State Fiscal Outlook and New Revenue Streams

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Current Economic and Fiscal Outlook
Finished FY 2019 with revenue surpluses

Rainy day funds at highest levels

FY 2020 budgets include another year of modest spending growth

K-12 and Higher Ed – usually big gainers in good times

Cautionary tale: preparing for the next downturn

Long term challenges: pensions and retiree health liabilities; infrastructure and transportation demands

What’s the state fiscal environment for 2020 legislative sessions? (February 2020)
All sources of revenue being impacted by COVID-19
• Personal income, sales, corporate income, gaming, motor fuel

Impacting states in different ways and different magnitude
• E.g. oil producing states; tourism; manufacturing

Different than other recessions – public health emergency and sharp economic declines

States are facing both increased spending demands and significant revenue declines

States took steps to balance fiscal 2020 and fiscal 2021 budgets

More mid-year actions are expected in fiscal 2021

What is the current fiscal environment for states?
(August 2020)
Ways to address budget shortfalls

• Budget cuts
  • Can include targeted cuts, across the board, personnel, etc.

• Rainy day funds and reserves
  • Size of shortfalls greater than amount in rainy day funds
  • Try not to drain immediately

• Increased taxes
  • Typically not first option and amount less than budget cuts

• Federal aid
  • Was helpful during Great Recession
  • This time: question of how flexible and how much
  • States will still need to make cuts even with additional federal aid
How are states adjusting their budgets

• Spending reductions
  • Includes across-the-board cuts, targeted cuts, freezing discretionary spending, halting program expansions and other new spending initiatives, restricting contracts

• Personnel actions
  • Instituting hiring freezes, layoffs, and furloughs; cancelling planned pay increases

• Tapping rainy day funds

• One-time measures
  • Fund transfers, agency cash reserves, capital project delays, contract renegotiations, debt restricting, etc.

• Federal aid
  • CARES Act and other bills have helped to address COVID-19 related spending demands
Strategies Used to Manage Budgets, Fiscal 2010

- 35 states TARGETED CUTS
- 25 states ACROSS THE BOARD CUTS
- 24 states LAYOFFS
- 16 states FURLoughs
- 9 states SALARY REDUCTIONS
- 13 states CUTS TO STATE EMPLOYEE BENEFITS
- 19 states REDUCE LOCAL AID
- 14 states REORGANIZE AGENCIES
- 13 states RAINY DAY FUND
- 19 states USER FEES
State General Fund Spending Was Expected to See Modest Increase in Fiscal 2021 Before COVID-19 Crisis

* 42-year historical average annual nominal growth rate in state general fund spending is 5.4 percent.
Most States Continued to Strengthen Rainy Day Funds Coming Into the COVID-19 Crisis

Median balance reached all-time high in Fiscal 2019 and was on track to beat that record in Fiscal 2020 before COVID-19 crisis.

Source: Spring 2020 Fiscal Survey of States
No States Made Mid-Year Budget Reductions in Fiscal 2019 Due to a Shortfall

Budget Cuts Made After The Budget Passed

Note: Beginning in Fiscal 2018, NASBO asked states reporting net mid-year budget reductions as to whether the reductions were made due, at least in part, to a revenue shortfall. Effective in FY2018 going forward, only states reporting mid-year budget cuts due to a shortfall are included in the totals reported in this figure. Prior to FY2018, particularly in non-recessionary periods, states that reported mid-year cuts that were due to other reasons, such as a reduction in caseload, would have been included in the counts above.
Revenue Outlook for States
All States - Revenue Sources in the General Fund

Percentage

Fiscal 2019

Source: NASBO Fiscal Survey of States
Southern States - Revenue Sources in the General Fund

Fiscal 2019

Percentage

Sales 36.1%
Personal Income 43.6%
Corporate Income 4.3%
Gaming 1.0%
All Other 14.9%

Source: NASBO Fiscal Survey of States
Steep Declines During the Great Recession and a Sluggish Recovery Led Revenues to Lag Behind Real Fiscal 2008 Levels for a Decade

Fiscal 2020 figure is estimated (pre-COVID-19). Fiscal 2021 figure is based on governors’ recommended budgets (pre-COVID-19).

Percentages shown represent total annual general fund spending growth.

*Beginning with the Fall 2019 Fiscal Survey edition, Massachusetts now excludes federal reimbursements in its general fund spending and revenue totals. NASBO has adjusted prior 50-state totals from the Fiscal Survey to remove Massachusetts’ federal reimbursement amounts (as reported in the state’s Comprehensive Annual Financial Report, or CAFR) for comparison purposes.
42 States Saw Revenue Collections Coming in Ahead of Budget Projections Prior to the COVID-19 Crisis

A few states reporting collections below projections incorporated early impacts of COVID-19 on their tax collections.

*Fiscal 2020 figures were estimated based predominantly on pre-COVID-19 data. A few states that reported collections coming in lower than projections incorporated some early COVID-19 impacts on their tax collections.

Source: Spring 2020 Fiscal Survey of States
## Summary of Revenue Changes, Fiscal 2021 Recommended

<table>
<thead>
<tr>
<th>Revenue Type</th>
<th>Sales Tax</th>
<th>Personal Income Tax</th>
<th>Corporate Income Tax</th>
<th>Cigarette/Tobacco Tax</th>
<th>Motor Fuel Tax</th>
<th>Alcohol Tax</th>
<th>Gaming/Lottery Revenue</th>
<th>Other Tax</th>
<th>Fees</th>
<th>All Revenue Changes</th>
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<tbody>
<tr>
<td><strong># of States Recommending Increases</strong></td>
<td>7</td>
<td>3</td>
<td>4</td>
<td>6</td>
<td>2</td>
<td>0</td>
<td>6</td>
<td>7</td>
<td>7</td>
<td>14</td>
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<tr>
<td><strong># of States Recommending Decreases</strong></td>
<td>2</td>
<td>14</td>
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<td>0</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>15</td>
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<tr>
<td><strong>Net Change ($ In Millions)</strong></td>
<td>+$767</td>
<td>-$1,079</td>
<td>+$47</td>
<td>+$195</td>
<td>+$1,070</td>
<td>-$5</td>
<td>+$85</td>
<td>+$843</td>
<td>+$519</td>
<td>+$2,431</td>
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<tr>
<td><strong>Net Change – General Fund Only ($ in Millions)</strong></td>
<td>+$714</td>
<td>-$1,607</td>
<td>+$39</td>
<td>+$177</td>
<td>$0</td>
<td>-$5</td>
<td>+$53</td>
<td>-$86</td>
<td>+$127</td>
<td>-$588</td>
</tr>
</tbody>
</table>

Spring 2020 Fiscal Survey of States
Impact of COVID-19 on State Revenues

- States rely on personal income taxes and sales taxes combined for roughly 75 percent of their general fund revenue
  - These revenue sources were hit hard by stay-at-home orders, business closures, and rising unemployment
  - Energy-producing states impacted by collapsing oil prices
  - Tourism heavy states are being especially hard hit as well

- Most states were seeing revenues come in ahead of projections for fiscal 2020 before the pandemic, which provided some immediate cushion
  - Strong growth for most states for ¾ of fiscal 2020

- The worst is likely still to come for state tax revenues, as the full economic impacts of the pandemic are felt
  - Federal stimulus measures (checks to individuals, enhanced UI benefits, PPP, etc.) are propping up the economy and state revenues, but those are going to run out.
  - 2020 tax returns mostly based on 2019 economy, which was strong

- States have been releasing updated revenue forecasts – many projecting multi-billion-dollar revenue declines over the next few years
  - As revenues are slow to fully recover, it becomes more difficult to make spending cuts from a lower base
Revenue declines during Great Recession (From fiscal 2008 to fiscal 2010)

-11.6%  
Total general fund revenue

-6.8%  
Sales Tax

-14.7%  
Personal Income Tax

-24.1%  
Corporate Income Tax

-7.8%  
Gaming Tax

-8.2%  
All Other Revenue
New and Expanded Revenue Streams
State Revenue Challenges and Issues

- South Dakota v. Wayfair response
- Murphy v. NCAA response
- E-cigarettes/vaping
- Marijuana legalization
- Gas taxes and fees
- April tax collections
- TCJA impact
- Income tax volatility
- Shrinking sales tax base
Online Sales Tax
Current Status of State Actions

• 43 of 45 sales tax states have statutes or regulations in place to require remote sellers to collect and remit – with small-seller thresholds

• Not Yet: FL and MO

• Many states updated FY 20 revenue estimates with the impact of online sales tax revenues. Averaged around 2% of sales tax totals.

- By July 2018: HI, OK, RI, PA, VT
- Sept 2018: MS
- Oct 2018: AL, IL, IN, KY, ME, MD, MA, MI, MN, NV, NJ, ND, WA, WI
- Nov 2018: NC, SC, SD
- Dec 2018: CO, CT
- Jan 2019: GA, IA, NE, UT, WV
- Feb 2019: WY
- Later 2019: AR, AZ, CA, ID, LA, NM, NY, TN, TX, VA
Sports Betting

• **Murphy/Christie v. NCAA**, US Supreme Court 6-3 decision, May 14, 2018
  
  • Held that the provisions of the Professional and Amateur Sports Protection Act that prohibits state authorization and licensing of sports gambling violates the Constitution’s anticommandeering rule

• Grandfathered: Nevada, Delaware, Montana, Oregon – had legalized sports betting laws on the books of some type

• Eighteen states, plus Washington, D.C., have established laws that allow for legal, regulated sports-betting within their borders
**Sports Betting**

**Issues Considered:**

- Illegal to Legal Activity/Expansion?
- Tourism enhancement?
- Existing Facilities?
- On-Premise Only?
- Licensing & Enforcement Body?
- What type of Bets?
- Tax Rates or Revenue Sharing?
- Upfront License Fee?
- General Fund or Dedicated Uses?
- Remote online betting?
- Underage enforcement?
- Prohibition on in-state college teams?
E-Cigarettes and Vaping Taxes

- Most states tax on percentage of price, flat rate per milliliter of e-liquid or per cartridge, or combination of both

- Before 2019, 11 states imposed vaping taxes

- At least 10 states passed vaping taxes in 2019 sessions:
  - **Connecticut** 10% open system, 40 cents/ml closed system
  - **Illinois** 15% wholesale
  - **New York** 20% retail ($19 million)
  - **Nevada** 30% wholesale
  - **New Mexico** 12.5% open wholesale, 50 cents/ml closed
  - **Oregon** 65% wholesale – placed on ballot
  - **Utah** 86% wholesale ($23.6 million)
  - **Vermont** 92% wholesale
  - **Washington** 9 cents/ml open, 27 cents/ml closed
  - **Wisconsin** 5 cents/ml

Additional states, including southern region, acted in 2020 session
Marijuana legalization

- 11 states and the District of Columbia have legalized marijuana for recreational use, although no states in the southern region

- At least 34 states and the District of Columbia have established medical marijuana programs, including some in the south

- 7 states may have legalization initiatives on their November ballot, with more expected in 2021 and 2022
  - Signature gathering has been impacted by coronavirus outbreak

- Issues to consider include:
  - Determining appropriate level of taxation
  - Forecasting marijuana revenue
  - Budgetary impact
  - Establishing a regulatory framework
  - Contending with banking issues and current federal laws
Gas taxes raised in 33 states since 2013
- 3 states in 2019 (AL, AR, OH)
- 1 state in 2018 (OK)
- 8 states in 2017 (Rate increases: CA, IN, MT, OR, SC, TN. Formula change: UT, WV)

32 states have constitutional restrictions on how revenues in transportation fund can be spent

Road Usage Charges
The next frontier of transportation resources

27 states now have electric vehicle fees
2016 – 9% of fleet were electric
2021 – 12% of fleet (est’d)
Transportation Funding – Electric and Hybrid Vehicle Fees

• 27 states have enacted electric and/or hybrid vehicle fees through 2019
  • 5 states in their 2019 sessions
  • Low of $50 to high of $200 – median fee $120

• 10 Southern States:
  • 2019 - Alabama and Arkansas
  • 2018 - Mississippi
  • 2017 - South Carolina (biennial), Tennessee (indexed), West Virginia
  • 2015 - Georgia (indexed)
  • 2013 - North Carolina
  • 2012 - Virginia
  • 1998 – Missouri (alternative fuel special fee)
Outlook for States
States will continue to respond to increased spending demands from the coronavirus.

Adjusting revenue forecasts for fiscal 2021 while examining potential impact on fiscal 2022.

Fiscal 2021 budgets will continue be revised.

Budget instructions are being issued for fiscal 2022; some calling for cuts up to 15 percent.

Question of how much added federal aid and how flexible

- States will still need to make cuts even with more aid.

States will likely face impact of COVID-19 for many years to come.

Outlook for states FY 2021 and beyond.