Awash in Red Ink: Fiscal Crisis Sweeping the States

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Five Main Parts

I. Current Predicament

II. Fundamental Reasons for the Crisis

III. What the Current Conditions Mean for States

IV. What Measures States Have Taken

V. State Economic Development Prospects in the Near Term
Federal Budget Deficits Loom in Upcoming Federal Fiscal Years (FFY)
1992 = $-290.4 Billion
1996 = $-107.5 Billion
1998 = $69.2 Billion
1999 = $125.5 Billion
2000 = $125.5 Billion
2001 = $127.1 Billion
2002 = $-159 Billion
2003 = $-304 Billion
2004 = $-307 Billion

In January 2001, CBO predicted a federal budget surplus of $5.6 trillion between 2002 and 2011; in March 2003, CBO announces about $2.7 trillion in deficits in next decade

In February 2003, the Administration announced cumulative deficits totaling $1.1 trillion over the next four years
At least 46 states struggled to close a cumulative budget gap of $37 billion in last fiscal year (FY 2002).

While enacting their FY 2003, states grappled with budget gaps totaling $50 billion; an additional $26 billion in deficits opened up between November 2002 and January 2003.

For FY 2004, the estimated shortfall is a staggering $60 billion to $85 billion, some 13 to 18 percent of all state expenditures.

Highlights from outside the region:
- California faces an almost unmanageable $35 billion shortfall in the next 18 months.
- New York City alone faces a budget gap of $7.5 billion in the next 18 months.
I. Current Predicament (cont):

Some Examples

- Virginia - $2 billion in current year and next
- Texas - $10 billion in next biennium
- Colorado - $850 million in current year
- Oklahoma - $514 million in current year
- Maryland - $1.9 billion in current year and next
- Georgia - $620 million in current year
- Kansas - $1.1 billion in current year and next
- North Carolina - $2 billion next year
- Missouri - $1.5 billion in current year and next
- Nebraska - $175 million in current year and $675 million in next biennium
### I. Current Predicament (cont):
#### Estimate of 2004 Deficits

<table>
<thead>
<tr>
<th>State</th>
<th>Deficit (Millions)</th>
<th>% of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO</td>
<td>$900</td>
<td>13.4%</td>
</tr>
<tr>
<td>FL</td>
<td>$2,000</td>
<td>10.1%</td>
</tr>
<tr>
<td>GA</td>
<td>$900</td>
<td>5.8%</td>
</tr>
<tr>
<td>KS</td>
<td>$700-$750</td>
<td>15.7%</td>
</tr>
<tr>
<td>MD</td>
<td>$1,200</td>
<td>11.0%</td>
</tr>
<tr>
<td>MO</td>
<td>$1,000</td>
<td>13.1%</td>
</tr>
<tr>
<td>NC</td>
<td>$1,700-$2,000</td>
<td>12.4% - 14.6%</td>
</tr>
<tr>
<td>OK</td>
<td>$800</td>
<td>15.9%</td>
</tr>
<tr>
<td>VA</td>
<td>$1,116</td>
<td>9.3%</td>
</tr>
</tbody>
</table>

Source: Center on Budget and Policy Priorities
II. Fundamental Reasons:

1. Negative Pressures Generated by Downturn in the Economy
   a. Dwindling Revenue Flows
   b. Rising Unemployment Numbers
   c. Exploding Medicaid Costs

2. Structural Problems Associated with State Tax Systems
   a. State economies now service-driven whereas when tax systems were created state economies revolved around the retail and manufacturing sectors
   b. Steady increase in sales tax-free Internet purchases
   c. Decline in corporate tax revenues
According to The Federation of Tax Administrators, there are 164 different services taxed across the country.

Three States (HI, NM, and SD) tax more than 140 of these services.

14 States (including AR, FL, KS, MS, NY, TN, TX) tax more than 60 of these services.

The remaining 29 states tax fewer than 60 services, with over half of these states taxing fewer than 30 services.
## II. Fundamental Reasons

### Structural Problems (cont):

**Taxing Services**

<table>
<thead>
<tr>
<th>State</th>
<th>Number of Services Taxed</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO</td>
<td>14 (includes Utilities)</td>
</tr>
<tr>
<td>FL</td>
<td>64 (includes Repair, Installations, Admissions)</td>
</tr>
<tr>
<td>GA</td>
<td>34 (includes Utilities, Admissions)</td>
</tr>
<tr>
<td>KS</td>
<td>76 (includes Repair, Installation, Admissions)</td>
</tr>
<tr>
<td>MD</td>
<td>39 (includes Business Services, Admissions)</td>
</tr>
<tr>
<td>MO</td>
<td>28 (includes Admissions, Utilities)</td>
</tr>
<tr>
<td>NE</td>
<td>49 (includes Utilities, Admissions)</td>
</tr>
<tr>
<td>NC</td>
<td>28 (includes Utilities, Admissions)</td>
</tr>
<tr>
<td>OK</td>
<td>32 (includes Admissions, Utilities)</td>
</tr>
<tr>
<td>VA</td>
<td>18 (includes Business Services)</td>
</tr>
</tbody>
</table>
## II. Fundamental Reasons

### Structural Problems (cont):

Revenue Losses in $ Millions

<table>
<thead>
<tr>
<th>State</th>
<th>2001</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO</td>
<td>$225.5</td>
<td>$654.6</td>
<td>$982.7</td>
</tr>
<tr>
<td>FL</td>
<td>$1,224.8</td>
<td>$3,320.0</td>
<td>$4,993.5</td>
</tr>
<tr>
<td>GA</td>
<td>$547.8</td>
<td>$1,535.9</td>
<td>$2,324.7</td>
</tr>
<tr>
<td>KS</td>
<td>$157.2</td>
<td>$429.3</td>
<td>$626.5</td>
</tr>
<tr>
<td>MD</td>
<td>$261.8</td>
<td>$688.2</td>
<td>$1,021.0</td>
</tr>
<tr>
<td>MO</td>
<td>$312.9</td>
<td>$855.6</td>
<td>$1,257.6</td>
</tr>
<tr>
<td>NC</td>
<td>$367.4</td>
<td>$1,021.4</td>
<td>$1,539.7</td>
</tr>
<tr>
<td>NE</td>
<td>$79.8</td>
<td>$223.9</td>
<td>$328.9</td>
</tr>
<tr>
<td>OK</td>
<td>$220.9</td>
<td>$606.5</td>
<td>$867.6</td>
</tr>
<tr>
<td>VA</td>
<td>$315.8</td>
<td>$842.9</td>
<td>$1,256.8</td>
</tr>
</tbody>
</table>

Source: Bruce & Fox, University of Tennessee, September 2001
According to the Rockefeller Institute, corporate tax revenues have declined from 8% of total state tax revenues in the early 1990s to less than 4% recently.

More exemptions, incentives and tax breaks granted to corporations by states.

Corporations becoming more astute in minimizing their tax burdens.

In FY 2003, there was a net increase of $1 billion in corporate taxes from nine states; $900 million of this amount came from NJ.
III. What the Current Conditions Mean (cont): Anemic Revenue Flows

- CO – Revenue estimates for FY 03 reduced by $113.4 million
- FL – As of January 2003, FY 2003 Y-T-D revenue collections $88.4 million over Nov. 2002 revised estimates
- GA – As of February 2003, FY 2003 Y-T-D revenue collections 3.4% below same period last year
- KS – To date, FY 2003 collections $50 million behind estimates
- MD – First 7 months of FY 2003 revenues vs. estimate down: corporate (-5%); income (-1%); sales (-1%)
- MO – As of February 2003, FY 2003 revenue collections down by 4% over same period last year
- NE – Total gross General Fund receipts 8.5% below the revised estimates for the month in January 2003
- NC – As of January 2003, FY 2003 Y-T-D revenue collections 7.1% more compared to same period last year
- OK – In January 2003, revenue collections 9.1% below same period last year and 17.3% below estimates
- VA – As of January 2003, FY 2003 Y-T-D revenue collections 2.2% more compared to same period last year
III. What the Current Conditions Mean (cont): Rising Unemployment Rates

<table>
<thead>
<tr>
<th>State</th>
<th>Dec. 2002</th>
<th>Historical Low</th>
<th>Date</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO</td>
<td>5.5%</td>
<td></td>
<td>Jan. 2001</td>
<td>2.7%</td>
</tr>
<tr>
<td>FL</td>
<td>5.3%</td>
<td></td>
<td>July 2000</td>
<td>3.5%</td>
</tr>
<tr>
<td>GA</td>
<td>4.8%</td>
<td></td>
<td>Dec. 2000</td>
<td>3.6%</td>
</tr>
<tr>
<td>KS</td>
<td>4.6%</td>
<td></td>
<td>June 1978</td>
<td>2.7%</td>
</tr>
<tr>
<td>MD</td>
<td>4.1%</td>
<td></td>
<td>Sep. 1999</td>
<td>3.4%</td>
</tr>
<tr>
<td>MO</td>
<td>4.9%</td>
<td></td>
<td>Jan. 2000</td>
<td>2.9%</td>
</tr>
<tr>
<td>NE</td>
<td>3.4%</td>
<td></td>
<td>June 1990</td>
<td>2.1%</td>
</tr>
<tr>
<td>NM</td>
<td>5.9%</td>
<td></td>
<td>Jan. 2001</td>
<td>4.5%</td>
</tr>
<tr>
<td>NC</td>
<td>6.4%</td>
<td></td>
<td>June 1999</td>
<td>3.0%</td>
</tr>
<tr>
<td>OK</td>
<td>4.7%</td>
<td></td>
<td>Jan. 2001</td>
<td>2.9%</td>
</tr>
<tr>
<td>VA</td>
<td>3.9%</td>
<td></td>
<td>Apr. 2000</td>
<td>2.1%</td>
</tr>
<tr>
<td>WY</td>
<td>4.4%</td>
<td></td>
<td>Apr. 1979</td>
<td>2.2%</td>
</tr>
</tbody>
</table>
III. What the Current Conditions Mean (cont): Exploding Medicaid Costs

- Average annual growth rates of Medicaid spending has been rising
- The almost 13% increase in 2002 is the highest in a decade
- After dropping from the high of 27% in the early 1990s to 3.2% in the mid 1990s, the rates are rising again
According to a January 2003 Kaiser Commission report, states now expect Medicaid spending to increase by 9% in FY 2003, higher than the 4.8% growth rate anticipated by states in formulating FY 2003 Medicaid budgets.

Major reasons cited by states for exploding Medicaid budgets: Prescription Drugs and Increased Enrollment.

Cost Containment Strategies In Use in Jan. 2003:
- Provider Rate Reductions or Freezes (37 states)
- Prescription Drug Actions (45 states)
- Benefit Limits or Eliminations (25 states)
- Eligibility Cuts and Reductions (27 states)
- Beneficiary Co-payments (17 states)
- Long Term Care Reduction Strategies (19 states)
IV. Measures Adopted by States to Deal with Budget Shortfalls

- Slash Spending
- Tap Rainy Day Funds
- Deploy Tobacco Settlement Monies
- Raise Taxes
- Hike Cigarette Taxes
- Cut Funds to Local Governments
- Rack-up Debt
- Generate Funds via Gaming
IV. What Measures State have Taken to Deal with Shortfalls: Slash Spending

- VA cuts $858 million in spending last fall with agency budgets reduced by 11%-15% with another $400 million in cuts in January 2003
- OK makes across-the-board cuts totaling 9%
- GA agency budgets reduced by 5%
- MD considering a number of measures including cutting all employee pay by 1 percent, withholding aid to local governments, scaling back scholarships, raising income taxes on the wealthy and hiking the state’s sales tax and property tax rates
- TX proposes across-the-board cuts of 9%
- MO laid-off almost 900 workers and is looking at further layoffs
- CO enacts across-the-board tax cuts totaling 10%
- TN seeks to cut all agency spending by 8%
In FY 2002, 19 states around the country tapped into their rainy day funds to close out their budget gaps. It is estimated that in FY 2003, 10 states would resort to this strategy. In FY 2002, Oklahoma, utilized $268 million from its rainy day fund; in the past five years, OK has used $571 million. Last month, Gov. Henry tapped the fund again leaving it with only $74 million. North Carolina drew down its rainy day fund from $522 million in FY 1999 to $125 million in FY 2002. In Louisiana, Gov. Foster secured $86 million of the $263 million currently in rainy day fund. Maryland uses $190 million in its rainy day fund last fall. In TN, the Governor just announced that the $178 million left in the state’s rainy day fund will disappear by June 2003.
IV. What Measures State have Taken to Deal with Shortfalls: Deploy Tobacco Settlement Monies

- In FY 2002, 12 states used the proceeds of securitizing their tobacco settlement monies to address mounting budget gaps
- In FY 2003, it is estimated that 7 states would do so
- Missouri tapped $139 million of its funds to offset its shortfall and hopes to use another $350-$400 million
- Alabama secured $30 million of its funds for Medicaid
- Tennessee used $368 million of its funds to close the shortfall in fiscal year 2002. In addition, the legislature decided to count $160 million to be received every year under the agreement for the next 20 years as “recurring revenue” in its budget deliberations
AL increased business taxes by $58 million by taxing long-distance telephone calls

Sales taxes went up in TN and NC. In certain counties in TN, the sales tax is 9.75%, among the highest in the country. In NC, the sales tax could be as high as 7%

AR’s governor, after re-election, proposed raising state’s sales tax and generating $474 million in new revenue

MO, MD, FL and AR reviewing a number of corporate exemptions to bring in additional revenue

AR Senate considering a list of 33 tax increases

Personal income taxes went up in OK because of an automatic trigger. Gov. Henry has also proposed 10 different fee increases to bring in $154 million to balance OK’s FY 04 budget
IV. What Measures State have Taken to Deal with Shortfalls: Hike Cigarette Taxes

- 21 states implemented higher cigarette taxes in 2002
- 26 states have not increased their cigarette taxes for at least five years
- Some of the states that increased their cigarette taxes in 2002 include Arkansas (34 cents), Kansas (79 cents), Louisiana (36 cents), Maryland (100 cents), Nebraska (64 cents) and Tennessee (20 cents)
- WV Gov. Wise’s proposal to increase his state’s cigarette tax to 55 cents per pack and use all the revenue to bail out the state’s Medicaid program about to be approved by the Legislature
- Proposals in GA, KY, SC and TX to raise the cigarette tax and secure additional revenue
IV. What Measures State have Taken to Deal with Shortfalls: Cut Funds to Local Governments

- TN proposes to keep more than $100 million in funds that the state shares with counties and cities
- TX proposes to cut back on a number of expenditures the state shares with local entities and save $600 million
- MD’s two biggest counties are bracing for cuts in state funds
- In FY 03 and 04, Kansas to withhold $134 million to be sent to cities and counties
According to early reports, state borrowing has risen to its highest level in 50 years.

State and local governments borrowed $127 billion in 2002 (9.7% of revenue), almost three-and-a-half times the level of 1999.

Enhanced borrowing levels increases the cost of government with rise in debt servicing costs though the low interest rates encouraged states to borrow.
IV. What Measures State have Taken to Deal with Shortfalls: Generate Funds via Gaming

- In Nov. 2002, TN became the latest state to move closer towards establishing a state lottery to pay for education
- FL mulling over new video lottery terminals at parimutuel facilities to bring in up to $1 billion annually
- Governor in MD campaigned on slots at the racetracks and has proposed 13,500 slot machines to bring in a potential $600 million in new revenue
- KY reviewing a proposal from the racing industry that would guarantee the state $400 million up front (and $200 million each additional year) if slot machines were allowed at the race tracks
- NC, AR and OK are all considering proposals to introduce a lottery to fund education
- NE considering a constitutional amendment to allow casinos
V. State Economic Development
Propects in the Near Term:
National Trends

- Both the federal and state governments will face significant budgetary problems in the next few years.
- The economic, geopolitical and legislative uncertainties surrounding the economy remain significant.
- Yet, there are several positive features of the current economy which should not be disregarded.
  1. Inflationary pressures are minimal
  2. The economy is still expanding
  3. Record-low interest rates, lowest in some 40 years
  4. American productivity gains continue to be very impressive
American productivity has continued to post impressive gains recently growing by 4.7% in 2002, the best performance since 1950.

Low mortgage rates have sustained the explosive growth pattern of the housing market as more and more Americans purchase their first homes and re-finance their existing mortgages.
V. State Economic Development Prospects in the Near Term: Some State Projects

- TX announces a $800 million Toyota plant near San Antonio
- NE introduces a cluster-approach towards attracting various high-tech industries
- MO proposes lowering the state’s corporate tax
- NC seeks to borrow $700 million to boost several capital infrastructure projects
- CO authorizes spending $10 million on tourism promotion
- AR signs new legislation offering breaks for R & D efforts and incentives to attract high-tech companies
Thank You

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