

State Budget Surpluses

June 6, 2022

While the Federal Reserve takes center stage in the battle against inflation, the economy continues to perform better than expected. Last week, the monthly employment numbers continued to rise with a gain of 390,000 jobs or 4.5% year-over-year and close to levels achieved prior to the onset of the virus. As growth continues to expand, the boogeyman is inflation and the tool the Federal Reserve is using to lower inflationary pressures is higher interest rates. In addition to targeting the level of the fed funds rate, the Fed is shrinking its balance sheet by not reinvesting the proceeds from maturing securities.

As we have mentioned recently, this “tight” monetary policy is being complemented by tight fiscal policy — the government ran a \$308 billion surplus in April and federal income tax revenues are up 97% year-over-year. Federal government coffers continue to swell to record levels. Today’s Wall Street Journal reports that “individual income tax collections are poised to reach \$2.6 trillion, or 10.6% of the economy in the fiscal year that ends Sept. 30, according to the Congressional Budget Office. That is up from 9.1% in 2021 and would mark a record in the 109-year history of the tax, topping the war-tax receipts of 1944 and the dot-com boom of 2000.” Yet, the media has not focused on the fact that state tax revenues have been soaring as well.

Remember when states were complaining because they were running huge budget deficits and were falling behind on their ability to fund future liabilities such as pensions? Once the pandemic hit, the crisis became critical, and the federal government had to come to the aid of several states that were running out of money. Let’s look at how state balance sheets are doing today.

The state with the largest budget surplus is Texas with over \$100 billion! California would have been #1 with \$102 billion but the federal government gave them \$27 billion so they are #2. Another big winner from Covid is New Jersey with a \$10 billion surplus. We have not calculated the total state surplus nationally but looking at the report of the NCSL survey of legislative offices ended in January, general fund revenue collections across the states are strong and most state budgets have never been in better shape.

The enormous spending spree that the federal government undertook to waylay the Coronavirus is coming back to state governments in the form of personal income taxes, sales taxes, corporate income taxes and real estate taxes on the back of a strong economic recovery. The question is, what will these states do with all that money? There are three options; one is to fund additional spending programs, two is to put some aside in a rainy-day fund and three is to give some of that tax revenue back to the taxpayers. Legislatures have a lot of decisions to make but these should not include raising taxes in such a favorable budget environment.