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STATE BUDGET TROUBLES WORSEN

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States are facing a great fiscal crisis. At least 47 states faced or are facing shortfalls in their budgets for this and/or next year, and severe fiscal problems are highly likely to continue into the following year as well. Combined budget gaps for the remainder of this fiscal year and state fiscal years 2010 and 2011 are estimated to total more than $350 billion.

States are currently at the mid-point of fiscal year 2009 — which started July 1 in most states — and are in the process of preparing their budgets for the next year. Over half the states had already cut spending, used reserves, or raised revenues in order to adopt a balanced budget for the current fiscal year — which started July 1 in most states. Now, their budgets have fallen out of balance again. New gaps of $53 billion (over 8% of state budgets) have opened up in the budgets of at least 42 states plus the District of Columbia. These budget gaps are in addition to the $48 billion shortfalls that these and other states faced as they adopted their budgets for the current fiscal year, bringing total gaps for the year to 15 percent of budgets.

The states' fiscal problems are continuing into the next two years. At least 44 states have looked ahead and anticipate deficits for fiscal year 2010 and beyond. These gaps total almost $105 billion — 17 percent of budgets — for the 38 states that have estimated the size of these gaps and are likely to grow as gaps are re-estimated in the next few months.

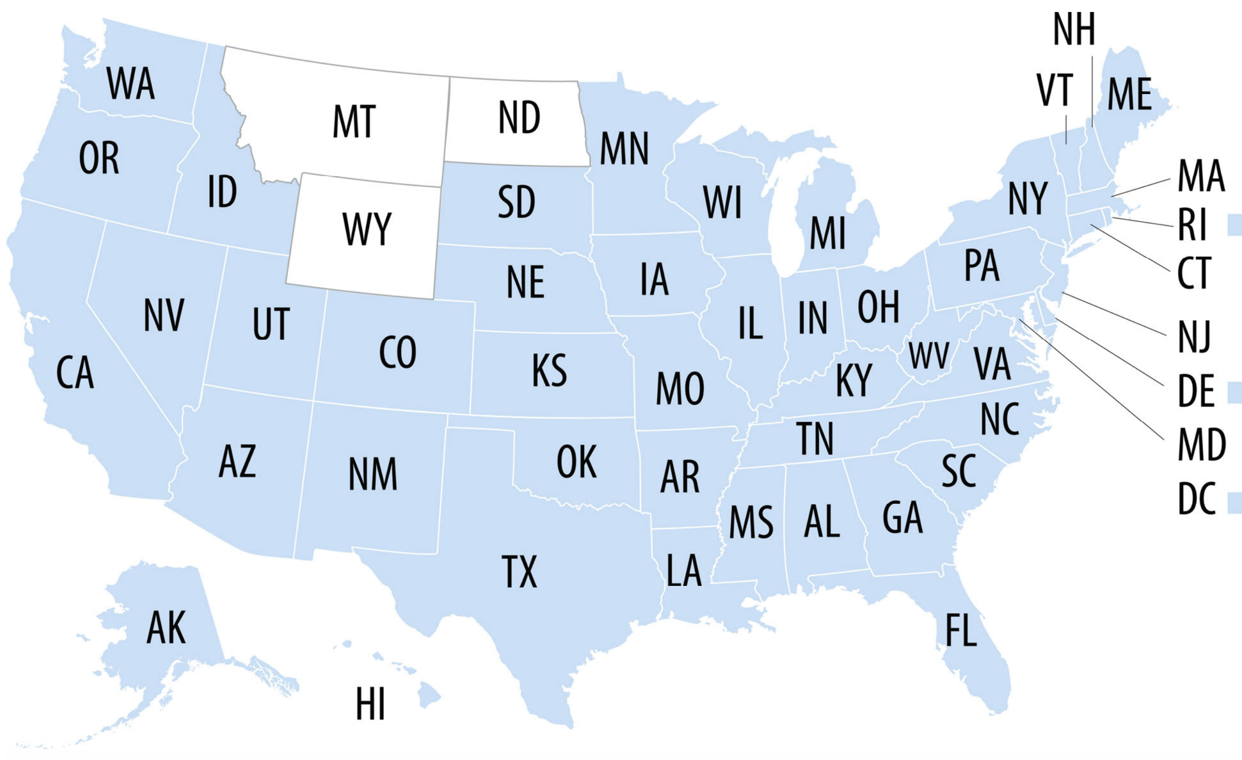
The deficit figures for FY2010 and FY2009 show the impact the economic downturn has had on state budgets. These figures are the total size of the shortfall identified by each state listed. In some cases all or part of this shortfall has already been closed through a combination of spending cuts, withdrawals from reserves, revenue increases or use of federal stimulus dollars.

STATE FISCAL STRESS DEEPENS

- Some 47 states are facing fiscal stress in their FY2009 and/or FY2010 budgets.
- New mid-year fiscal year 2009 shortfalls of $53 billion have opened up in the budgets of at least 42 states and the District of Columbia.
- Budget deficits are already projected in 44 states for the upcoming fiscal year. Initial estimates of these shortfalls total almost $105 billion. As the full extent of 2010 deficits become known, shortfalls are likely to equal $145 billion.
- Combined budget gaps for the remainder of this fiscal year and state fiscal years 2010 and 2011 are estimated to total $350 billion to $370 billion.

FIGURE 1:

47 States Face Budget Shortfalls



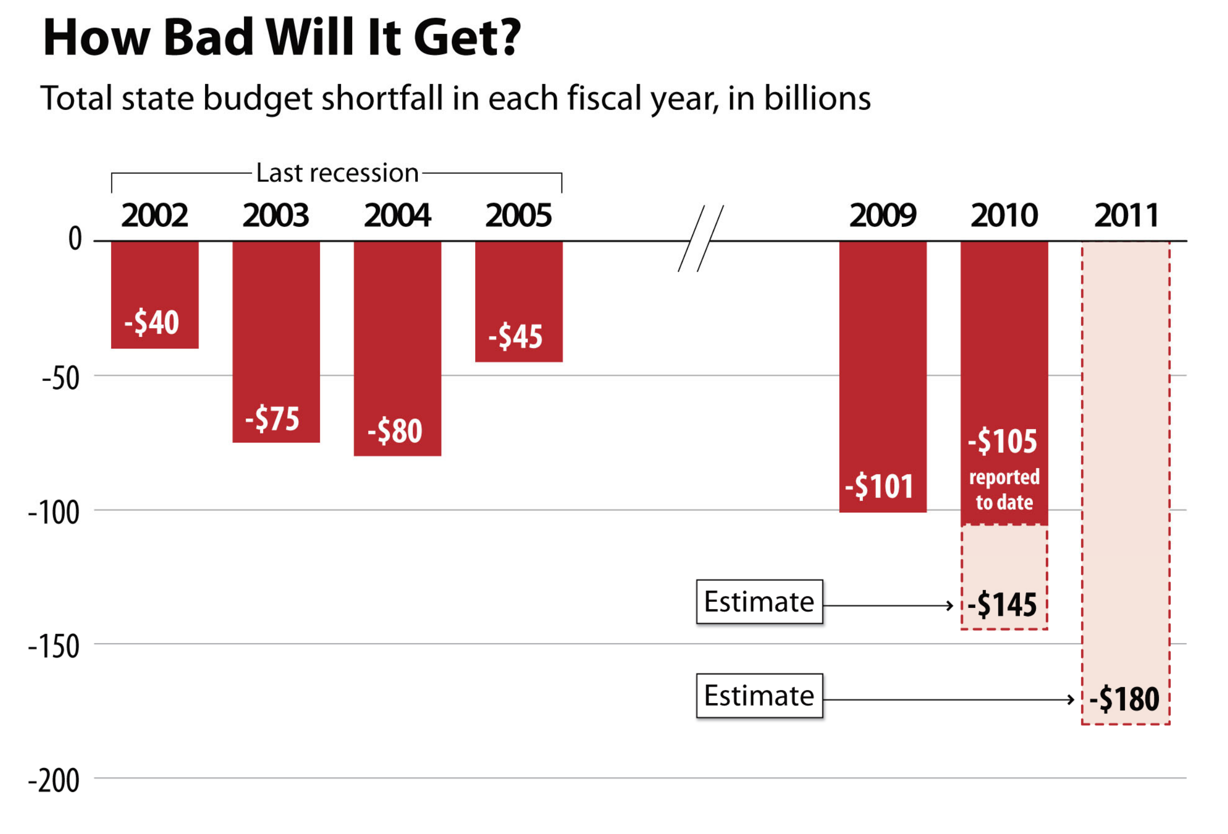
Note: Includes states with shortfalls in fiscal 2009 or projected shortfalls for fiscal 2010.

Figure 2 shows the size and duration of the deficits in the recession that occurred in the first part of this decade, and estimates of the likely deficits this time. This recession is more severe — deeper and longer — than the last recession, and thus state fiscal problems are likely to be worse. Unemployment, which peaked after the last recession at 6.3 percent, has already hit 8.1 percent, and many economists expect it to rise to 9 percent or higher, which will reduce state income taxes and increase demand for Medicaid and other services. With consumers' reduced access to home equity loans and other sources of credit, sales taxes are also likely to fall more steeply than they did in the last recession. These factors suggest that state budget gaps will be significantly larger than in the last recession. Based on past experience and the depth of this recession, it appears likely that all but a handful of states will face shortfalls in fiscal year 2010 and these deficits will end up totaling about $145 billion. If, as is widely expected, the economy does not begin to significantly recover until the end of calendar year 2009, state deficits are likely to be even larger in state fiscal year 2011 (which begins in July 2010 in most states).[1] The deficits over the next two-and-a half years are likely to be in the $350 billion to $370 billion range.[2]

[1] The projected budget shortfalls do not account for the effects of major economic recovery legislation. The fiscal aid states will receive will reduce these shortfalls. In addition if economic growth is significantly better than projected next year as a result of stimulus efforts, state revenue collections would likely be higher than projected — although it is difficult to know when that effect would first be felt.

[2] The deficits over the next two-and-a-half years are likely to be in the $350 billion to $370 billion range.

FIGURE 2:
How Bad Will It Get?



It may be particularly difficult for states to recover from the current fiscal situation. Housing markets may be slow to fully recover; the decline in housing markets has already depressed consumption and sales taxes as people refrain from buying furniture, appliances, construction materials, and the like. Property tax revenues are also affected, and local governments will be looking to states to help address the squeeze on local and education budgets. And as the employment situation continues to deteriorate, income tax revenues will weaken further and there will be further downward pressure on sales tax revenues as consumers are reluctant or unable to spend.

The vast majority of states cannot 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.

TABLE 1: STATES WITH MID-YEAR FY2009 BUDGET GAPS		
	Size of Gap	Percent of FY2009 General Fund
Alabama	$1.1 billion	12.7%
Alaska	$360 million	6.8%
Arizona	$1.6 billion	15.9%
California	$13.7 billion	13.6%
Colorado	$604 million	7.7%
Connecticut	$1.7 billion	10.1%
District of Columbia	$393 million	6.3%
Delaware	$226 million	6.2%
Florida	$2.3 billion	9.0%
Georgia	$2.2 billion	10.3%
Hawaii	$232 million	4.0%
Idaho	$218 million	7.4%
Illinois	$4.3 billion	15.1%
Indiana	$1.1 billion	8.0%
Iowa	$134 million	2.1%
Kansas	$186 million	2.9%
Kentucky	$456 million	4.9%
Louisiana	$341 million	3.7%
Maine	$140 million	4.6%
Maryland	$691 million	4.6%
Massachusetts	$2.4 billion	8.4%
Michigan	$200 million	0.9%
Minnesota	$654 million	3.8%
Mississippi	$175 million	3.4%
Missouri	$342 million	3.8%
Nevada	$536 million	7.3%
New Hampshire	$50 million	1.6%
New Jersey	$3.6 billion	11.1%
New Mexico	$454 million	7.5%
New York	$1.7 billion	3.0%
North Carolina	$2.0 billion	9.3%
Ohio	$1.2 billion	4.2%
Oregon	$442 million	6.6%
Pennsylvania	$2.3 billion	8.1%
Rhode Island	$372 million	11.4%
South Carolina	$871 million	12.7%
South Dakota	$27 million	2.2%
Tennessee	$884 million	7.8%
Utah	$620 million	10.4%
Vermont	$82 million	6.7%
Virginia	$1.1 billion	6.7%
Washington	$509 million	3.4%
Wisconsin	$594 million	4.2%
TOTAL	**$53.0 billion**	**8.2%**

Note: In some cases all or part of these shortfalls have already been addressed.

TABLE 2: STATES WITH PROJECTED FY2010 BUDGET GAPS		
	Size of Gap	Percent of FY2009 General Fund
Alabama	DK	
Arizona	$3.0 billion	29.8%
Arkansas	$146 million	3.2%
California	$25.9 billion	25.6%
Colorado	$386 million	4.9%
Connecticut	$4.0 billion	23.1%
Delaware	$557 million	15.3%
District of Columbia	$650 million	10.4%
Florida	$5.8 billion	22.6%
Georgia	$3.1 billion	14.5%
Hawaii	$682 million	11.9%
Idaho	$411 million	13.9%
Illinois	$4.7 billion	16.4%
Iowa	$779 million	12.2%
Kansas	$1.1 billion	16.7%
Kentucky	DK	
Louisiana	$2.0 billion	21.7%
Maine	$177 million	5.8%
Maryland	$1.9 billion	12.5%
Massachusetts	$3.1 billion	11.0%
Michigan	$1.6 billion	6.9%
Minnesota	$3.2 billion	18.3%
Mississippi	$87 million	1.7%
Missouri	DK	
Nebraska	$152 million	4.3%
Nevada	$1.1 billion	30.0%
New Jersey	$7.0 billion	21.6%
New Mexico	DK	
New York	$13.7 billion	24.3%
North Carolina	$3.3 billion	15.3%
Ohio	$2.0 billion	7.1%
Oklahoma	$600 million	9.2%
Oregon	DK	
Pennsylvania	DK	
Rhode Island	$450 million	13.7%
South Carolina	$725 million	10.5%
South Dakota	$32 million	2.7%
Tennessee	$712 million	6.3%
Texas	$3.5 billion	7.6%
Utah	$721 million	12.1%
Vermont	$253 million	20.8%
Virginia	$1.8 billion	10.4%
Washington	$2.8 billion	18.2%
West Virginia	$80 million	2.1%
Wisconsin	$2.6 billion	18.4%
TOTAL	**$104.5 billion**	**16.7%**

Notes: An entry of “DK” in Size of Gap means that an estimate of the size of the projected gap in that state is not yet available.
In some cases all or part of these shortfalls have already been addressed.

Major State Fiscal Organizations Find State Fiscal Crisis of Historic Proportions That Will Last for a Number of Years

The three main organizations that track state fiscal conditions — the National Conference of State Legislatures, the National Association of State Budget Officers and the Center on Budget and Policy Priorities — have found large and growing shortfalls in the vast majority of states. There may be some confusion, however, about the ways in which these deficit estimates differ and whether they are in conflict. The Center has projected that states will face deficits of some $350 billion over the next 30 months, which appears to be very different than the $90 billion to $100 billion deficits being discussed by NCSL and NASBO. The differences, however, can be simply explained by two factors:

- **The freshness of the data**. The Center's estimate reflects the most current data on deficits that each state has released. Two frequently-cited NCSL and NASBO reports reflect data collected in November 2008. The economy has deteriorated substantially since November, and states have revised their revenue estimates downward since then. Estimates of current deficits in an updated survey released by NCSL at the end of January are essentially the same as the Center's January estimates.

- **Projections into FY 2011**. The Center's estimate includes shortfalls that have already been announced *plus* a projection of the additional deficits states will experience through fiscal year 2011; this projection is based on the relationship of revenues to economic conditions. The NCSL and NASBO are reporting solely on deficits states have announced so far for mid-year fiscal year 2009 and for fiscal year 2010. NCSL and NASBO are not attempting to estimate the totality of states' deficits over the course of the expected fiscal crisis, although analysts at both organizations acknowledge that the fiscal crisis is likely to last for several years.

Despite the different timing and scope of the estimates, the three organizations are finding the same thing. Each of these surveys clearly indicates that states are facing a fiscal crisis of historic proportions that will continue for number of years.

Some states have not been affected by the economic downturn but the number is dwindling. There are a number of reasons why. Some mineral-rich states — such as New Mexico, Alaska, and Montana — saw revenue growth as a result of high oil prices. However, the recent decline in oil prices has begun to affect revenues in some of these states. The economies of a handful of other states have so far been less affected by the national economic problems.

In states facing budget gaps, the consequences sometimes are 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. As the current fiscal year ends and states plan for next year, budget difficulties have led some 34 states to reduce services to their residents, including some of their most vulnerable families and individuals.[3]

For example, at least 18 states have implemented cuts that will affect low-income children's or families' eligibility for health insurance or reduce their access to health care services. Programs for the elderly and disabled are also being cut. At least 18 states and the District of Columbia are

[3] For more detailed information see Facing Deficits, Many States are Imposing Cuts that Hurt Vulnerable Residents http://www.cbpp.org/3-13-08sfp.htm.

cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities, or significantly increasing the cost of these services.

At least 21 states are cutting or proposing to cut K-12 and early education; several of them are also reducing access to child care and early education, and at least 28 states have implemented cuts to public colleges and universities.

In addition, at least 37 states and the District of Columbia have made cuts affecting their state workforce. Workforce cuts often result in reduced access to services residents need. They also add to states' woes by contracting the state economy.

If revenue declines persist as expected in many states, additional budget cuts are likely. Budget cuts often are more severe in the second year of a state fiscal crisis, after reserves have been largely depleted and thus are no longer an option for closing deficits. The experience of the last recession is instructive as to what kinds of actions states may take. Between 2002 and 2004 states reduced services significantly. For example, 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.

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. In 18 states, general fund spending for FY2008 — six years into the economic recovery — remained below pre-recession levels as a share of the gross domestic product.

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 were suffering even as states turned to budget cuts to close the new budget gaps. Spending as a share of the economy declined in FY2008 and is projected to decline further in FY2009.

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. 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. In this recession, states have already drawn down much of their available reserves; the available reserves in states with deficits are likely to be depleted in the near future.

Federal Assistance Needed

Federal assistance can lessen the extent to which states take pro-cyclical actions that can further harm the economy. The American Recovery and Reinvestment Act recognizes this fact and includes substantial assistance for states. The amount of funding that will go to states to help them maintain current activities is approximately $135 billion to $140 billion — or about 40 percent of projected state deficits. Most of this money is in the form of increased Medicaid funding and a “Fiscal Stabilization Fund.” This funding will reduce the depth of state budget cuts and moderate state tax and fee increases. There are also other streams of funding in the economic recovery bill that will flow through states to local governments or individuals, but those funds will not address state budget shortfalls.

TABLE 3: SIZE OF TOTAL FY2009 BUDGET GAPS				
	Gap before budget was adopted	Additional mid-year gap	Total	Total Gap as Percent of FY2009 General Fund
Alabama	$784 million	$1.1 billion	$1.8 billion	22.2%
Alaska		$360 million	$360 million	6.8%
Arizona[1]	$1.9 billion	$1.6 billion	$3.5 billion	34.8%
Arkansas	$107 million		$107 million	2.4%
California	$22.2 billion	$13.7 billion	$35.9 billion	35.5%
Colorado		$604 million	$604 million	7.7%
Connecticut	$150 million	$1.7 billion	$1.9 billion	11.0%
Delaware	$217 million	$226 million	$443 million	12.2%
District of Columbia	$96 million	$393 million	$489 million	7.8%
Florida	$3.4 billion	$2.3 billion	$5.7 billion	22.2%
Georgia[1]	$245 million	$2.2 billion	$2.4 billion	11.5%
Hawaii		$232 million	$232 million	4.0%
Idaho		$217 million	$217 million	7.4%
Illinois	$1.8 billion	$4.3 billion	$6.1 billion	21.4%
Indiana		$1.1 billion	$1.1 billion	8.0%
Iowa	$350 million	$134 million	$484 million	7.6%
Kansas		$185 million	$185 million	2.9%
Kentucky	$266 million	$456 million	$722 million	7.8%
Louisiana		$341 million	$341 million	3.7%
Maine	$124 million	$140 million	$265 million	8.6%
Maryland	$808 million	$691 million	$1.5 billion	10.0%
Massachusetts	$1.2 billion	$2.4 billion	$3.6 billion	12.7%
Michigan	$472 million	$200 million	$672 million	2.9%
Minnesota	$935 million	$654 million	$ 1.6 billion	9.2%
Mississippi[1]	$90 million	$175 million	$265 million	5.2%
Missouri		$342 million	$342 million	3.8%
Nevada	$898 million	$536 million	$1.4 billion	19.6%
New Hampshire	$200 million	$50 million	$250 million	8.0%
New Jersey[1]	$2.5 billion	$3.6 billion	$6.1 billion	18.8%
New Mexico		$454 million	$454 million	7.5%
New York	$4.9 billion	$1.7 billion	$6.6 billion	11.7%
North Carolina		$2.0 billion	$2.0 billion	9.3%
Ohio[1]	$733 million	$1.2 billion	$1.9 billion	6.8%
Oklahoma	$114 million		$114 million	1.7%
Oregon		$442 million	$442 million	6.6%
Pennsylvania		$2.3 billion	$2.3 billion	8.1%
Rhode Island	$430 million	$372 million	$802 million	24.5%
South Carolina	$250 million	$871 million	$1.1 billion	16.3%
South Dakota		$27 million	$27 million	2.2%
Tennessee[1]	$468 million	$884 million	$1.4 billion	12.0%
Utah		$620 million	$620 million	10.4%
Vermont	$59 million	$82 million	$141 million	11.6%
Virginia	$1.2 billion	$1.1 billion	$2.3 billion	13.8%
Washington		$509 million	$509 million	3.4%
Wisconsin	$652 million	$594 million	$1.2 billion	8.8%
TOTAL	$47.6 billion	$53.0 billion	$100.6 billion	15.2%

[1]Only the low end of the estimated FY09 gap for these states — ones that provided a range of estimates — is shown in this table. For more detail see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.

Note: In some cases all or part of these shortfalls have already been addressed.

TABLE 4 – SOURCE OF MID-YEAR FY2009 & FY2010 GAP ESTIMATES	
State	Source
Alabama	Legislative Fiscal Office
Alaska	Legislative Finance Division Overview of proposed budget
Arizona	Joint Legislative Budget Committee and Financial Advisory Committee
Arkansas	Governor's proposed budget
California	Governor's proposed budget
Colorado	Legislative Council
Connecticut	Office of Fiscal Analysis
Delaware	Governor's proposed budget
District of Columbia	Chief Financial Officer
Florida	Revised revenue projections
Georgia	Governor's proposed budget and revised revenue projections
Hawaii	Council on Revenue forecast
Idaho	Governor's proposed budget
Illinois	Voices for Illinois Children analysis of State Comptroller data
Indiana	Budget Director
Iowa	Fiscal Services Division
Kansas	Legislative Research Department
Kentucky	State budget director
Louisiana	Revenue Estimating Conference /Commissioner of Administration
Maine	Revenue Forecasting Committee
Maryland	Legislature's projection
Massachusetts	Massachusetts Budget and Policy Center
Michigan	Consensus Revenue Forecast
Minnesota	Management and Budget forecast
Missouri	Governor-elect's office
Mississippi	Governor's proposed budget
Nebraska	Tax Rate Review Committee
Nevada	Board of Examiners
New Hampshire	Budget Director
New Jersey	Governor's budget address
New Mexico	Revised revenue projections
New York	Division of Budget
North Carolina	North Carolina Budget and Tax Center
Ohio	Office of Budget and Management
Oklahoma	Press reports of State Tax Commission projections
Oregon	November revenue re-estimate shortfall plus $300 million based on State Economist's estimate of additional revenue shortfall of $300 million to $600 million
Pennsylvania	Governor's office
Rhode Island	House Finance Office
South Carolina	State Budget and Control Board and revised revenue projections
South Dakota	Governor's proposed budget
Tennessee	Press reports of State Funding Board meeting
Texas	Center on Public Policy Priorities analysis of Legislative Budget Board, Comptroller and HHS Commission data.
Utah	Governor's proposed budget
Vermont	Governor's proposed budget
Virginia	Governor's office
Washington	Legislature's projections (FY10 is half of biennial estimate.)
West Virginia	Press reports of Governor's speech
Wisconsin	Legislative Fiscal Bureau

For source information for the original shortfall estimates, see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.