A Snapshot of Current State Finances

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In this edition of State Fiscal Affairs, the authors discuss state and local financial data from 2014, particularly as compared with similar data from the time of the Great Recession. The authors identify several ways in which state and local financial situations have changed and offer predictions for likely additional changes.

In December the Governments Division of the U.S. Census Bureau released the latest data about state-local government finances for fiscal 2014. Our preliminary analysis of this information provides a first snapshot of how subnational governments were collecting and spending revenue in 2014, as well as a detailed perspective of the important changes in state-local finances since the Great Recession.

It seems worth reiterating why census data provide the best information for comparing state-local finances, both across jurisdictions and over time. The census applies uniform financial definitions and accounting methods to permit consistent comparisons among the states even with different state financial accounting practices and fiscal years. Also, for each state the Census Bureau reports separate aggregate data for state government, local governments, and other governmental entities such as public universities and special districts, permitting an examination of overall governmental finances in a state regardless of the institutional structure. This process takes considerable time, partly because data provision by states and localities is voluntary — the reason census data are released with a time lag. Also, because of this process, the census data for an individual government may differ from similar information reported in a state or city government's budget or financial report.

State Government Finances in Fiscal 2014

State government finances in 2014 are represented in Figure 1. Traditional taxes provided about 37 percent of state government revenue, led by the individual income tax at 13 percent. Grants from the federal government accounted for 23 percent of state revenue, more than any one tax and substantially more than user charges (8 percent). Outside general revenue, unemployment insurance taxes, employee contributions to retirement funds, and net earnings on those funds amounted to 25 percent of total revenue.

Figure 1. State Governments

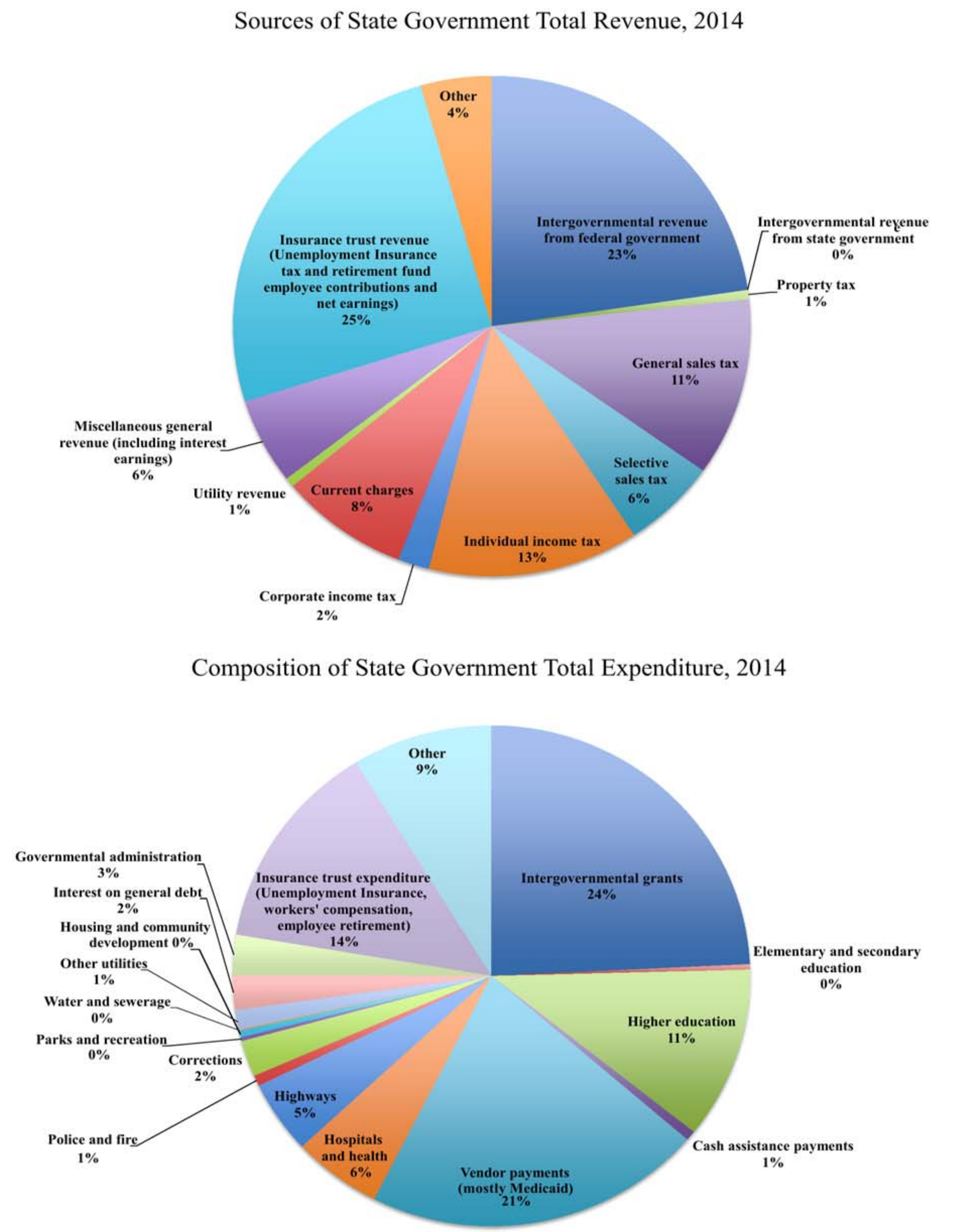
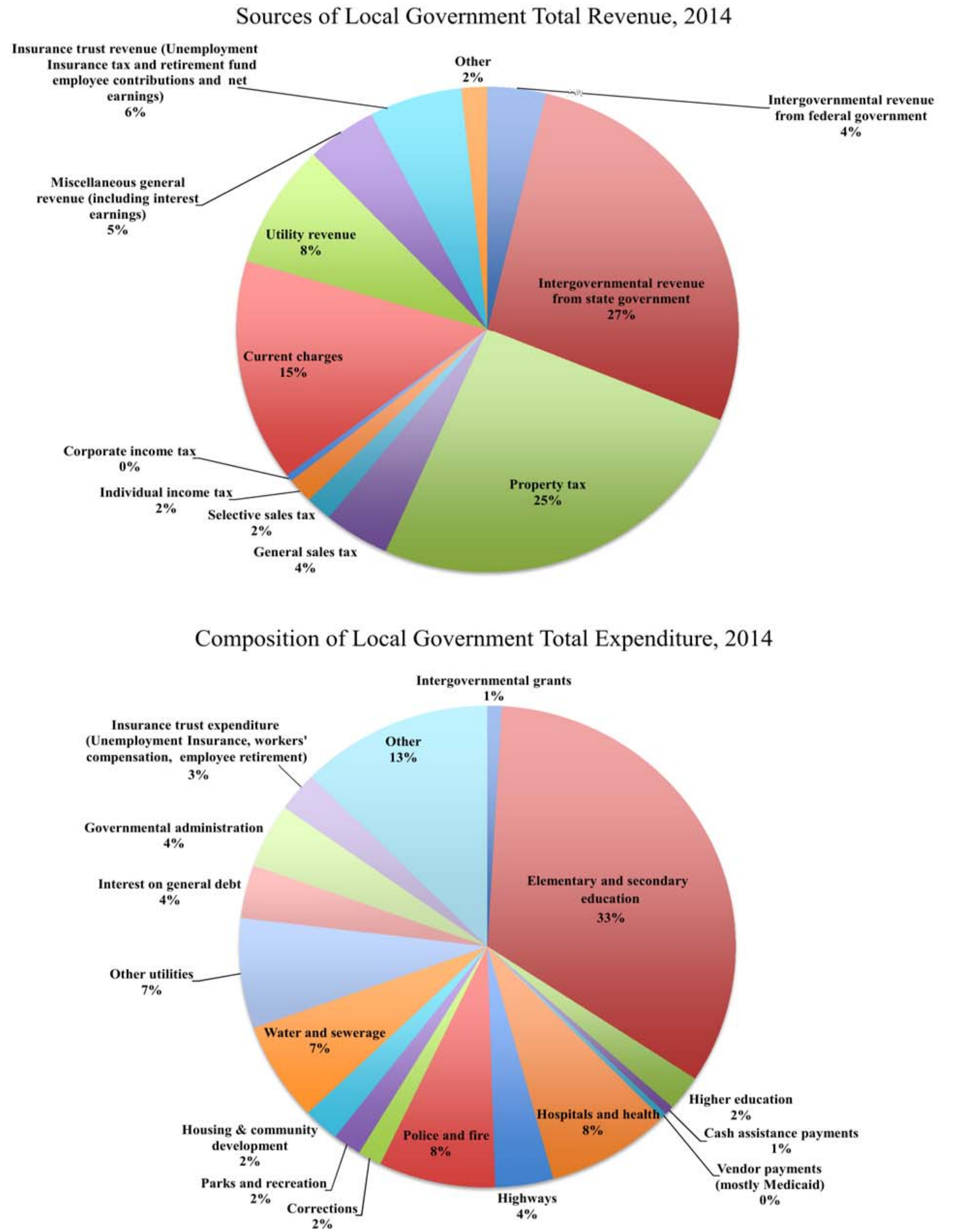


Figure 2. Local Governments



Major Changes in State and Local Government Finances, 2007 to 2014

State Governments			
Amount of Revenue		**Amount of Expenditure**	
Real per capita	↓ ($7,635 to $7,468)	Real per capita	↑ ($6,268 to $6,478)
Percentage of personal income	↓ (16.6% to 15.9%)	Percentage of personal income	↔ (13.7% to 13.8%)
Long-Term Debt Outstanding			
Real per capita	↑ ($3,561 to $3,607)		
Percentage of personal income	↔ (7.8% to 7.7%)		
Share of Revenue		**Share of Expenditure**	
Taxes	↓ (38% to 36.7%)	Capital outlay	↓ (6.7% to 5.7%)
Federal grants	↑ (20.4% to 22.7%)	Grants to local governments	↓ (28.1% to 24.3%)
		Vendor payments (mostly Medicaid)	↑ (17.2% to 21.2%)
		Insurance trust expenditure	↑ (11.2% to 13.6%)
Local Governments			
Amount of Revenue		**Amount of Expenditure**	
Real per capita	↓ ($5,888 to $5,604)	Real per capita	↓ ($5,734 to $5,448)
Percentage of personal income	↓ (12.8% to 12%)	Percentage of personal income	↓ (12.5% to 11.6%)
Long-Term Debt Outstanding			
Real per capita	↑ ($5,523 to $5,692)		
Percentage of personal income	↔ (12.1% to 12.2%)		
Share of Revenue		**Share of Expenditure**	
State government grants	↓ (29% to 27.4%)	Capital outlay	↓ (14.4% to 11.9%)
Miscellaneous general revenue	↓ (6.8% to 4.5%)	Elementary and secondary education	↓ (35.1% to 33.6%)
Current charges	↑ (13.7% to 14.8%)		
Insurance trust revenue	↑ (4.9% to 6%)		
Notes: Census Bureau data; real 2014 dollars based on Consumer Price Index.			

In terms of total spending, the largest category is grants paid to local governments, especially to schools, accounting for 24 percent of total state government spending. The only other category of similar magnitude is payments to healthcare providers, especially for Medicaid, at 21 percent. These two areas thus represent almost half of total state government expenditure. Some types of spending that many people associate with state governments — highways, corrections, and interest on debt, for example — are actually quite small relatively. Outside of what might be thought of as traditional state budgets, 14 percent of total state government spending is for unemployment or workers' compensation and retirement benefits and 11 percent is by state universities (which is counted as state spending by the census).

Local Government Finances in Fiscal 2014

The snapshot of local government finances is in Figure 2. Local government revenue is dominated by grants from state governments (27 percent) and property tax (25 percent). The next largest category is user charges (15 percent), including transit fees, parking fees, community college fees, and revenue collected by local public utilities (8 percent). A variety of other categories, many of which vary greatly among different states and types of localities, are relatively small.

Local government spending in the aggregate is led by expenditures for elementary and secondary education, which amount to 33 percent of the total. The remainder of local government spending — by a variety of counties, cities, and special districts — goes for a wide range of services, including police and fire protection (8 percent), water and sewer services (7 percent), and other utilities (7 percent) among others. Local government spending for some purposes is relatively smaller than many might think, with road spending only 4 percent of the total and the cost of running local government also only 4 percent.

Changes in the Fiscal Landscape

Although understanding the picture of state-local fiscal conditions in 2014 is important, major changes and trends in those circumstances may be even more interesting and have greater implications. The major changes in both the level and composition of state-local finances since the Great Recession are illustrated in Table 1. A few clear trends stand out.

In comparing 2014 (the most recent data) with 2007 (the year before the Great Recession), the aggregate result is that both state and local governments collect less revenue now (in real per capita amounts and as a fraction of personal income) than before the recession. State government revenue has not kept pace with income, falling from 16.6 percent of personal income in 2007 to 15.9 percent in 2014. Similarly, local government revenue declined from 12.8 percent of income in 2007 to 12 percent in 2014. State government spending was at about the same level in 2014 as in 2007, whereas local government spending was lower. Both state and local governments had higher amounts of debt relatively in 2014 compared with 2007.

State government tax revenue is down compared with 2007, and federal grants are up, although not enough to offset the tax decline. State taxes generated 38 percent of revenue in 2007 compared with 36.7 percent in 2014, whereas the share from federal grants rose from 20.4 percent to 22.7 percent. The share of state government budgets for capital investment and grants to local governments decreased at the same time the share of spending for Medicaid and insurance trust programs increased. Thus, these data suggest that state governments have been receiving increased federal government support, particularly for Medicaid, which has led to increased spending for that purpose. And states have spent relatively more on retirement benefits, addressing the much-discussed retirement fund issues. Spending for capital investment and financial support of local governments have been the casualties.

Local governments in the aggregate received less revenue and spent less relatively in 2014 compared with 2007. Although local governments seem to have increased user fees and employee contributions to retirement systems, these changes were insufficient to offset revenue declines in other categories. Importantly, as noted above, local governments have received less financial support from the state governments. Consequently, local governments spent relatively less on K-12 education (their largest spending area) and capital investment especially. Spending for capital investment decreased from 14.4 percent of local budgets in 2007 to 11.9 percent in 2014.

The View

The following is the prevailing view from the state and local budget landscape for 2007 to 2014:

- The size (revenue and expenditure) of the overall state-local government sector was smaller relative to the economy in 2014 than in 2007.
- State government budgets continue to be dominated by Medicaid, which has been growing, and financial support for localities, which has been declining.
- The decrease in state grants to localities seems consistent with the decrease in the share of local spending for education, which traditionally has been substantially supported by the states.
- Investment in public capital seems to have experienced the largest relative decline in spending by these governments.

With these trends and the recent political changes at the federal government level, we think it is reasonable to expect several future developments:

- The effect of the political changes on the size of the overall state-local government structure is difficult to predict because of opposing forces. Republican control of the federal government as well as many state governments seems likely to de-emphasize the role of government in our market economy. However, the emerging federal government agenda may counteract this with greater devolution of health insurance and other responsibilities to the states.
- More than half the states expanded Medicaid coverage as a result of the Affordable Care Act, and demographic pressures for state spending on Medicaid are not disappearing. If the federal government eliminates the increased support for Medicaid and the subsidies for health insurance for those not under Medicaid, states will face greater pressure to fund healthcare previously covered by the federal government. In that instance, even more reductions to revenue sharing for local governments seem likely.
- The rhetoric regarding the approach to fixing ailing public schools emanating from President Trump and his secretary of education, Betsy DeVos, coupled with a Republican majority in Congress, indicates that a new wave of solutions based on privatization is likely to flow from Washington. If this results in less money from the federal government for public education and pressures for states to expand support of private schools, then state-local expenditure for public schools is likely to continue to decline.
- The one recent fiscal trend that may be reversed is spending on public capital by state-local government. The new administration has signaled that our country's declining infrastructure is in need of attention and has suggested that a form of public-private partnership, which would entail greater spending in this area by subnational governments, is one possible response. ■