Facing the fiscal squeeze

Northeastern legislators confer on strategies for dealing with the budget crisis

BY SYD STEINHARDT

Braving a blizzard that dumped two feet of snow on the Eastern Seaboard, dozens of state budget officials trekked to Cambridge, Mass. on Feb. 7 to figure out how to subdue their states’ perfect budget storms.

Fifty-three legislators and staffers from nine Northeastern states, Puerto Rico and New Brunswick attended the two-day invitation-only seminar, “The States’ Fiscal Squeeze: Coping with Budget Shortfalls.” Convened by the Eastern Regional Conference’s Northeastern Legislative Budget Chairs’ Roundtable, the seminar brought together state budget and tax committee chairs and staffers, and experts in corrections, education, health care, debt financing and technology applications. The focus was on both immediate action options and long-term implications.

Fiscal outlook bleak

With the states confronting multibillion-dollar budget deficits for the foreseeable future, the fiscal crisis tempers everything legislators do these days. Estimates of the states’ cumulative fiscal year 2004 budget deficit range from $67 billion to $80 billion. In the Eastern Regional Conference, where every state constitution but Vermont’s mandates a balanced budget, the cumulative deficit between now and the end of FY 2004 is close to $28 billion.

The causes of the states’ worst fiscal predicament since World War II are well known. They include an erosion of tax revenues due to an anemic economy, the explosion in health care costs, and new federally mandated expenditures in areas such as homeland security and education. The likelihood of military action in the Persian Gulf, coupled with another possible round of federal tax cuts, could make the situation worse by increasing the federal deficit.

Most states are bracing for reductions or, at best, hoping for level funding in federal aid for such important programs as
education and transportation. Governors throughout the region are considering or already implementing measures such as service cuts, layoffs, reorganizations and tax increases to bring their budgets into balance.

The possibility of military action in Iraq adds one more element of uncertainty to an already weak regional economic outlook, a nationally known federal budget expert told the delegates.

“The federal deficit could be as much as $300 billion,” said Stanley E. Collender, managing director of the Federal Budget Consulting Group at public relations firm Fleishman-Hillard. “That’s not including a war, which could cost anywhere from $60 billion to $200 billion.”

Collender spoke of federal budgets that no longer contain surpluses, a reversal of the last years of the Clinton administration. He said that increased spending on homeland security, and the combination of passed and proposed tax cuts, will cause deficits far into the future.

“This administration says, ‘deficits don’t matter,’” he said, warning that the total federal debt could balloon to as much as $5.5 trillion. Already, he said, the 15 percent of the federal budget devoted to interest payments on debt is the third largest item in the budget, after defense and Social Security. As a result, he said, “the government’s ability to respond to any problem is limited” – not an encouraging sign for resource-strapped states.

U.S. Rep. John W. Olver (Mass.), a member of the House Committee on Appropriations, agreed with Collender. The congressman was pessimistic in assessing what the states can anticipate receiving from Washington, given the budget that President Bush submitted to Congress on Feb. 4.

“Deficits will be $300 billion this year and maybe $500 billion in 2012,” he said. States “can expect cuts in health care and education.”

Olver estimated that, without changes to states’ tax codes to alleviate the effect of proposals such as eliminating taxing corporate dividends, they could lose $4 billion a year.

It could get worse, said Bob Kurtter of Moody’s Investors Service. He and Peter Enrich, a Northeastern University law professor and taxation specialist, pinned the problems squarely on declining state revenues.

**Strategies for coping**

Enrich offered a solution to states’ deep decline in revenue by telling them of other states’ efforts to increase their tax bases. In particular, he cited Ohio and Kentucky as leaders in expanding “what states are subjecting to tax on the service side.”

He also addressed the “remote sellers issue” – that of online retailers avoiding sales tax on items sold over the Internet. The problem, he said, is that “no one knows how to collect these taxes.”

That is changing. The Streamlined Sales Tax Project, a multistate initiative started in March 2000, is working to harmonize the sales tax systems of the country’s approximately 7,500 state and local taxing jurisdictions. One goal of the project is to subject all retailers to sales tax, regardless of their location.

A 1992 Supreme Court decision, *Quill Corp. v. North Dakota*, exempted online-only retailers from collecting sales taxes in jurisdictions where they do not have a physical presence, such as a warehouse or call center. Consumers are supposed to calculate and pay use taxes to their local and state jurisdictions for goods bought online or through mail-order catalogues. Any overhaul of the sales tax laws, as envisioned by the project’s proponents, would shift responsibility for collecting the taxes to the seller.

While such a scheme offers hope for the future, Kurtter warned of other immediate problems that could complicate the already tough year ahead.

“Medicaid costs are rising again,” he said. After double-digit growth in the early 1990s, followed by a dip in the middle of the decade, these costs started to rise again in the last few years.

“Planning costs are rising, health care costs generally are rising,” he said. “Some of the program expansions of the late 1990s have contributed to an expanded Medicaid client base.”

To help states defray some of those costs, Vickie Gates of AcademyHealth, a health policy research and advocacy organization, admonished the delegates to get everything that they have coming to them. She termed this approach “Medicaid maximization.”

Some states have already caught on to this. By doing so, they have caught the attention of the federal government. In January, the General Accounting Office, the investigative arm of Congress, cited Medicaid as a high-risk program that states use to relieve their budget crunches.

States can cut costs in the corrections area without affecting citizens’ quality of life, said Prof. James Austin, director of the Institute on Crime, Justice and Corrections at The George Washington University. He told the delegates that a large number of low-risk prisoners could be released without jeopardizing public safety.

“Substantial reductions in the prison population can be achieved by moderate reductions in a prisoner’s length of stay,” he said. “For example, reducing a low-risk prisoner’s 24-month length of stay by three months – one-eighth of his or her sentence – translates into a one-eighth reduction in the prison population. Similarly, a three-month reduction in a 30-month stay lowers the prison population by one-tenth.”

“Most prisoners’ rate of offending drops sharply after release,” said Austin. “Only 3 to 5 percent of the crime rate is attributable to released prisoners.”

Other panels offered their perspectives on policy areas that will be reviewed by budget makers in the coming months. The education panel, which included Boston Public Schools Superintendent Thomas Payzant and Harvard education professor Richard Murnane, urged the legislators to continue the momentum toward higher standards and smaller class sizes. Three technology experts offered suggestions on saving money through automating traditional government services.

**States’ situations vary**

With the steep declines in revenues continuing into next year, the delegates traded stories, suggestions and solutions, comparing their situations with one another.

They learned that some states head into the next year in better shape than others. Rhode Island will finish the current year $12 million in the black, but currently is $175 million in the red for next year. Delaware, which closed a $95 million gap for this year, still has a $300 million hole in next year’s budget. Vermont balanced its
books for 2003 and expects to solve its projected $30 million shortfall next year, though it is not required to do so by law.

States’ approaches varied according to their situations. State agencies in New Hampshire and Rhode Island have been directed to submit budget requests at 92 percent of last year’s funding levels. Maine has begun laying off state employees and is cutting Medicaid benefits. Puerto Rico plans to raise taxes on cigarettes and liquor.

New York, with a combined FY 2003-2004 deficit of $11.5 billion, is cutting education and health care funding, laying off state workers and hoping to securitize $3.8 billion of the federal tobacco settlement, said Kristen Proud, director of the state Assembly’s Ways and Means Committee. Massachusetts legislators granted new Gov. Mitt Romney emergency authority to make cuts to close a combined $3.6 billion gap for FYs 2003 and 2004, said state Senate President Pro Tem Stan Rosenberg. The Legislature is hoping to avoid increasing taxes, borrowing more money and using tobacco settlement funding to balance the budget, he said, relying instead on cuts and on drawing down the state’s reserves.

The Pennsylvania delegation found itself in limbo as it awaited Gov. Edward G. Rendell’s first budget, scheduled for the first week in March.

“We’re in a very murky fiscal picture,” said Tom Starke, executive director of the Pennsylvania state Senate Appropriations Committee.

The best news of any jurisdiction represented at the seminar came from the Canadian province of New Brunswick. Legislative Assembly Speaker Bev Harrison spoke of his government’s success in cutting taxes and balancing the province’s budget for each of the past four years.

Harrison conceded that his province did not face some of the issues bedeviling his American counterparts, but that tough choices lie ahead.

“We’ve not gone through a massive review of health and education,” he said.

More information on the seminar, including summaries of the presentations and a roster of presenters, is available on the CSG ERC Web site at http://www.csgeast.org.

— Syd Steinhardt is communications manager for the Eastern Regional Conference of The Council of State Governments.

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The Spring 2003 symposium explores some of the short-term and long-term issues surrounding Medicaid and its funding. Contributors include the following:

- Tommy Thompson, Secretary, U.S. Department of Health and Human Services, “The Future of Medicaid”
- Mike Huckabee, Governor of Arkansas, “State Budget Crises and Medicaid”
- Vic Miller, Federal Funds Information for States, “Fiscal Federalism and Medicaid”

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