percentage of total state spending, growing from 20.5 percent in fiscal 2008 to an estimated 29.0 percent in fiscal 2016. At the same time, elementary and secondary education has gone from representing 22.0 percent of total state spending in fiscal 2008 to an estimated 19.4

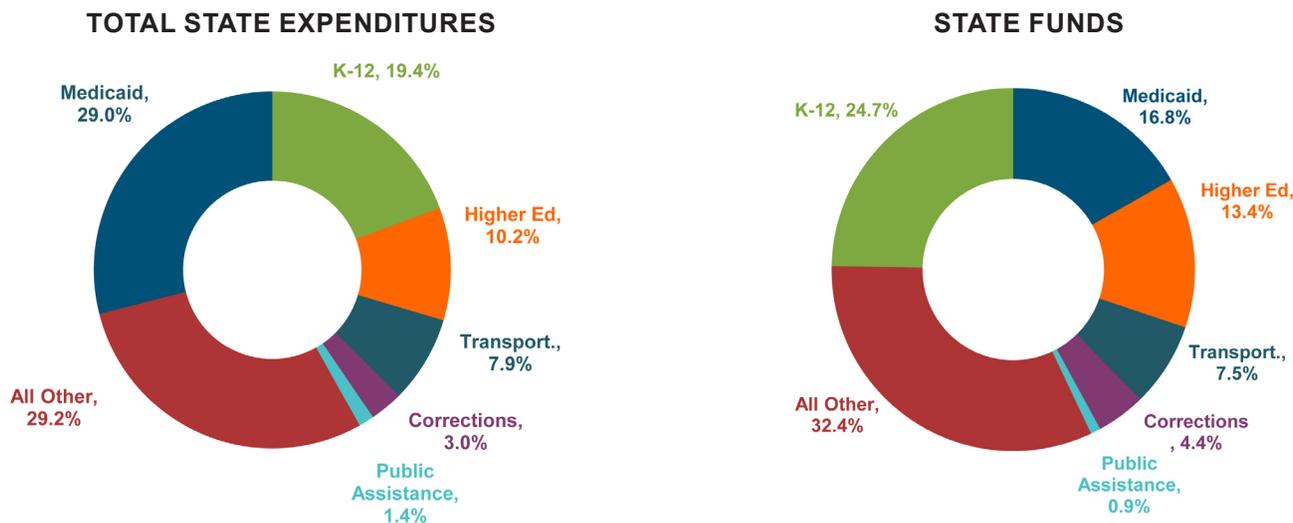
YEAR-OVER-YEAR PERCENTAGE SPENDING GROWTH BY FUND SOURCE



State funds are general funds and other state funds combined, excluding bonds. Total state expenditures are all federal and state funds.



EXPENDITURES BY FUNCTION (ESTIMATED FISCAL 2016)



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percent in fiscal 2016. The reason elementary and secondary education represents a smaller share of total state spending is not because nominal elementary and secondary spending has declined; instead it is a result of its growth rate being slower than the growth in total Medicaid spending. For example, in fiscal 2016, it is estimated that total elementary and secondary education spending grew 3.6 percent while total Medicaid spending grew 6.9 percent. When looking only at spending from state funds, elementary and secondary education remains the largest category in fiscal 2016, representing 24.7 percent, with Medicaid second at 16.8 percent.

Transportation Led the Way in Spending Growth from State Funds in Both Fiscal 2015 and Fiscal 2016, While Medicaid Experienced the Largest Gains from All Funds

Nearly all program areas of total state spending (including all state and federal funds) grew in both fiscal 2015 and estimated fiscal 2016 with only the public assistance category declining in fiscal 2015. Additionally, almost all areas of spending from

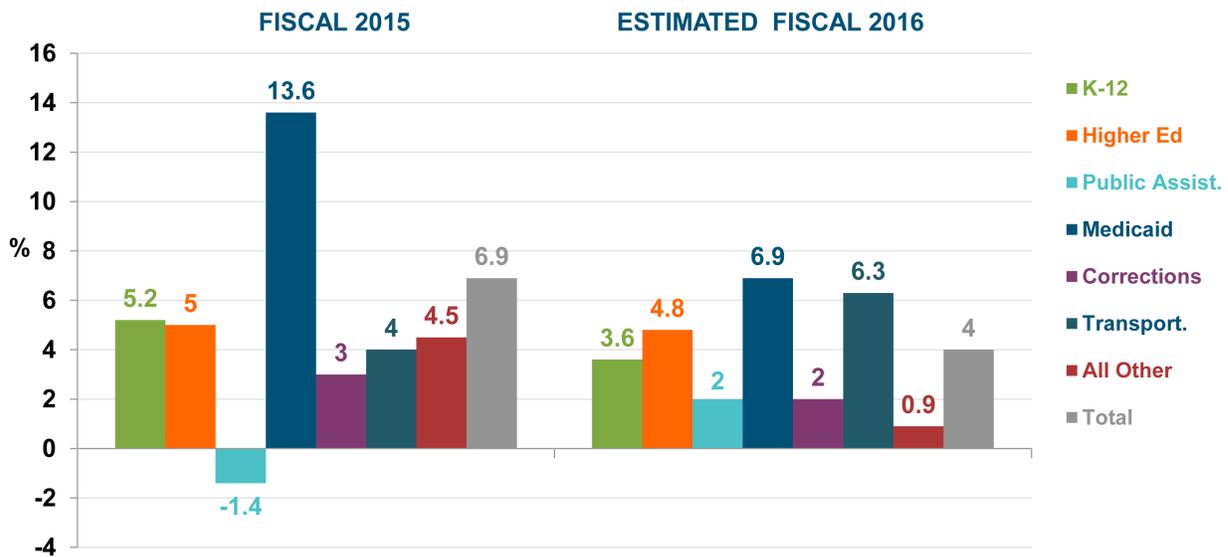
states' own funds increased in both fiscal 2015 and estimated fiscal 2016, with the exception of public assistance declining in fiscal 2015 and the "All Other" category decreasing in estimated fiscal 2016. Not surprisingly, **Medicaid** experienced the largest increases in total state spending in both fiscal 2015 and fiscal 2016, at 13.6 percent and 6.9 percent respectively, due to increased federal funds resulting from the ACA. **Transportation**, however, experienced the largest gains when looking at only spending from states' own fund sources, growing 8.8 percent in fiscal 2015 and 6.7 percent in fiscal 2016. The relatively sharp increase in the transportation area likely reflects a pent up demand for infrastructure spending at the state level.

Additional state expenditure details and trends include:

- When looking only at general fund spending, **elementary and secondary education** remains the largest category in fiscal 2016, representing 35.1 percent of general fund expenditures, with **Medicaid** second at 20.3 percent. Those two categories, combined with **higher education** at 9.7 percent, account for nearly two-thirds of general fund spending.



TOTAL STATE EXPENDITURES PERCENTAGE SPENDING GROWTH BY PROGRAM AREA

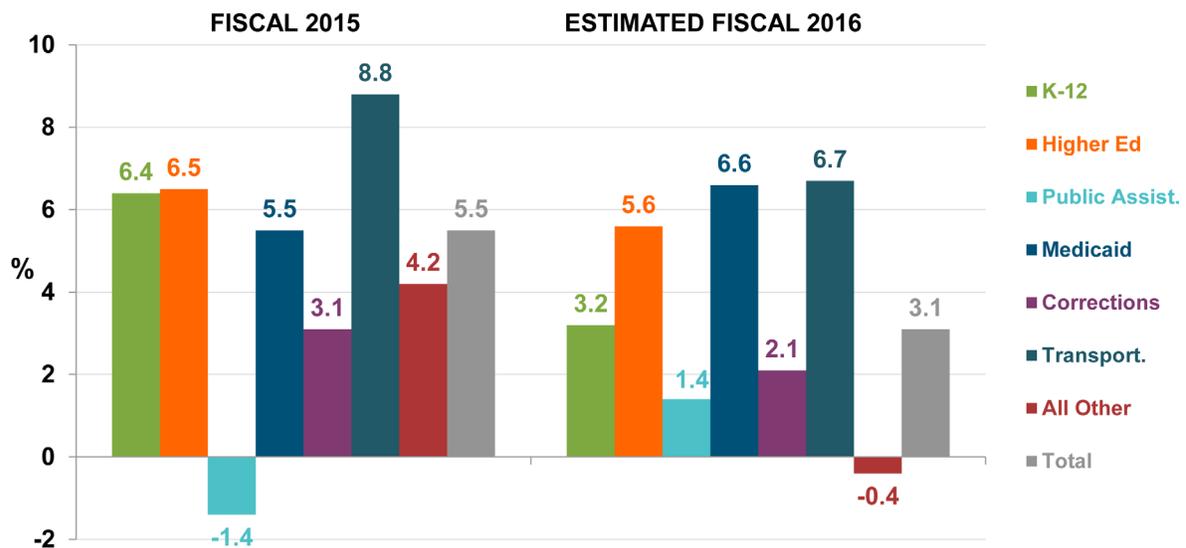


*Total state expenditures include spending from general funds, other state funds, bonds, and federal funds to states

- Elementary and secondary education** total expenditures increased by 5.2 percent in fiscal 2015 and increased by 3.6 percent in estimated fiscal 2016. While state funds for K-12 increased by 6.4 percent in fiscal 2015, federal funds declined 0.1 percent. In fiscal 2016, state funds increased 3.2 percent while federal funds grew 4.8 percent. As the national economy and state revenues continue to grow modestly, states are restoring some of the prior cuts made to K-12 education due to the most recent recession. Some states are also taking targeted steps to increase teacher compensation in order to improve recruitment and retention.
- Total expenditures for **higher education** increased by 5.0 percent in fiscal 2015 and by 4.8 percent in estimated fiscal 2016. State funds for higher education increased by 6.5 percent in fiscal 2015 and are estimated to have increased by 5.6 percent in fiscal 2016, while federal funds declined 4.9 percent in fiscal 2015 and increased by an estimated 1.1 percent in fiscal 2016. Over the years, the “Other State Funds” source (which includes tuition and fees for the vast majority of states) has grown as a percentage of higher education spending, comprising 46.8 percent of total state higher education expenditures in fiscal 2015.
- Total **public assistance** declined by 1.4 percent in fiscal 2015 and increased by 2.0 percent in estimated fiscal 2016. Public assistance represented 1.4 percent of total state expenditures in fiscal 2015. The public assistance chapter in the State Expenditure Report only contains data on cash assistance programs such as the Temporary Assistance for Needy Families (TANF) program, and does not include other supportive services.
- In fiscal 2015, total **Medicaid** state expenditures increased 13.6 percent, with state funds growing 5.5 percent and federal funds rapidly increasing at a rate of 19.4 percent due to increased Medicaid dollars provided through the ACA. In fiscal 2016, it is estimated that total Medicaid state expenditures increased 6.9 percent, with state funds growing 6.6 percent and federal funds increasing 7.0 percent. Additionally, in fiscal 2016, federal funds made up 61.2 percent of total Medicaid spending, up from 58.2 percent in fiscal 2014. Finally, it is estimated that in fiscal 2016 Medicaid represented 56.8 percent of all federal funds to states, a record high in the 29-year history of the *State Expenditure Report*.
- Total **corrections** expenditures increased by 3.0 percent in fiscal 2015 with state funds increasing 3.1 percent and



STATE FUNDS PERCENTAGE SPENDING GROWTH BY PROGRAM AREA



*State funds are general funds and other state funds combined, excluding bonds

federal funds declining 1.4 percent. In fiscal 2016 it is estimated that total corrections spending increased 2.0 percent, with state funds growing 2.1 percent and federal funds increasing 3.6 percent. In recent years, states have begun efforts to control costs through reducing recidivism rates, implementing changes to parole and probation systems, enhancing community supervision, offering increased treatment to address mental health and substance abuse disorders, and enacting sentencing reforms. In fiscal 2015, state funds comprised 97.8 percent of total corrections spending. Corrections accounted for 3.1 percent of total state expenditures in fiscal 2015 and 6.8 percent of general funds.

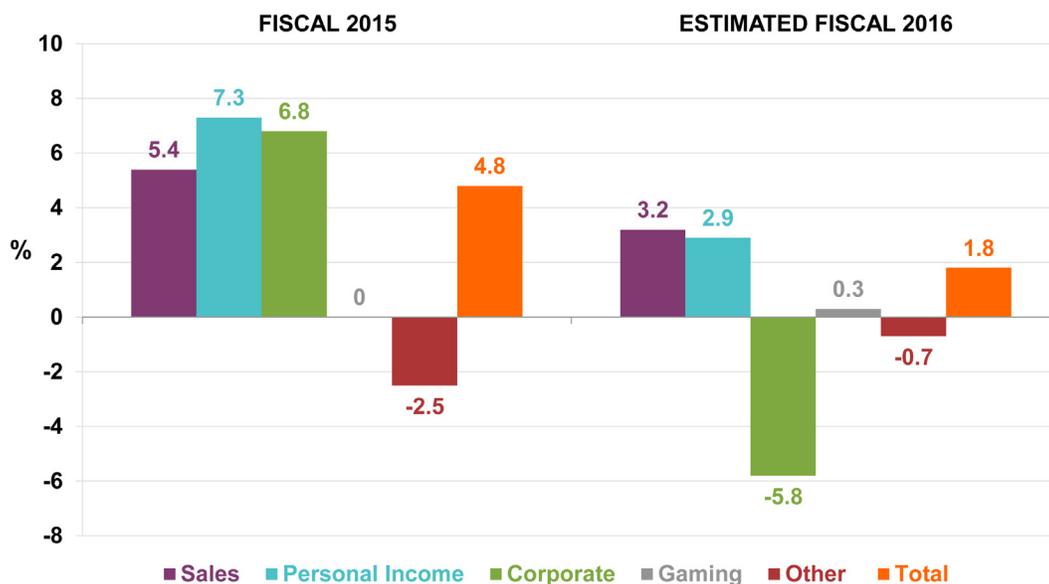
- Total **transportation** spending, representing 7.7 percent of total state expenditures, increased by 4.0 percent in fiscal 2015 and is estimated to increase by 6.3 percent in fiscal 2016. In fiscal 2015, the growth in transportation spending was driven by an increase in state funds, with state funds increasing 8.8 percent and federal funds declining 4.4 percent. In estimated fiscal 2016, state funds and federal funds for transportation grew at 6.7 percent and 10.0 percent respectively, while spending from bonds declined. Other state funds, which are typically

earmarked revenue sources such as gasoline taxes, comprised 58.6 percent of total transportation spending in fiscal 2015, with federal funds at 28.4 percent, bonds at 9.0 percent, and general funds only accounting for 4.0 percent. States are concerned that in the long term, gas tax revenue will not be sufficient to meet transportation needs and have begun exploring other funding options.

Revenue Growth Slowed Considerably in Fiscal 2016 as States Saw Weaker Collections from Sales, Personal Income, and Corporate Income Taxes

In fiscal 2016, it is estimated that total general fund **revenues** grew at a slower pace than in fiscal 2015, increasing 1.8 percent. The three largest sources of state revenue all saw slower growth in fiscal 2016 compared to fiscal 2015. Personal income taxes increased 2.9 percent, sales taxes grew 3.2 percent, and corporate income taxes declined 5.8 percent. In addition, gaming taxes only grew 0.3 percent, and other taxes and fees declined 0.7 percent. Part of the reason for the

REVENUE GROWTH BY PERCENTAGE (STATE GENERAL FUNDS)



moderate growth in fiscal 2016 was the fact that most states experienced a negative “April surprise,” in contrast to the prior year. States received less tax collections than expected in April partly due to the weaker stock market performance in calendar year 2015. In addition, fiscal 2016 revenue collections were affected by modest national economic growth and the impact of low oil and natural gas prices on energy-producing states.

In contrast to fiscal 2016, general fund revenue growth accelerated in fiscal 2015, increasing 4.8 percent. Personal income taxes experienced the largest increase in fiscal 2015 at 7.3 percent, while corporate income taxes grew 6.8 percent and sales taxes increased 5.4 percent. Gaming taxes were flat in fiscal 2015, while other taxes and fees declined 2.5 percent. The decrease in other taxes and fees was likely largely due to the decline in oil and natural gas prices impacting severance taxes, which are included within other taxes and fees.

Outlook

Looking forward, it is likely that spending from states’ own fund sources will continue its recent pattern of modest growth as state revenue collections increase in line with national economic and market trends, while the pace of growth in federal funds to states will likely decline as Medicaid enrollment growth slows in future years. States will continue to work to ensure that budgets are structurally balanced and sustainable, while contending with increased spending demands, pressures from long-term obligations, volatility in state revenues, uncertainty surrounding federal fiscal policies, and moderate economic growth.

Since its inception in 1987, the State Expenditure Report has developed into a definitive baseline for the analysis of state spending. This edition of the report includes data from actual fiscal 2014, actual fiscal 2015, and estimated fiscal 2016. The report details the seven main functional categories of state spending: elementary and secondary education, higher education, public assistance, Medicaid, corrections, transportation, and “all other.”

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