



After the Fact | What's the deal with state budgets this year?

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TRANSCRIPT

Dan LeDuc, host, "After the Fact" podcast: Welcome to "After the Fact." For the Pew Charitable Trusts, I'm Dan LeDuc. And today we begin with a programming note: Nine years after our first "After the Fact," this is my last podcast. I'm retiring from Pew and turning the microphone over to Giuliana Pence. She's been part of the "After the Fact" team for a while now, and you may recognize her from a few episodes already. Giuliana, take a moment and tell listeners a little bit about yourself.

Giuliana Pence, host, "After the Fact" podcast: Thanks, Dan. Well, I've been working behind the scenes on the podcast for about six years. I am a mom of two toddler boys. And I think I have the best job because I get to learn and dive into new topics and share stories and talk to community members about the impact that Pew is having. And now I'm excited to take over the mic. It's been wonderful working with you, and we're really going to miss you around here.

Dan LeDuc: Well, thanks so much. And I promise I'll still be listening.

Giuliana Pence: You better. And to our listeners, you'll be hearing from me often this season, along with a few new co-hosts. Thank you for being part of the journey. We can't wait to share what's next, so let's dive in.

Welcome to "After the Fact." For the Pew Charitable Trusts, I'm Giuliana Pence. It's January, which means legislative sessions are kicking off in statehouses across the country, and budgets are always a topic of conversation. In the past few years, state budgets have been bolstered by leftover COVID-era federal aid. In fact, in [fiscal year] 2023, federal dollars made up about 36% of state revenue.

But 2026 is gearing up to be a bit more of a challenge. New federal policy changes are in play that will leave lawmakers with tough choices about how to balance their budgets and still fund the programs that serve their communities.

Today, I'm joined by my colleague Liz Farmer from Pew's Fiscal 50 team to tell us more about the top state fiscal debates to watch out for in the new year and how they could impact your community.

Liz Farmer, welcome to “After the Fact.” Thank you for joining us.

Liz Farmer, senior officer, Fiscal 50: Super happy to be here. Thanks for having me.

Giuliana Pence: Of course. So, to start, can you tell us a bit about your role at Pew and what the Fiscal 50 team does?

Liz Farmer: Yeah, the Fiscal 50 team is part of the state fiscal arm of Pew, as I call it. And Pew works with policymakers to assess state fiscal conditions, help them prepare for economic downturns, manage uncertainty.

A lot of states don’t have the forward-looking data to be able to assess what to do. There’s this saying, it’s something along the lines of, “If you don’t measure it, you can’t manage it.” And the same thing is true in state budgets, and really true when it comes to money.

And so, our team focuses on tracking fiscal indicators, economic indicators, to look across the landscape of what’s going on. And not only do we help provide context for the data for policymakers, but we also give them that 3,000-foot view of what’s going on outside of their corner. So, often they wonder, am I alone? Is this happening everywhere? And we are able to provide that context for them.

Giuliana Pence: And I know that one of the things that you all have been doing is the “Debates to Watch” series for the past three years, where you look at the fiscal challenges states may face in the upcoming year. Can you tell us about how that got started and how it’s been effective?

Liz Farmer: Like all great ideas, it started with an offhand comment of, “Hey, we should be looking at themes coming up in the state legislatures this year. We’re already talking about it.”

And so, it initially started off with one story talking about five different themes, and it has grown from there. These are deep dives into policy topics that all ultimately affect how much money states have to spend, what they can best do for their constituents, and provide the services that their constituents expect.

Giuliana Pence: If you had to describe the overall mood for 2026, what’s the vibe in the states?

Liz Farmer: It’s funny. I knew this question was coming, and I’m still like, how should I answer this?

Giuliana Pence: I know, I can only imagine.

Liz Farmer: So many words. Cautious is a good one. I joke with my colleagues about this a lot, about how I’m so tired of the word “uncertainty,” but it truly is the word of the year. Federal policy and federal funding uncertainty are just now a core risk in state budgets. States are used to having to manage

against change. A new administration, of course, happens every four or every eight years. That is very, very normal.

What's different now, though, is that the pace and the scale of changes this time have been especially challenging for state and local leaders. And it's also unclear how many of these actions are temporary and may get turned back, and how many of them are going to be permanent.

Giuliana Pence: And what are the debates to watch in 2026?

Liz Farmer: One is no surprise. It's always kind of the "state of state budgets" piece. We always lead off with that. The rest of them, though, we decided early on that it was going to be around the state responses to all these federal policy changes. So, we've got one on the Medicaid changes, another one on the SNAP funding changes, and one on the FEMA disaster funding changes, or potential changes in that one. And the last one is a look at the use of AI and other types of technology and how those are helping states be more streamlined in how they provide taxpayer services.

Giuliana Pence: How are states preparing for some of this uncertainty?

Liz Farmer: A multitude of ways. So it's like this feeling you have before a storm. You can do all this stuff to prepare, but you're never quite sure how strong the winds are going to be until it actually hits.

One of my colleagues said this a while ago when we were talking about uncertainty is that there's no such thing as a typical budget year. But that is super, super true this year. And the tools that states have to prepare are largely the same. Things like budget stress testing, which is something that allows you to see what happens if you pull this lever, what's going to happen to the revenue or spending?

Looking further out with long-term budget assessments. Being able to know, like, your finances may be OK now, but in two years this spending gap is going to grow. We're going to have a long-term deficit. So a lot of states do that, and that helps give them a line of sight.

The other tools are, OK, so what do we do about it? Those are all kind of the same things as well. There's do we cut spending? Do we cut services? Do we raise revenue? They've been starting to chip away at that stuff already.

Last year was a tough budgeting session, and so you saw states kind of dip into reserves. The things that states least like to do is start looking at raising income and sales taxes. We may start hearing discussions like that this year.

Giuliana Pence: And where are states feeling most exposed, would you say?

Liz Farmer: It's a tough call. First thing that comes to mind is Medicaid. Medicaid is, for just about every state, the largest amount of money that they get every year from the federal government. In terms of the state's own money that they spend, it's the largest kind of line item in their budgets.

There aren't necessarily direct federal cuts coming in Medicaid, but there are a lot of changes that are ultimately going to result in lower enrollment, which means less money for states to spend on Medicaid.

Multiple states have budget deficits that they took care of last year but are opening up again this year. SNAP, the Supplemental Nutritional Assistance Program, is another one. And that is something where states are going to have to come up with money, like, in October, because the federal funding shift for that program kicks in in October 2026. You've got ongoing problems meeting new pressures, mostly because of federal policy.

Giuliana Pence: I also wanted to ask you about rainy day funds. For our listeners who might not know, rainy day funds are essentially savings accounts that states build up in good times so they have money to fall back on if hard times arise. And rainy day fund capacity, or the amount saved in those accounts, has fallen for the first time since the Great Recession. What should we make of that?

Liz Farmer: So capacity has fallen for the first time. States have spent years—a decade-plus now—building up their capacity in reserves. And it's really notable that they did that at a time after the Great Recession when revenue was really, really tight.

While, yes, capacity has fallen, rainy day funds are still at historic highs, and it is really quite an achievement for states. It signals that they are—I don't want to say battening down the hatches—but they are really being diligent about having a cushion to fall back on, if and when it's needed.

Giuliana Pence: What strategies are helping them do that?

Liz Farmer: So states saw this huge swell of revenue in the years immediately following the onset of the pandemic in 2020. 2020 obviously was a rough year for budgets, but states came out of that financially OK, largely because of the federal aid.

The additional federal aid helped states be able to make a lot of one-time investments in new programs. It really just helped cushion budgets through what was still a very unpredictable time. And, ultimately, what that did is it led to states really collecting far more in revenue than they ever had.

And so states—a lot of them—put that into one-time uses, like rainy day funds or other kinds of special funds, disaster aid funds, for example. And so that, again, speaks to just laying the foundation and being as prepared as one possibly can be for whatever's coming next.

Giuliana Pence: So shifting a little bit to examples of some fiscal wins that we've seen from states over the past few years. Are there any states that are managing their budgets particularly well?

Liz Farmer: I would say states that are managing their budgets with an eye to fiscal stability.

Giuliana Pence: That's important. We want to be stable.

Liz Farmer: You cannot predict everything. So much of budget management and doing it well or not revolves around these budget and revenue forecasts. And what we've seen is that those who are doing these forecasts are being super cautious about how much revenue is expected to come in. And that does really help lawmakers set boundaries for what kind of policies we can implement.

Giuliana Pence: So being strategic and kind of slowly taking care of that deficit, but then also not getting rid of the programs that are really important to constituents in that state.

Liz Farmer: Exactly.

Giuliana Pence: That's great. What's important for the average person thinking about, "Hey, what's happening in my state?"

Liz Farmer: As someone who is a resident of a state that has a budget deficit, has a kid in public school, what I would care about is: Is my state acting responsibly? I want the state to make the best decisions that it can with the money that it has, but to maintain the programs I care about.

It reminds me a lot, actually, when I was doing a lot of writing in the post-Great Recession era about public pensions. And I was speaking with somebody who was an expert at moderating between two parties for pensions. And his approach was like, you put the data out there, you let everybody see it. And nobody's going to get everything they want, but at the end of the day, things are balanced and the whole system is safe.

And so that kind of approach right now, especially because, like I said, we know that storm is coming. We don't know how strong it's going to be. I guess the headline is to be prepared and to temper your expectations.

Giuliana Pence: Liz, thank you so much. Other than pew.org/fiscal50—shameless plug there—where else can our listeners find you?

Liz Farmer: You can find me and my colleagues' work at the Budget Threads website, which you can access on Fiscal 50. That's all of our news analyses work. I also moonlight on the side—not associated with Pew—I also co-host the "Public Money" podcast with my good friend Justin Marlowe from the University of Chicago.



Giuliana Pence: Thanks for listening. And make sure you're subscribed to "After the Fact" wherever you get your podcasts to hear all of our latest episodes. For the Pew Charitable Trusts, I'm Giuliana Pence, and this is "After the Fact."