State of the States: Abundance of Cash Supports Stable Outlook

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Early January presents an opportune time to review the fiscal health of the states, yet the unusual circumstances of the past two years have muddled the annual practice of year-over-year comparisons. Despite some accounting noise, the data clearly shows the state sector to be on solid footing due to unprecedented federal support and stronger-than-expected revenue performance.

The General Fund is the states' primary operating fund, and for most, is largely supported by a combination of personal income and sales taxes, representing approximately 75% of total fund receipts. In the midst of the pandemic's outbreak, finance officials prepared cautious budget plans for fiscal 2021 that anticipated declining revenues and offsetting program cuts, yet the forecasts proved to be overly pessimistic. According to the National Association of State Budget Officers (NASBO), General Fund receipts totaled $1.002 trillion for the year ending June 30, a 14.5% increase over 2020. There is some static in the data, due to tax filing extensions and the receipt of federal aid. However, adjusting for the filing delays, NASBO estimates personal income tax collections increased 12% versus 2020, while sales tax revenues posted 9% gains. The solid revenue performance was supported by multiple federal stimulus measures, higher-wage earners largely remaining employed, healthy consumer spending and continued superb returns in (nearly all) equity markets.

The cornerstone of the sector's stability is the level of pandemic relief provided by the federal government over the past two years. Moody's cites in its recent US States Outlook that the direct support offered in the Coronavirus Aid, Relief and Economic Security (CARES) Act ($147 billion) and the American Rescue Plan Act (ARPA, $195 billion) equaled 28% of states' own-source revenue in fiscal 2020. Most states tapped CARES Act monies during 2020 and 2021, including in some cases, General Fund transfers to cover eligible operating expenses. ARPA grants are available through December 2024 and provide a generous cushion against future financial and economic uncertainties associated with the pandemic.

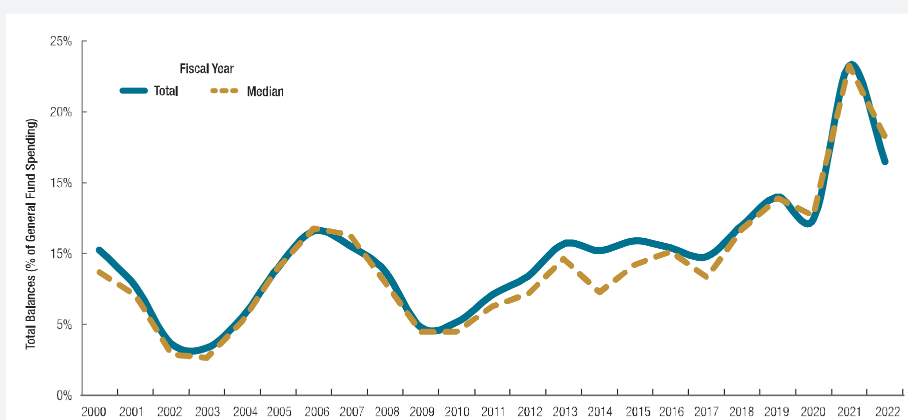
Additionally, the Infrastructure Investment and Jobs Act introduces $550 billion of new federal funding over the next five years for numerous capital programs including electricity grid reliability, expanded broadband access, water infrastructure and cybersecurity. Whereas, those federal dollars will not be used for general operations, the legislation will alleviate a portion of the cost burden for these essential projects and/or free up state capital spending for other priorities.

The revenue windfall of 2021 has left state coffers flush with cash. In its annual Fall Survey, NASBO reports total balances, including "rainy day" reserves nearly doubled to register a record $217.1 billion or 23.3% of General Fund spending, with 46 states posting total balances greater than 10% of operations.

The survey responses indicate 32 states will use a portion of these resources during the current fiscal year, yet ending balances are expected to remain healthy at 16.5% of budget. The planned draw on reserves is factored into spending plans that show General Fund expenses will rise more than 9% in fiscal 2022 to $1.02 trillion. The sizeable increase incorporates the use of one-time revenues, as well as expectations for robust tax collections. Historically, education mandates (including aid to colleges and universities) and the state share of Medicaid are the two largest expense areas for the sector. Cost escalations have been applied to both line items for 2022, yet Medicaid disbursements are projected to grow at a faster clip, since supplemental program expenses picked up by the federal government during the pandemic are set to expire. Nonetheless, approximately 45% of budget growth is tied to "All Other" expenses, which are largely pandemic related and non-recurring. Some examples of these outlays include one-time state stimulus packages, housing programs, children and family services, local government assistance or additional deposits to pension, reserve or debt service funds.

The federal government's COVID-19 response has provided both direct and indirect benefits that have produced a once-in-a-generation abundance of cash for the peer group. The sector appears poised for another solid year as 32 of the 42 early reporting states in the NASBO Fall Survey indicated fiscal 2022 receipts are exceeding budget estimates, with the remainder witnessing on-target collections. We are encouraged thus far by the thoughtful allocation of generous reserves and expect continued fiscal prudence will serve the states well.

Total Balances as a Percentage of Expenditures, Fiscal 2000 to Fiscal 2022



Source: National Association of State Budget Officers, The Fiscal Survey of States, Fall 2021