

Fiscal crunch

*States are awash in red ink,
but there is positive news*

BY SUJIT M. CANAGARETNA

After a decade of sustained economic growth, unsurpassed in the economic history of the country, the U.S. economy is currently recovering from the negative effects of the recession that swept across the land last year.

While technically the economy has emerged from the recession, the pace of economic growth and, in particular, the pace at which the economy has been generating jobs, has been extremely sluggish. During the decade of expansion, between March 1991 and March 2001, the country experienced an unparalleled level of prosperity that facilitated soaring personal incomes and corporate profits; dwindling unemployment and inflation numbers amidst rapid economic growth rates; rising revenue flows leading to budget surpluses at the federal, state and local levels; and a booming stock market that elevated the investment portfolios of a number of American households to remarkable levels.

Unfortunately, the economic boom years of the 1990s are over and federal, state and local governments continue to grapple with the lingering effects of the 2001 recession. Across a number of criteria, the grim economic news percolating across the country continues to befuddle both astute students of public policy and casual observers of the economy alike. Every level of government currently remains awash in red ink with the federal government returning to deficits after four years of surpluses. The federal deficit in fiscal year 2002 was \$159 billion and almost every state government confronted a rising tide of red ink, too. At least 46 states struggled to close a cumulative budget gap of \$37 billion in their most recent fiscal year, most often ending

June 30, 2002. For the current fiscal year, the estimated state budget gaps are even higher, with a combined \$58 billion deficit expected.

Virginia currently faces a budget shortfall of up to \$2 billion, and Governor Warner has already begun making substantial program and personnel cuts. In Texas, the state's budget shortfall may reach an unmanageable \$12 billion by early next year. As Maryland's new governor and General Assembly arrive in Annapolis this month, they will face a budget shortfall of as much as \$1.9 billion. In Kentucky, analysts estimate a revenue shortfall of between \$150 million and \$200 million for the current fiscal year. Mississippi's Medicaid program faces a \$75 million shortfall this current fiscal year while the state anticipates a budget shortfall exceeding \$400 million for fiscal year 2004, which begins July 1, 2003.

In October 2002, Georgia experienced another month of negative revenue inflows, confirming that 15 of the last 16 months had brought on declining tax revenues and fee collections for the state. In North Carolina, while budget writers used more than \$800 million in non-recurring revenue to fund ongoing expenses in the

fiscal 2003 budget, a deficit that could exceed \$1.5 billion is a real possibility next year. Missouri's Governor Holden announced in late November that five months into FY 2003, the state's budget shortfall had grown to \$100 million and estimated that this gap could triple by the end of the fiscal year.

The consequences of these dire fiscal circumstances confronting state policymakers are reflected in several developments. Chief among them are anemic revenue flows, rising unemployment levels and exploding Medicaid expenditures. In fiscal year 2002, for instance, for the 16 states in The Council of State Governments' Southern region, revenue collections, on average, came in 4.5 percent under estimates. In terms of national unemployment rates, after bottoming out in the low 4-percent-range in the late 1990s, the rate soared to 5.7 percent in October 2002. State Medicaid spending, propelled by explosive growth in pharmaceutical costs and higher enrollments, has increased since the mid-1990s. In fiscal 2002, overall state Medicaid spending leapt by 12.8 percent in 2002, the highest expansion in almost a decade.

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In response to these grim fiscal times, states have adopted a range of measures. Among them are slashing spending, tapping rainy-day funds, deploying tobacco settlement monies, raising sales taxes, hiking cigarette taxes and generating funds via state lotteries. In Virginia, the governor announced \$858 million in emergency spending cuts including laying off almost 1,900 state government workers, shutting down all Department of Motor Vehicles offices for one week, forcing colleges to raise tuition or lay off staff members and reducing many community services by 10 percent. Nineteen states tapped their rainy day funds in fiscal year 2002 and 12 are expected to do so in FY 2003. States have

also resorted to bridging their budget shortfalls by using cash infusions from tobacco securitizations to pay for day-to-day operations, a practice frowned upon by the bond rating agencies. States have increased taxes, with sales taxes being raised in Tennessee and North Carolina this year. Raising cigarette taxes remains another popular bridging strategy with 19 states doing so in 2002.

In conclusion, policy-makers at the state level are certainly grappling with a dramatic deterioration in their fiscal positions brought on by souring economic conditions. Rapidly diminishing revenue flows have resulted in reductions in public services and there is no respite in the short term. The federal government faces its own string of fiscal problems compounded by a range of national security concerns.

Yet, the sense of gloom that currently permeates the financial and economic climate has to be tempered with the following items of positive news: the economy is still expanding and is likely to expand at a rate between 2.5 percent and 3 percent this year; inflation remains quite subdued; the efficiency and productivity gains of the late 1990s remain intact and the economy can build on those pillars to reach higher productivity levels and higher incomes in the future; and finally, the record low interest rates have propelled consumers to purchase homes and refinance their mortgages. ★

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