

The State of State Finances

THE NELSON A.
ROCKEFELLER
INSTITUTE
OF GOVERNMENT

**Multistate Tax Commission:
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**The Davenport Hotel
Spokane, WA**

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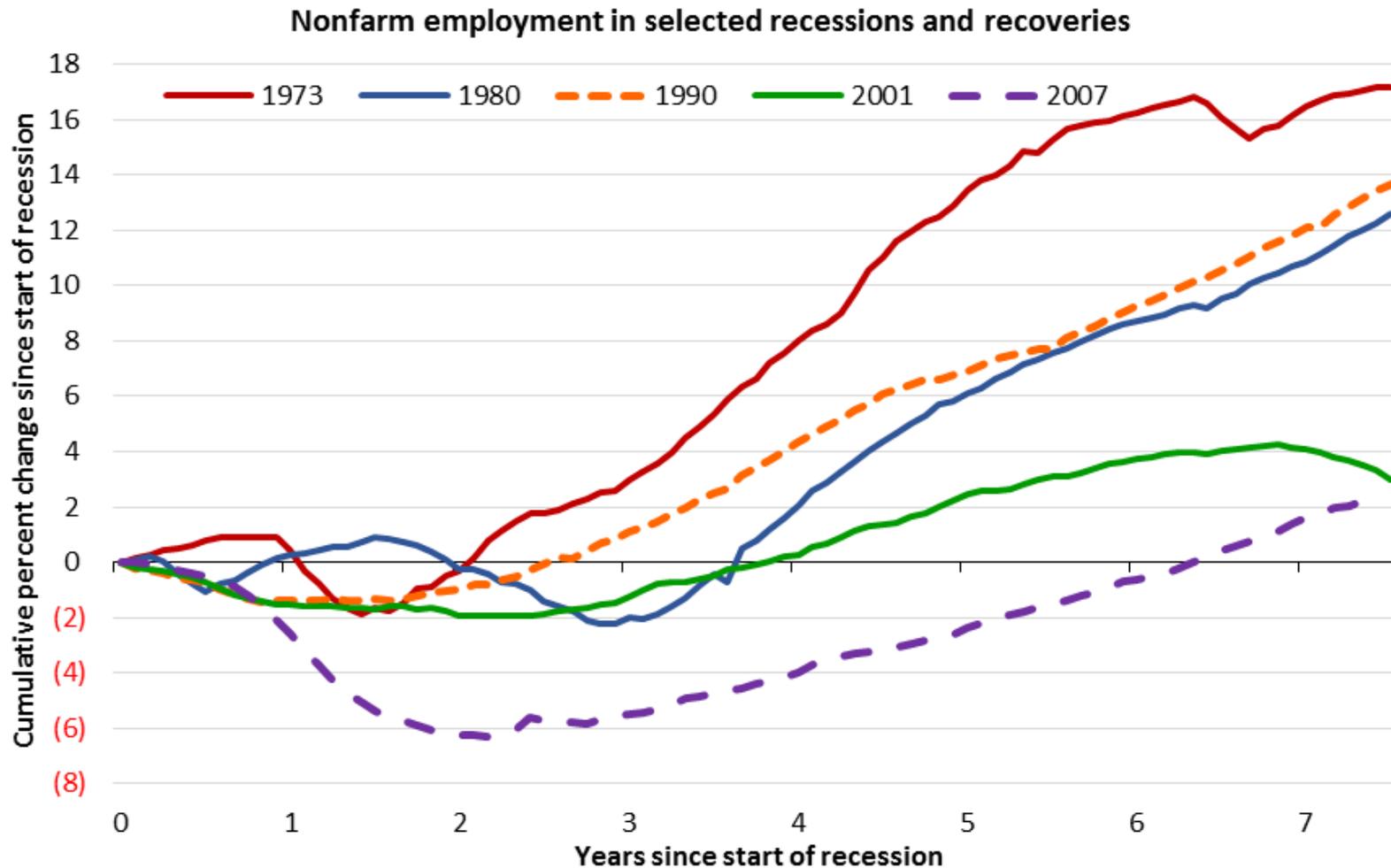


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States face risks and challenges

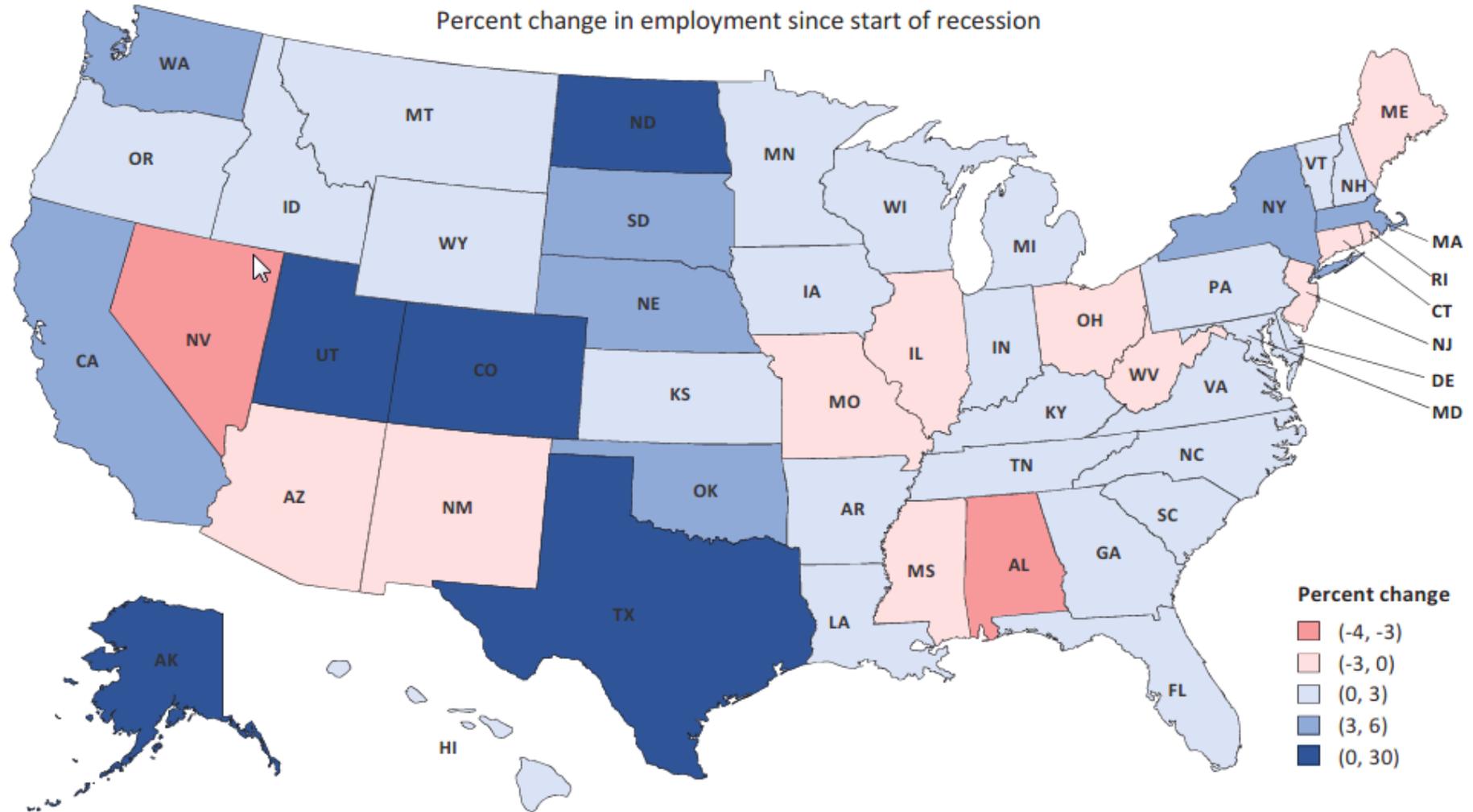
- Revenue growth: slow, in the face of slow economic growth
- Greater revenue volatility
- Pent-up spending pressure after years of cuts
 - K-12
 - Infrastructure
- Plus spending states have to do (probably)
 - Medicaid
 - Pensions
- Some states in special circumstances: oil prices; pension crises
- A lot of claims on slowly growing revenue

Employment is below where it was in past recoveries



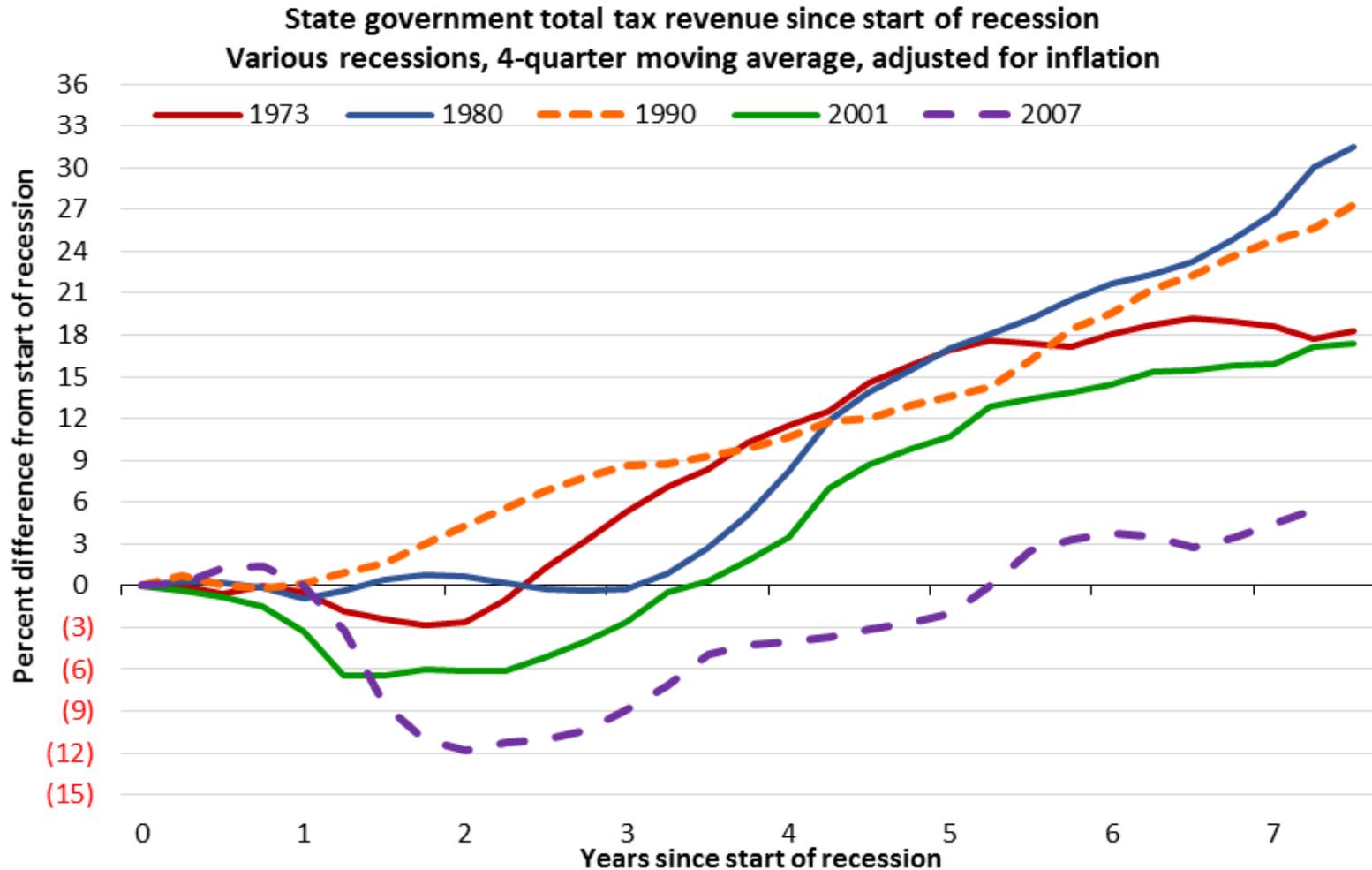
Source: U.S. Bureau of Labor Statistics.

Employment in 13 states is below start of the recession



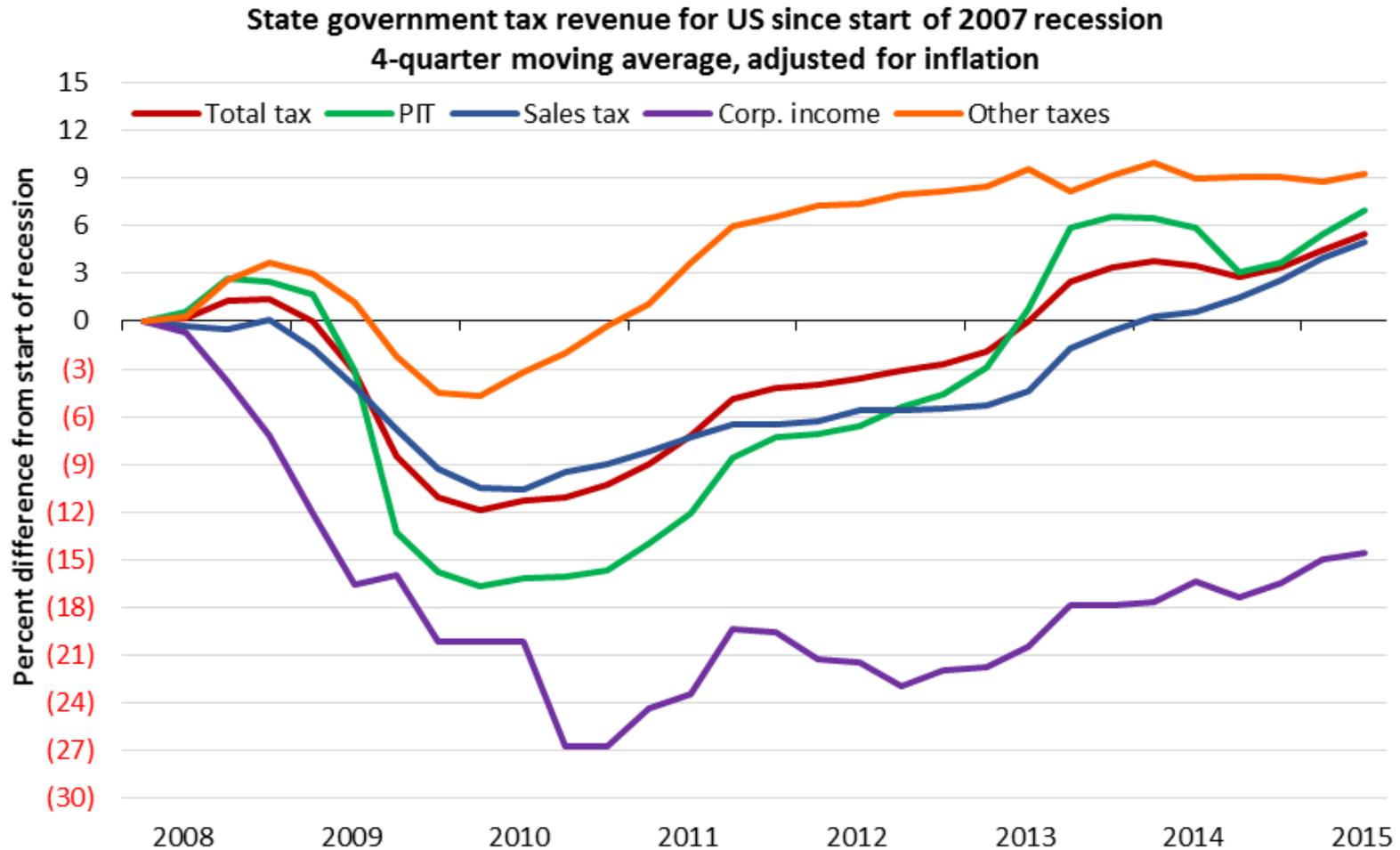
Source: Rockefeller Institute analysis of employment data from U.S. Bureau of Labor Statistics.

7+ years after recession start, tax revenue is only 5+% above prior peak



Sources: Rockefeller Institute analysis of Census Bureau tax data. Adjusted for inflation with GDP price index.

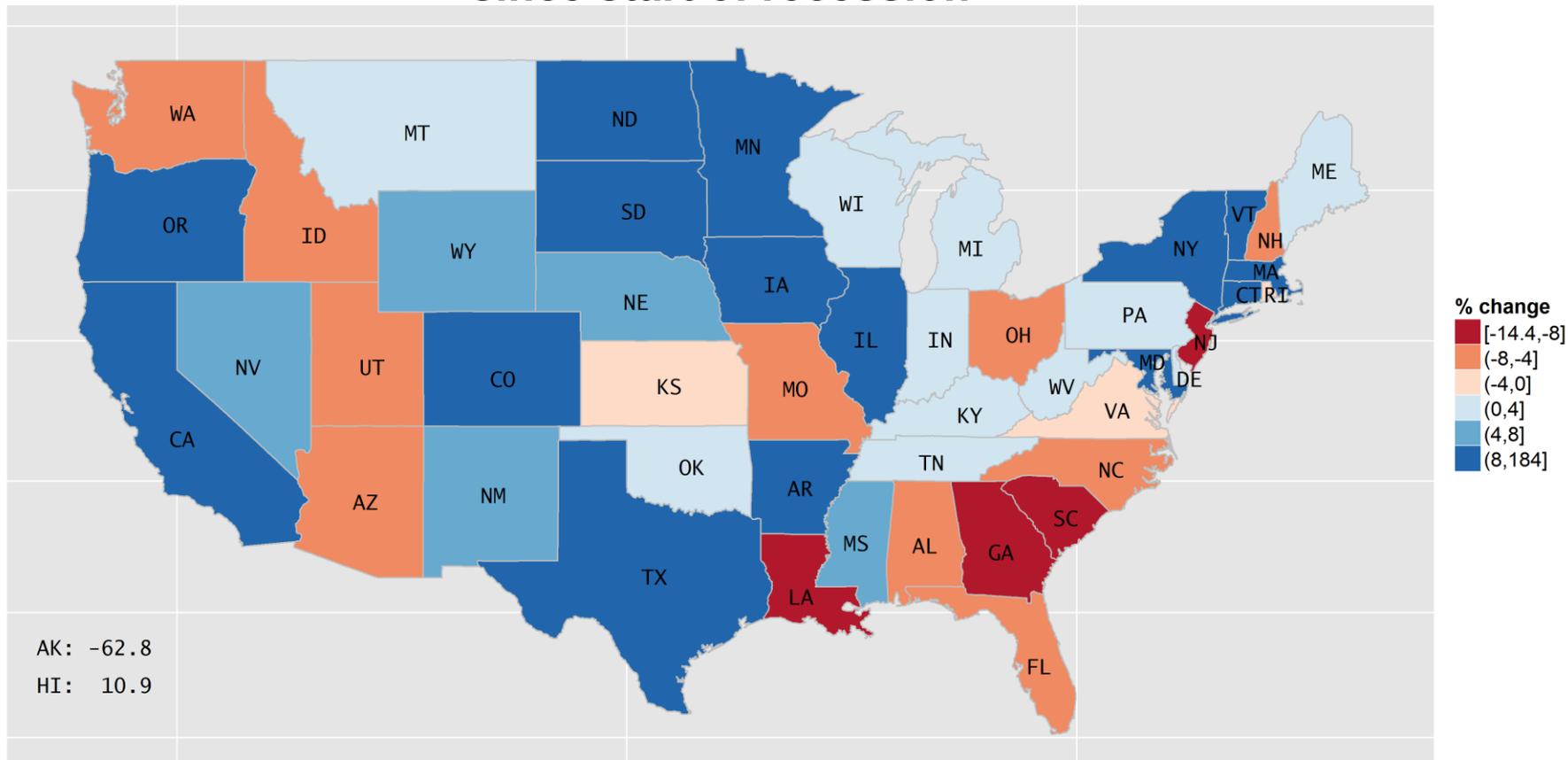
“Other” taxes were increased; sales and income are recovering; corporate 15% below prior peak



Sources: Rockefeller Institute analysis of Census Bureau tax data. Adjusted for inflation with GDP price index.

Real tax revenue in 18 states is below recession start. Southeast languishes

Percent change in inflation-adjusted state tax revenue since start of recession



Source: Rockefeller Institute analysis of tax data from Census Bureau
Adjusted using GDP price index from Bureau of Economic Analysis

Greater revenue volatility



Capital gains: A volatility driver. Only 2/3 their 2007 level



Source: Congressional Budget Office, The Budget and Economic Outlook: 2015 to 2025, January 2015.

Recent quarters

- 2015q1 was pretty good:
 - +5.1% overall
 - +7.2% PIT
 - +5.1% sales tax
- Still gathering data on 2015q2, but it was good. Very strong income tax, as expected – a lot of double-digit growth.

Pent-up spending pressure

- States cut aggregate spending, other than K-12, higher ed, health by 6% (inflation-adjusted), 2008-2013
- K-12
 - States cut inflation-adjusted K-12 spending by approximately 4 percent between 2008 and 2013.
 - Local governments have been cutting school teachers and other education positions for the last six years
 - Growth in # of K-12 pupils projected to rise 0.6% annually 2015-2024, after recent lull
- Massive cuts in state higher ed support, exceeding 20% per FTE in real terms, 2008-2014
- Infrastructure
 - 2007q4 to 2014q4, real SLG gross investment fell 18%; net investment (after capital consumption) plummeted 55%
 - Real construction spending on K-12 buildings -46%; higher ed buildings -6%; waste disposal and water supply facilities -15%

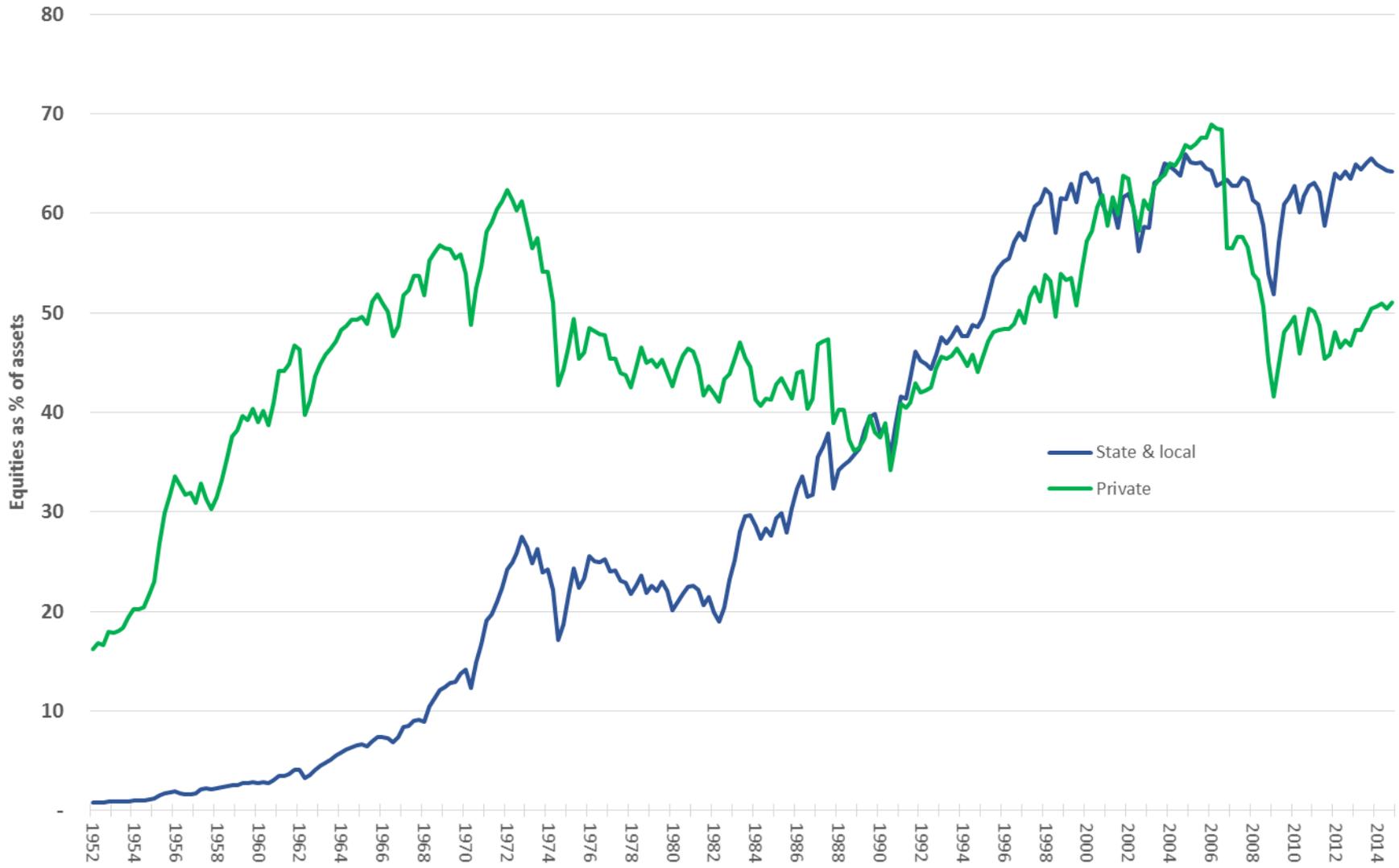
Pensions

- Underfunded by >\$1.1 trillion, using chosen assumptions on investment returns. Considerably greater by other measures.
- Actuarial contributions currently underpaid by \$21+b annually.
- Picture varies greatly around the country, but all are subject to heightened risk.

Pension risks are greater now

	1977	1987	1992	1997	2002	2007	2013
Ratio: actives to retirees	4.48	2.91	2.53	2.47	2.28	1.92	1.53
Cash flow before earnings, % assets	6.35	2.17	0.14	(0.70)	(2.58)	(2.31)	(3.26)
Assets as % of GDP	6.1	10.7	14.3	20.8	17.8	23.2	21.4
Equity % of assets	22.9	32.3	45.8	61.1	58.6	63.3	65.5
Equity assets % of GDP	1.4	3.5	6.6	12.7	10.4	14.7	14.0
Earnings assump.	~7.5	na	8.0	na	8.0	8.0	7.8
30-year Treasury	<u>7.6</u>	<u>8.6</u>	<u>7.8</u>	<u>6.8</u>	<u>5.4</u>	<u>5.2</u>	<u>3.4</u>
Gap	~0	na	0.2	na	2.6	2.8	4.4

Equities as % of defined benefit pension fund assets State & local funds and private funds



Source: Institute analysis of data from Federal Reserve Board, Flow of Funds, March 2015, Tables L.118.b and L.120.b

Adds up to a lot of claims on slowly growing revenue, plus some risks

- Slow revenue growth
- Pent-up spending demands
- “Must do” spending: Medicaid, pensions
- Not a lot of headroom for new spending or tax cuts
- But financial markets are always a wild card, for revenue and for pensions...

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