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## 20 STATES FACE TOTAL BUDGET SHORTFALL OF AT LEAST \$34 BILLION IN 2009; 7 OTHERS EXPECT BUDGET PROBLEMS

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### Summary

At least twenty-four states, including several of the nation's largest, face budget shortfalls in fiscal year 2009. Of these 24 states, 20 have already made specific estimates; the combined deficits of these 20 states are expected to total at least \$34 billion for fiscal 2009 — which begins July 2008 in most states. Another 3 states expect budget problems in fiscal year 2010, although some of those gaps may occur earlier than expected. Many of the other states have not yet released information about their fiscal status.

The bursting of the housing bubble has reduced state sales tax revenue collections from sales of furniture, appliances, construction materials, and the like. Weakening consumption of other products has also cut into sales tax revenues. Property tax revenues have also been affected, and local governments will be looking to states to help address the squeeze on local and education budgets. And if the employment situation continues to deteriorate, income tax revenues will weaken and there will be further downward pressure on sales tax revenues as consumers become reluctant or unable to spend.

The vast majority of states cannot simply run a deficit or borrow to cover their operating expenditures. As a result, states have three primary actions they can take during a fiscal crisis: they can draw down available reserves, they can cut expenditures, or they can raise taxes. States already have begun drawing down reserves; the remaining reserves are not sufficient to allow states to weather a significant downturn or recession. The other alternatives — spending cuts and tax increases — can further slow a state's economy during a downturn and contribute to the further slowing of the national economy, as well.

The Center on Budget and Policy Priorities currently is monitoring state fiscal reports and is in touch with state officials and/or relevant state nonprofit organizations in the 50 states and DC. The fiscal situation appears to be as follows.

- Over half of the states are anticipating budget problems.

TABLE 1: 20 STATES WITH PROJECTED GAPS FOR FY2009		
	Amount	Percent of FY2008 General Fund
Alabama	\$784 million	9.2%
Arizona	\$1.3 billion – \$1.7 billion	12.1 – 16.2%
California	\$14.5 billion	13.9%
Florida	\$2 billion	6.5%
Illinois	\$2.5 billion - \$3.0 billion	9.1 – 10.9%
Iowa	\$350 million	6.0%
Kentucky	\$266 million	2.9%
Maine	\$57 million	1.8%
Maryland	\$550 million	3.8%
Massachusetts	\$1.2 billion	4.2%
Minnesota	\$373 million	2.2%
Nevada	\$565 million	7.8%
New Hampshire	\$50 million - \$150 million	1.6 – 4.8%
New Jersey	\$2.5 – \$3.5 billion	7.6 – 10.6%
New York	\$4.4 billion	8.2%
Ohio	\$733 million - \$1.9 billion	3.6 to 9.4%
Rhode Island	\$380 million	11.2%
South Carolina	\$160 million	2.4%
Virginia	\$1.2 billion	6.9%
Wisconsin	\$300 million - \$400 million	2.2 – 2.9%
<b>TOTAL</b>	<b>\$34.2 – \$37.5 billion</b>	<b>8.0 – 8.8%</b>

- The 20 states in which revenues are expected to fall short of the amount needed to support current services in fiscal year 2009 are **Alabama, Arizona, California, Florida, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, Ohio, Rhode Island, South Carolina, Virginia, and Wisconsin**. The budget gaps total \$34.2 to \$37.5 billion, averaging 8.0 – 8.8 percent of these states' general fund budgets. (See Table 1.)
- Another four have said that they will have deficits that will need to be closed for fiscal year 2009, but have not released information on the size of those deficits. They are **Michigan, Mississippi, Oklahoma, and Vermont**. Analysts in three other states — **Connecticut, Missouri, and Texas** — are projecting budget gaps a little further down the road, in FY2010 and beyond.

This brings the total number of states identified as facing budget gaps to 27 — more than half of all states. The remaining 22 states did not foresee FY2009 budget gaps at the time of the survey either because their budgets remain strong or because they have not yet prepared updated revenue and spending projections for fiscal year 2009. The list of states facing budget gaps is likely to grow as additional state budgets are released in preparation for the upcoming legislative session.

Some mineral-rich states — such as New Mexico, Alaska, Montana and Wyoming — are seeing revenue growth as a result of high oil prices. Other states' economies have so far been less affected by the national economic problems. This does not mean, however, that *local governments* in those states will escape fiscal stress. Some states with mineral revenues or with industries less affected by the national downturn have been affected by the housing bubble and could face widespread local government deficits.

In states facing budget gaps, the consequences could be severe — for residents as well as the economy. Unlike the federal government, states cannot run deficits when the economy turns down; they must cut expenditures, raise taxes, or draw down reserve funds to balance their budgets. Even if the economy does not fall into a recession as it did in the earlier part of this decade, actions will have to be taken to close the budget gaps states are now identifying. The experience of the last recession is instructive as to what kinds of actions states may take.

- *Cuts in services like health and education.* In the last recession, some 34 states cut eligibility for public health programs, causing well over 1 million people to lose health coverage, and at least 23 states cut eligibility for child care subsidies or otherwise limited access to child care. In addition, 34 states cut real per-pupil aid to school districts for K-12 education between 2002 and 2004, resulting in higher fees for textbooks and courses, shorter school days, fewer personnel, and reduced transportation.
- *Tax increases.* Tax increases may be needed to prevent the types of service cuts described above. However, the taxes states often raise during economic downturns are regressive — that is, they fall most heavily on lower-income residents.
- *Cuts in local services or increases in local taxes.* While the property tax is usually the most stable revenue source during an economic downturn, that is not the case now. If property tax revenues decline because of the bursting of the housing bubble, localities and schools will either have to get more aid from the state — a difficult proposition when states themselves are running deficits — or reduce expenditures on schools, public safety, and other services.

Expenditure cuts and tax increases are problematic policies during an economic downturn because they reduce overall demand and can make the downturn deeper. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and nonprofit organizations that provide direct services, and cut benefit payments to individuals. In all of these circumstances, the companies and organizations that would have received government payments have less money to spend on salaries and supplies, and individuals who would have received salaries or benefits have less money for consumption. This directly removes demand from the economy. Tax increases also remove demand from the economy by reducing the amount of money people have to spend.

The federal government — which can run deficits — can provide assistance to states and localities to avert these “pro-cyclical” actions.

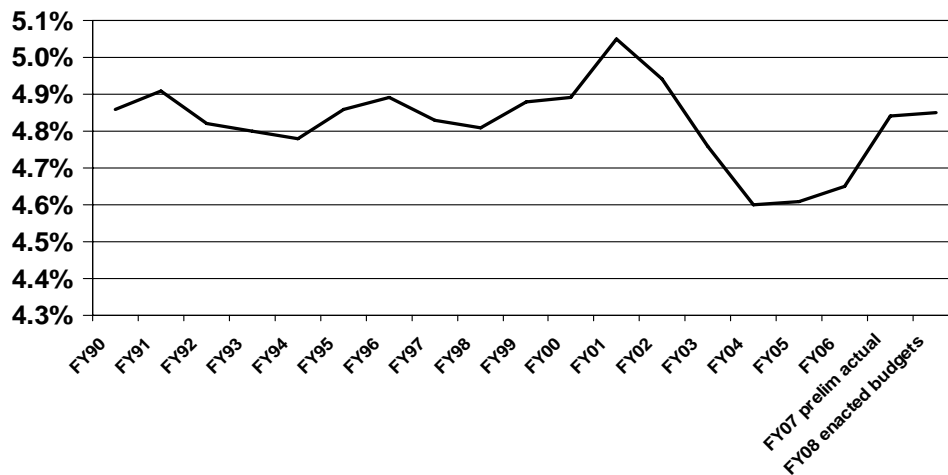
## **States Have Restrained Spending and Accumulated Rainy Day Funds**

Many states have never fully recovered from the fiscal crisis in the early part of the decade. This fact heightens the potential impact on public services of the deficits states are now projecting.

State expenditures fell sharply relative to the economy during the 2001 recession, and for all states combined they remain below the FY2001 level. (See Figure 1.) In 18 states, general fund spending for FY2008 — six years into the economic recovery — remains below pre-recession levels as a share of the gross domestic product.

FIGURE 1

## State General Fund Spending as Percent of GDP



Source: CBPP calculations of NASBO, BEA, and CBO data.

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In a number of states the reductions made during the downturn in education, higher education, health coverage, and child care remain in effect. These important public services will suffer even more if states turn to budget cuts to close the new budget gaps they now anticipate.

One way states can avoid making deep reductions in services during a recession is to build up rainy day funds and other reserves. At the end of FY2006, state reserves — general fund balances and rainy day funds — totaled 11.5 percent of annual state spending. These reserves are estimated to decline to 6.7 percent of annual spending by the end of this fiscal year. Reserves can be particularly important to help states adjust in the early months of a fiscal crisis, but generally are not sufficient to avert the need for substantial budget cuts or tax increases.

### Federal Assistance is Needed

Federal assistance can lessen the extent to which states take pro-cyclical actions that can further harm the economy. In the recession in the early part of this decade, the federal government provided \$20 billion in fiscal relief in a package enacted in 2003. There were two types of assistance to states: 1) a temporary increase in the federal share of the Medicaid program; and 2) general grants to states, based on population. Each part was for \$10 billion. The increased Medicaid match averted even deeper cuts in public health insurance than actually occurred, while the general grants helped prevent cuts in a wide variety of other critical services. The major problem with that assistance was that it was enacted many months after the beginning of the recession, so it was less effective than it could have been in preventing state actions that deepened the economic downturn. The federal government should consider aiding states earlier, rather than waiting until the downturn is nearly over.

APPENDIX		
State	Source	Notes
<b>Alabama</b>	Legislative Fiscal Office	
<b>Arizona</b>	Joint Legislative Budget Committee and Governor's proposed budget	
<b>California</b>	Governor's proposed budget	Assumes \$2 billion gap carried over from FY2008.
<b>Connecticut</b>	Office of Fiscal Analysis	
<b>Florida</b>	Florida Legislature	
<b>Illinois</b>	Voices for Illinois Children based on reports from the Comptroller and the Commission on Government Forecasting and Accountability	
<b>Iowa</b>	Summary of FY 2009 Budget, Legislative Services Agency and Revenue Estimating Conference	This is the gap between projected revenues and spending before accounting for the expenditure limitation.
<b>Kentucky</b>	State Budget Director	Revenues falling short of projections.
<b>Maine</b>	Press reports on Revenue Forecasting Committee report	
<b>Maryland</b>	Maryland Budget and Tax Policy Center	Gap will occur if \$550 million in spending cuts assumed in special session bill are not enacted in budget. About \$350 million of cuts were specified. The rest are at the discretion of the governor. (In addition, revenue estimates were lowered.)
<b>Massachusetts</b>	Executive Office of Administration and Finance	
<b>Michigan</b>	Michigan League for Human Services	
<b>Minnesota</b>	Minnesota Department of Finance	
<b>Mississippi</b>	Mississippi Economic Policy Center	
<b>Missouri</b>	Missouri Budget Project	
<b>Nevada</b>	Governor's office	
<b>New Hampshire</b>	Press reports of Governor's speech	
<b>New Jersey</b>	Governor's state of the state address and press reports	
<b>New York</b>	Division of Budget, press reports on governor's upcoming budget	
<b>Oklahoma</b>	Community Action Project	
<b>Ohio</b>	Press reports on report issued by governor's office	
<b>Rhode Island</b>	Office of the Senate Fiscal Advisor of the Rhode Island Senate	
<b>South Carolina</b>	Revenue Forecasting Council, budget hearing	
<b>Texas</b>	Center for Public Policy Priorities	
<b>Vermont</b>	Public Assets Institute	
<b>Virginia</b>	Commonwealth Institute	
<b>Wisconsin</b>	Legislative Fiscal Bureau	