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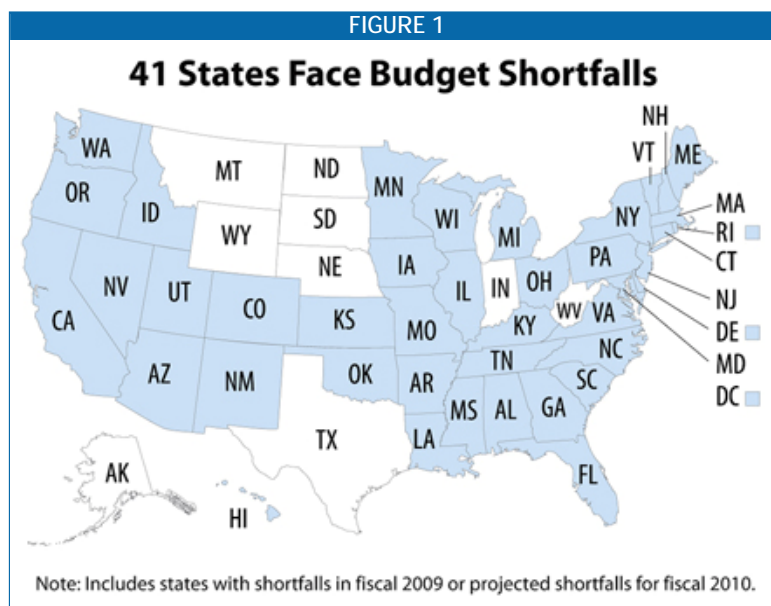
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## STATES IN TROUBLE DUE TO ECONOMIC DOWNTURN

The weak economy is generating great fiscal distress among states. Because states cannot run deficits, they must close their shortfalls by cutting spending or raising taxes. That causes two further problems. First, their spending cuts and tax increases take money out of the economy, making the downturn even worse. Second, as states have to cut back, they cannot respond to the rising need for health care and other services that occurs when workers lose jobs or are otherwise hit by the economic downturn.

### **Forty-one states faced or are facing budget shortfalls.**

- Twenty-nine states and Washington, D.C. closed shortfalls of \$48 billion in enacting their fiscal 2009 budgets, which began on July 1 in most states. The shortfalls equaled 9 percent of these states' general fund (operating) budgets.
- In 31 states and D.C., 2009 budgets have fallen out of balance since their enactment, producing new, mid-year deficits that total more than \$24 billion (or 6.6 percent of budgets).



- Twenty-one states already project shortfalls totaling more than \$40 billion for fiscal 2010 (which in most states begins July 1, 2009): Alabama, Arizona, California, Connecticut, Florida, Hawaii, Kansas, Louisiana, Maine, Maryland, Minnesota, Missouri, Nevada, New York, North Carolina, Oregon, Rhode Island, Vermont, Virginia, Washington and Wisconsin.
- Based on the rate at which states' revenue bases are deteriorating and the history of prior recessions, the total 2010 state budget gaps will likely be about \$100 billion.

### **The state revenue situation is rapidly worsening.**

- To keep pace with the cost of services, state revenues must grow. But overall revenues last year were essentially flat and are weakening dramatically this year.
- In the most recent quarter, July-September 2008, tax revenues are below last year's levels in most states after adjusting for inflation and are likely to weaken further. The median decline in states that have released data for this quarter is 5 percent after adjusting for inflation.
- Sales taxes are the hardest hit so far, reflecting a fall in both personal consumption and business purchases. But income taxes and other taxes are also falling. Recent stock market declines and continued job losses will depress revenues further

### **States face other problems from the weakening economy.**

- Employers are reducing jobs and cutting back on employer-provided health coverage. As a result, more families are turning to programs like Medicaid, which provides health coverage to low- and moderate-income families and is jointly funded by Washington and the states.
- State spending levels were relatively low even before this crisis. Aggregate state spending fell sharply relative to the economy during the 2001 recession, and it remained below the 2001 level as a share of the economy when states adopted their 2008 budgets. The funding cuts that states will likely make in the coming months will reduce overall spending further below 2001 levels.
- States have already substantially used budget reserves to address funding gaps, but these reserves are limited. States ended fiscal 2006 and 2007 with \$69 billion in reserves each year, equal to about 11 percent of their budgets. Those are the largest reserves states have ever accumulated. But now states have used a significant portion of those reserves, and the remaining amount will not be enough to solve state budget problems.
- California and Massachusetts officials have expressed concerns about their states' ability to obtain short-term loans. Such short-term borrowing is a routine part of state fiscal practices, and not an indicator of budget problems. States are simply facing the same problem faced by millions of businesses across the country: tightening credit markets. But in the unlikely event that states cannot obtain needed loans from private lenders or the federal government, their budget problems would worsen significantly.

### **25 states have cut a range of services, including those aimed at some of their most vulnerable residents. Also, some states have raised taxes.**

- At least 17 states have enacted or implemented cuts that will affect low-income families' eligibility for health insurance or reduce their access to health care; at least 15 states are cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities; at least 16 states are cutting K-12 and early education; and at least 21 states have implemented cuts to public colleges and universities. Also, at least 20 states have proposed or implemented cuts to their state workforce.
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- Also, several states already have enacted tax increases, closed loopholes, restricted tax credits, increased tobacco taxes, raised tuitions, or implemented other revenue-raising measures. For example, Maryland, Michigan, and New York each raised revenues by more than \$1 billion for fiscal 2009, while also cutting spending.

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