STATE AND LOCAL GOVERNMENTS’ FISCAL OUTLOOK

2018 Update

What GAO Found

GAO’s simulations suggest that the state and local government sector will likely face an increasing difference between revenues and expenditures during the next 50 years as reflected by the operating balance—a measure of the sector’s ability to cover its current expenditures out of its current receipts. While both expenditures and revenues are projected to increase as a percentage of gross domestic product (GDP), a difference between the two is projected to persist because expenditures are expected to grow faster than revenues throughout the simulation period.

State and Local Government Sector Operating Balance as a Percentage of Gross Domestic Product (GDP), 2008 through 2067

GAO’s simulations also suggest that growth in the sector’s overall spending is largely driven by health care expenditures—in particular, Medicaid spending and spending on health benefits for state and local government employees and retirees. These expenditures are projected to grow as a share of GDP during the simulation period. GAO’s simulations also suggest that revenues from personal income taxes and federal grants to states and localities will increase during the simulation period. However, revenues will grow more slowly than expenditures such that the sector faces a declining fiscal outlook.

GAO also identified federal policy changes that could affect the state and local government sector’s fiscal outlook. For example, the effects of the recently-enacted Tax Cuts and Jobs Act will likely depend on how states incorporate the Act into their state income tax rules. In addition, other factors, such as economic growth and rates of return on pension assets, could shift future fiscal outcomes for the sector.