CENTER ON BUDGET AND POLICY PRIORITIES

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STATE BUDGET DEFICITS PROJECTED FOR FISCAL YEAR 2005

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Recent press reports may give the impression that the state fiscal crisis is nearing an end. A recent National Conference of State Legislatures report is headlined "Fiscal Storm Shows Signs of Subsiding," and notes that revenues in the current fiscal year are meeting or exceeding original forecasts in 34 states. The Rockefeller Institute reports that state revenues — adjusted for inflation and legislative changes — grew slightly in the July-September 2003 quarter, following eight quarters of revenue decline. The stronger revenue growth suggests that there will be less need for *mid-year* budget cuts to keep state budgets in balance in the current fiscal year (state fiscal year 2004, which ends on June 30, 2004 in most states) than there have been in the past two years.

These more positive indicators do not mean, however, that the state fiscal crisis is over. As states begin to debate their fiscal year 2005 budgets, tough budget choices will still be prevalent.

- Some 30 states are projecting deficits for Fiscal Year 2005 totaling about $39 billion to $41 billion. This represents between 7 percent and 8 percent of state general fund expenditures.[1] The attached table shows the deficits reported for each state. The figures in the table reflect the projected deficits prior to any executive or legislative action to address the shortfalls.

- In eight states, the shortfall estimate exceeds 10 percent of the budget including Alabama, Alaska, Arizona, California, Kansas, Mississippi, New Jersey, and New York.[2]

There are a number of reasons that the news is not quite as good as it appears to be, and that large shortfalls will continue to persist for fiscal year 2005.

- While revenue growth has increased, it still remains extremely modest. The Rockefeller Institute of Government reports that in the most recent quarter, state tax revenue adjusted for inflation and legislative changes was only 0.4 percent

[1] The count of states includes the District of Columbia throughout the report.

[2] In two additional states, Missouri and South Carolina, the upper end of the range of estimates exceeds 10 percent of the budget.

Recent Reports Express Significant Concern about State Budgets in 2005

"Comprehensive information is not yet available on the outlook for FY 2005 budgets. Anecdotal information suggests, however, that problems will persist well into the coming fiscal year. One fiscal officer said, 'We're okay for FY 2004. Our real problems will hit in FY 2005.'"

— National Conference of State Legislatures, *State Budget Update: November 2003.*

"The adopted budgets for 2004 included sharper spending cuts and larger tax increases than 2003 budgets, but … states will be back at the negotiating table in just a few months to present their FY 2005 budgets, and will be facing more gaps and difficult decisions. Even that will not be the end of it... Continuing policy response to the crisis could take another two years or more….

"The conclusion we reach, and we would print this in red if we could, is that despite the welcome economic recovery, this is still crunch time for state and local finance and public services. Furthermore, states and their citizens will probably continue to feel the crunch for quite some time to come."

— Richard P. Nathan et al., *It's Crunch Time for State Budgets*, Nelson A. Rockefeller Institute of Government, November 2003.

"Although the state fiscal situation has stabilized, states are not out of the woods yet. Fiscal Year 2005 will be a difficult year for most states, as they grapple with revenues that have not yet grown substantially, and that still remain significantly below the levels of just two years ago. Although states expect 2004 to be a much better year than 2003 and 2002, they have not regained the ground they lost in 2001, and revenue growth is likely to continue to be nowhere near as strong as the growth states experienced in the late 1990s.

— Donald Boyd and Victoria Wachino, *Is the State Fiscal Crisis Over? A 2004 State Budget Update*, Kaiser Commission on Medicaid and the Uninsured, January 2004.

"While the economy has begun to show some signs of improvement, states continue to grapple with short term cyclical and long-term structural problems. Plagued by budget shortfalls for the past three years, states still face uncertainty in the current fiscal year and difficult budgetary choices in the years ahead, even amid strong growth recently in gross domestic product and declining job losses."

— National Association of State Budget Officiers, *Fiscal Survey of the States*, December 2004.

higher than in the same period in 2002. This low rate of growth occurred despite a 3.5 percent growth in real GDP over the same period.

- States budgeted quite modestly for the current fiscal year. Budgeted spending for fiscal year 2004 is 0.2 percent *less* than for fiscal year 2003, according to NCSL, which means that the improved fiscal stability was gained only at the expense of significant budget cuts. States budgeted for revenue growth of just 1.8 percent in the current fiscal year, probably not enough growth to maintain current services in most states. Thus the fact that revenues are meeting or even exceeding this low forecast does not mean that states will be able to provide an adequate level of services this year and next.

- Many states are meeting their balanced-budget requirements this year (fiscal 2004) in part with reserve-fund transfers or other one-time budget actions (such as accelerating revenues and deferring spending). A number of states also borrowed funds to fill their gaps. Revenue growth would have to be extremely strong to be able both to replace in next year's budget the one-time funds that closed the gap this year *and* to meet the normal year-to-year increase in the cost of services. Most states are not anticipating that degree of revenue growth.

- The federal government is presently providing $20 billion in fiscal relief to states spread out over 18 months. Current year budgets would be in far worse shape without this federal fiscal relief. Most states are assuming that the relief will expire at the beginning of fiscal year 2005 and therefore not be available to help fill budget shortfalls.

Given the magnitude of the deficits, states likely will enact further cuts to basic services such as health care and education and/or impose new tax burdens particularly on low- and middle-income families (who have borne the majority of the tax increases so far). These are the type of actions that already have been taken throughout the country this year; states have slashed health insurance programs, cut deeply into budgets for elementary and secondary education and child care, and forced double-digit tuition increases at state colleges and universities.

The Budget Gaps for Fiscal Year 2005

In some states, such as California, Maryland, and New York, formal estimates of fiscal year 2005 budget deficits have been made. In other states, this may not occur until governors' budgets are released over the next few weeks. Nevertheless, many states have at least working estimates of the gap that must be closed. The Center has compiled these working estimates from a variety of sources including public and private statements of government officials, information from nonprofit organizations that work on budget issues, and press reports. While these estimates are subject to change, they provide the best available information on the magnitude of the problems states are facing for the upcoming fiscal year.

In most cases, the estimates reflect both lagging revenues and the impact of inflation, population growth, and other factors that increase costs. Some 30 states anticipate fiscal year 2005 deficits totaling about $39 billion to $41 billion, or between 7 percent and 8 percent of general fund spending.[3]

In addition, a substantial minority of states budget on a biennial basis, meaning that the budget actions they took in the spring of 2003 had the effect of balancing their budgets (at least

[3] This estimate takes into account that several states, including Oregon, Texas, Washington and Wisconsin, resolved their FY 2005 budget gap in the last budget cycle and therefore are no longer projecting a shortfall for that year, assuming revenues meet projections.

prospectively) through the end of fiscal year 2005. Some of those states may nonetheless need to cut spending or raise revenues to keep their budgets in balance if revenues fall short of projections. Moreover, it is possible that at least some of those states will again face shortfalls in their next budget cycle — that is, for the FY2005-07 biennium — because one-time sources of revenue will no longer be available, because expenditure costs are expected to rise, and because revenues are not expected to grow at a rate sufficient to cover the gap. Oregon, Washington and Wisconsin — as well as Florida, which budgets on an annual basis — are among the states where analysts already project substantial budget gaps beginning in 2005-06.

Projections of FY 2005 State Budget Deficits

State	FY 2005 Deficit Projection (In Millions of Dollars)	Deficit as a Percent of General Fund
Alabama	$620	11%
Alaska	475	21%
Arizona	1,100	17%
Arkansas	0	0%
California	15,000	21%
Colorado	200 to 300	4% to 5%
Connecticut	200	2%
Delaware	0	0%
Florida*	0	0%
Georgia	700 to 900	5% to 6%
Hawaii	0	0%
Idaho	0	0%
Illinois	2,000	9%
Indiana	595	5%
Iowa	336	7%
Kansas	600	13%
Kentucky	200	3%
Louisiana	500	8%
Maine	173	7%
Maryland	738	7%
Massachusetts	1,000 to 1,500	4% to 7%
Michigan	900	4%
Minnesota	185	1%
Mississippi	709	20%
Missouri	600 to 900	7% to 11%
Montana	0	0%
Nebraska	211	8%
Nevada	0	0%
New Hampshire	0	0%
New Jersey	5,000	21%
New Mexico	0	0%
New York	5,100	13%
North Carolina	400 to 800	3% to 5%
North Dakota	0	0%
Ohio	0	0%
Oklahoma	300	6%
Oregon	0	0%
Pennsylvania	0	0%
Rhode Island	188	7%
South Carolina	300 to 500	6% to 10%
South Dakota	17	2%
Tennessee	0	0%
Texas	0	0%
Utah	0	0%
Vermont	0	0%
Virginia	927	8%
Washington	0	0%
West Virginia	120	4%
Wisconsin	0	0%
Wyoming	0	0%
District of Columbia	0	0%
Total	**$39,393 to $41,093**	**7.4% to 7.8%**

Notes:
Florida: Substantial structural shortfall expected in FY 2006

Sources: Center on Budget and Policy Priorities; FY 2004 General Fund data from NASBO, *Fiscal Survey of the States*, December 2003, Table A-3.