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29 STATES FACE TOTAL BUDGET SHORTFALL OF AT LEAST $48 BILLION IN 2009

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At least 29 states plus the District of Columbia, including several of the nation's largest states, faced or are facing an estimated $48 billion in combined shortfalls in their budgets for fiscal year 2009 (which begins July 1, 2008 in most states.) Three other states expect budget problems in fiscal year 2010.

In general, states will close these budget gaps through some combination of spending cuts, use of reserves or revenue increases before they adopt a fiscal year 2009 budget. At this point in the year, most states have already adopted those budgets while a handful of states continue to deliberate.[1] In order to present a complete picture of the impact of the current economic downturn on state finances, we report both the gaps that have been closed and those that will be closed in the future.

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 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.

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[1] The states that we discuss here that have not adopted budgets for FY2009 as of the writing of the report are California, Delaware, Illinois, Massachusetts and Michigan. California has partially addressed its shortfall.

TABLE 1: SIZE OF FY2009 BUDGET GAPS		
	Amount	**Percent of FY2008 General Fund**
Alabama[1]	$784 million	9.2%
Arizona[1]	$1.9 billion	17.8%
Arkansas[1]	$107 million	2.5%
California[2]	$22.2 billion	21.3%
Connecticut[1]	$150 million	0.9%
Delaware	$217 million	6.4%
District of Columbia[1]	$96 million	1.5%
Florida[1]	$3.4 billion	11.0%
Georgia[1]	$200 million - $300 million	1.0 – 1.5%
Illinois	$1.8 billion	6.6%
Iowa[1]	$350 million	6.0%
Kentucky[1]	$266 million	2.9%
Maine[1]	$124 million	4.0%
Maryland[1]	$808 million	5.5%
Massachusetts	$1.2 billion	4.2%
Michigan	$472 million	4.9%
Minnesota[1]	$935 million	5.5%
Mississippi[1]	$90 million	1.8%
Nevada[1]	$898 million	13.5%
New Hampshire[1]	$200 million	6.4%
New Jersey[1]	$2.5 – $3.5 billion	7.6 – 10.6%
New York[1]	$4.9 billion	9.1%
Ohio[1]	$733 million - $1.3 billion	2.7 - 4.7%
Oklahoma[1]	$114 million	1.6%
Rhode Island	$430 million	12.6%
South Carolina	$250 million	3.7%
Tennessee[1]	$468 million - $585 million	4.2 - 5.2%
Vermont[1]	$59 million	5.1%
Virginia[1]	$1.2 billion	6.9%
Wisconsin[1]	$652 million	4.8%
TOTAL	$47.5 – $49.3 billion	9.3 – 9.7%

[1]These states have adopted new or revised budgets that address these shortfalls.
[2]In a special session earlier this year, California adopted measures to close $7.0 billion of this shortfall. A gap of $15.2 billion remains to be closed. Assumes that FY08 gap would have carried over to FY09.

The fiscal situation appears to be as follows.

- Over half of the states have faced budget problems and/or expect to face them in the near future.

- The 29 states in which revenues were expected to fall short of the amount needed to support current services in fiscal year 2009 are **Alabama**, **Arkansas, Arizona**, **California**, **Connecticut, Delaware, Florida, Georgia, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota**, **Mississippi, Nevada, New Hampshire**, **New Jersey**, **New York**, **Ohio, Oklahoma, Rhode Island, South Carolina**, **Tennessee, Vermont**, **Virginia,** and **Wisconsin.** In addition, the **District of Columbia** is expecting a shortfall in fiscal year 2009. The budget gaps total $47.5 to $49.3 billion, averaging 9.3 percent to 9.7 percent of these states' general fund budgets. (See Table 1.) California — the nation's largest state —faced the largest budget gap. The shortfalls that states other than California face or faced average 6.2 percent to 6.7 percent of these states' general fund budgets.

- Analysts in three other states — **Missouri, Texas,** and **Washington** — are projecting budget gaps a little further down the road, in FY2010 and beyond.[2]

This brings the total number of states identified as facing budget gaps to 32 — more than half of all states. The remaining 18 states do not foresee FY2009 budget gaps. The list of states facing budget gaps is likely to grow as state revenue forecasts are updated during the legislative session.

Some mineral-rich states — such as New Mexico, Alaska, and Montana — 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.

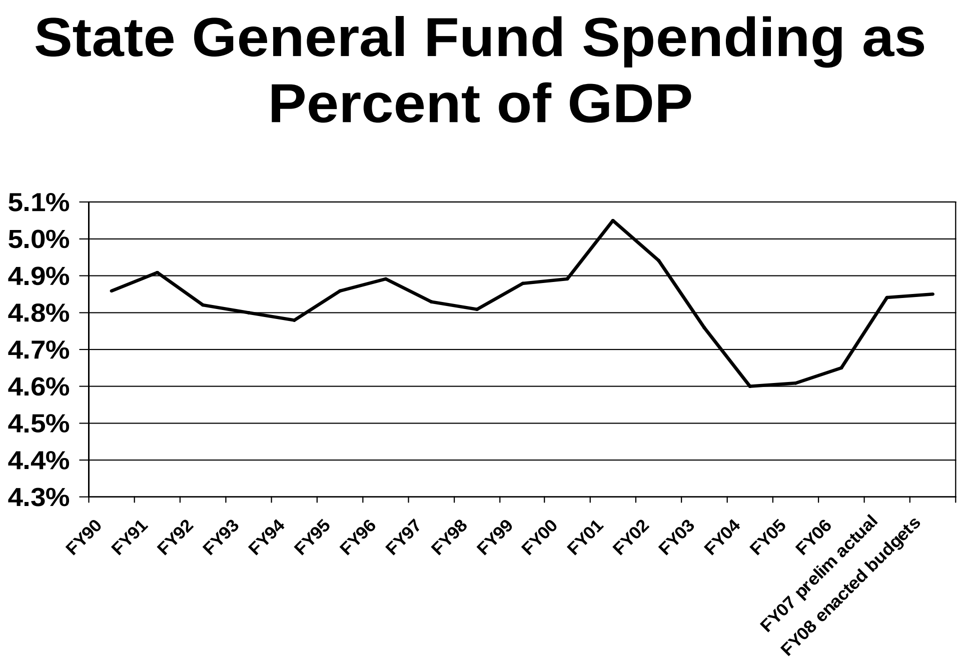
- *Tax increases.* Tax increases may be needed to prevent the types of service cuts described above. However, the taxes states often raise during economic downturns are regressive — that is, they fall most heavily on lower-income residents.

- *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,

[2] Analyses prepared by the legislature or by nonprofit fiscal organizations in these seven states found that expected revenues will fall short of the amount needed to support current services. The appendix to this paper shows the sources of these analyses.

FIGURE 1



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

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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.

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 were estimated to decline to 6.7 percent of annual spending by the end of fiscal year 2008. 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**
Alabama	Legislative Fiscal Office	
Arizona	Governor's proposed budget	
Arkansas	Department of Finance and Adminstration	
California	Legislative Analyst Office analysis of Governor's May revised budget	Assumes FY2008 gap carried over to FY2009. California has adopted measures to close $7 billion of this shortfall.
Connecticut	Office of Fiscal Analysis	
Delaware	Delaware Economic and Financial Advisory Council Revenue Forecast	
Florida	Florida Revenue Estimating Conference	
Georgia	Georgia Budget and Policy Institute	
Illinois	Calculated by Voices for Illinois Children based on the Governor's proposed budget	
Iowa	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. Iowa's adopted budget closes this gap.
Kentucky	State Budget Director	Revenues falling short of projections.
Louisiana	Five-Year Baseline Projection: State General Fund Summary	
Maine	Maine Revenue Forecasting Committee	FY2009 is the second year of the biennial budget. Measures were adopted to close shortfall.
Maryland	Maryland Budget and Tax Policy Center and Maryland Board of Revenue Estimates	Gap reflects $500 million in spending cuts assumed in special session bill plus the effect of lower revenue estimates. Adopted budget closed gap.
Massachusetts	Executive Office of Administration and Finance	
Michigan	May 2008 Consensus Revenue Forecast	
Minnesota	Minnesota Department of Finance	
Mississippi	Mississippi Economic Policy Center	
Missouri	Missouri Budget Project	
Nevada	Governor's office	FY2009 is the second year of the biennial budget. Governor has taken actions to close gap, some of which are being contested.
New Hampshire	Press reports	
New Jersey	Governor's proposed budget	
New York	Division of Budget	Revenues continue to weaken which may result in an additional gap.
Oklahoma	Oklahoma State Board of Equalization	
Ohio	Ohio Office of Budget and Management	
Rhode Island	Office of the Senate Fiscal Advisor of the Rhode Island Senate	Revenue forecasts have been lowered further.
South Carolina	Revenue Forecasting Council, budget hearing	
Tennessee	Press reports of Governor's statements	
Texas	Center for Public Policy Priorities	
Vermont	Public Assets Institute	
Virginia	Commonwealth Institute	Executive actions plus adopted budget closed gap.
Washington	Washington State Budget & Policy Center	
Wisconsin	Legislative Fiscal Bureau	