820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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NEW FISCAL YEAR BRINGS NO RELIEF FROM UNPRECEDENTED STATE BUDGET PROBLEMS*

By Elizabeth McNichol and Iris J. Lav

The unprecedented state fiscal problems brought on by the worst decline in tax receipts in decades show no signs of letting up. On July 1 — the start of the fiscal year in most states — an unusually high number of states were still struggling to adopt budgets for fiscal year 2010. Most states have adopted budgets that closed the shortfalls they faced with a combination of federal stimulus dollars, service reductions, revenue increases, and funds from reserves. But these budgets are already falling out of balance as the economy has caused state revenues to decline even more than projected. States will continue to struggle to find the revenue needed to support critical public services for a number of years.

The Center's most recent survey of state fiscal conditions found many signs of the depth of the state budget crisis.

- At least 48 states have addressed or still face shortfalls in their budgets for fiscal year 2010 totaling $168 billion or 24 percent of state budgets.

- An unusual number of these states are still struggling to balance their 2010 budgets two months after the start of the fiscal year. Three states — Arizona, Michigan, and Pennsylvania — have not yet adopted budgets for 2010. In addition, new shortfalls have opened up in at least 15 of the states that have adopted budgets — California, Colorado, Georgia, Hawaii, Kansas, Kentucky, Maryland, New Mexico, New York, Rhode Island, Utah, Vermont, Virginia, Washington, and Wyoming — plus the District of Columbia . These additional gaps — some of which have already been addressed[1] — totaled $28 billion.

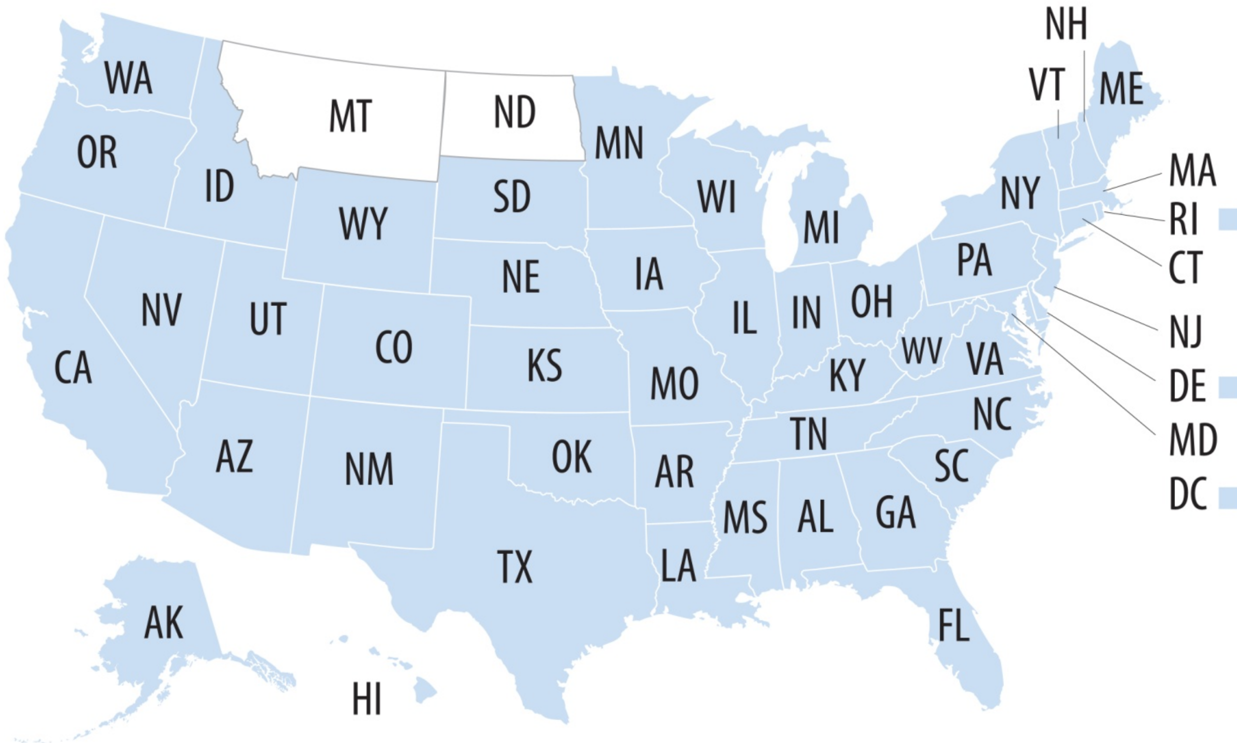
STATE FISCAL STRESS CONTINUES

- At least 48 states have addressed or still face shortfalls in their budgets for fiscal year 2010.
- Just two months into the new fiscal year, new shortfalls of $28 billion have opened up in the adopted 2010 budgets of at least 15 states and the District of Columbia. Shortfalls for fiscal year 2010 — those already addressed and those still open — total $168 billion.
- At least 36 states already anticipate deficits for 2011. Initial estimates of these shortfalls total almost $74 billion. As the full extent of 2011 deficits become known, shortfalls are likely to equal of at least $180 billion.
- Combined budget gaps for the next two years — state fiscal years 2010 and 2011 — are estimated to total at least $350 billion.

[1] For example, California, which faced the largest mid-year shortfall, has already closed its gap.
* This document was previously titled "State Budget Troubles Worsen"

FIGURE 1

48 States Face Budget Shortfalls



Note: Includes states with shortfalls in fiscal 2010.

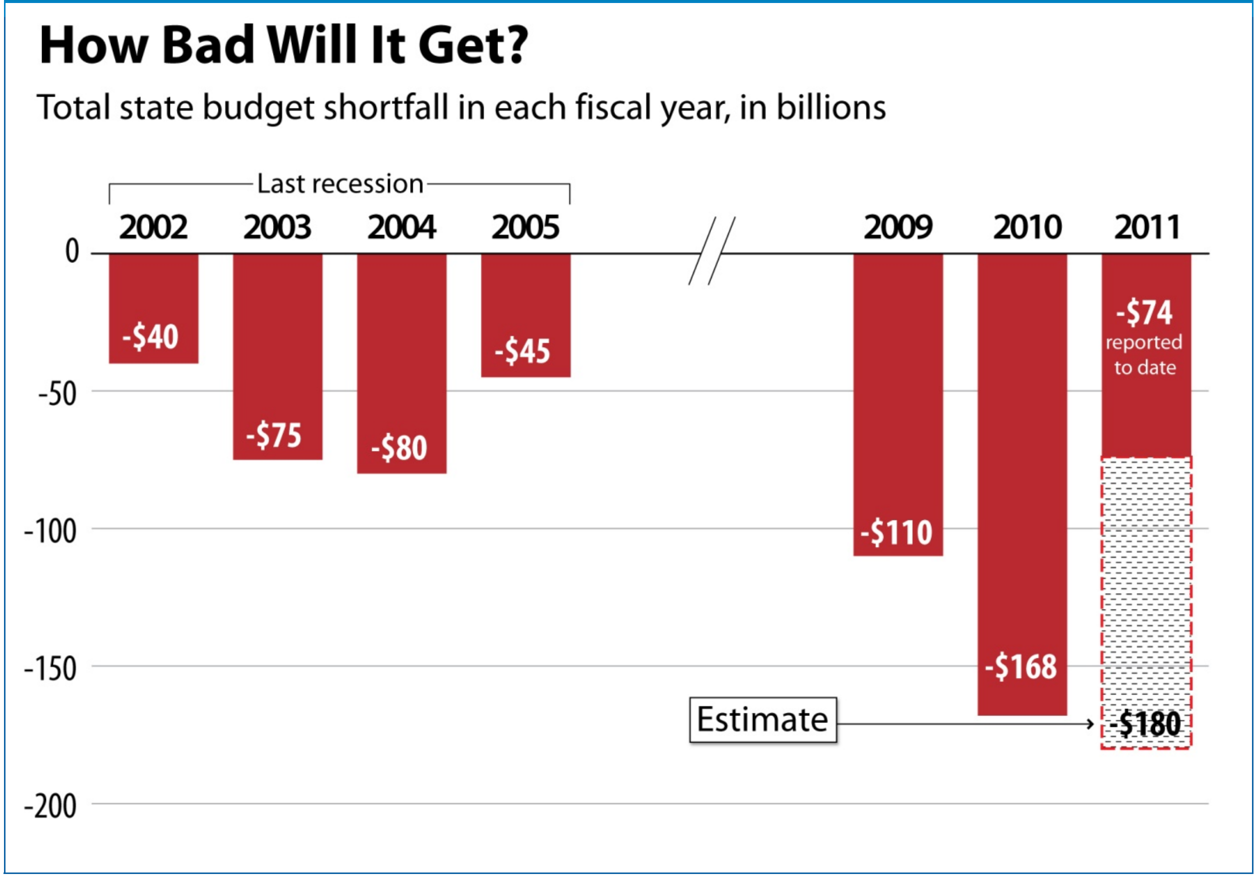
- The states' fiscal problems will continue into the next fiscal year and likely beyond. At least 36 states have looked ahead and anticipate deficits for fiscal year 2011. These shortfalls total $74 billion — 15 percent of budgets — for the 30 states that have estimated the size of these gaps by comparing expected spending with estimated revenues, and are likely to grow as more states prepare projections and revenues continue to deteriorate.

- Combined budget gaps for the next two fiscal years — those already mostly closed for 2010 and those projected for 2011 — are estimated to total at least $350 billion.

Figure 2's budget shortfall figures for fiscal years 2009 and 2010 show the national recession's impact on state budgets. These figures are the total size of the shortfall identified by each state listed. In many cases all or part of this shortfall has already been closed through a combination of spending cuts, withdrawals from reserves, revenue increases, and use of federal stimulus dollars.

Figure 2 also compares the size and duration of the shortfalls that occurred in the recession of the first part of this decade to shortfalls this time. The current recession is more severe — deeper and longer — than the last one, and state fiscal problems have proven to be worse and are likely to remain so. Unemployment, which peaked after the last recession at 6.3 percent, has already hit 9.4 percent, and many economists expect it to rise higher. This would further reduce state income tax

FIGURE 2



receipts and increase demand for Medicaid and other essential services that states provide. With consumers' reduced access to home equity loans and other sources of credit, sales tax receipts have fallen more steeply than in the last recession. These factors suggest that state budget gaps will continue to be significantly larger than in the last recession. All but a handful of states have had to face or are still dealing with shortfalls in fiscal year 2010 that total some $168 billion. If, as is widely expected, the economy does not begin to significantly recover until the some time in calendar year 2010 and unemployment remains high through 2010, state shortfalls are likely to be even larger in fiscal year 2011 (which begins in July 2010 in most states). The deficits over the next two fiscal years — 2010 and 2011 — are likely to be more than $350 billion.[2]

Several factors could make it particularly difficult for states to recover from the current fiscal situation. Housing markets might be slow to fully recover; their decline already has depressed consumption and sales tax revenue as people refrain from buying furniture, appliances, construction materials, and the like. This also would depress property tax revenues, increasing the likelihood that local governments will look to states to help address the squeeze on local and education budgets. And as the employment situation continues to deteriorate, income tax revenues will weaken further

[2] In general, the projected budget shortfalls reflect state fiscal conditions before deficit-closing actions are taken. States are using a combination of actions to close the deficits including use of federal stimulus funds, budget cuts, tax increases, and reserves. (For FY2011, however, some states projected the size of the deficit after use of federal stimulus funds. This would be reflected in the $74 billion in shortfalls reported to date for FY2011. The estimated total of $180 billion reflects the projected deficit before use of federal stimulus funds.)

and there will be further downward pressure on sales tax revenues as consumers are reluctant or unable to spend.

Unlike the federal government, the vast majority of states are governed under rules that prohibit them from running a deficit or borrowing to cover their operating expenses. As a result, states have three primary actions they can take during a fiscal crisis: draw down available reserves, cut spending, and raise taxes. States already have begun drawing down reserves; the remaining reserves are not sufficient to allow states to weather the remainder of the recession. The other alternatives — spending cuts and tax increases — can further slow a state's economy during a downturn, which produces a cumulative negative impact on national recovery as well.

Some states have not been affected by the economic downturn, but the number is dwindling. Mineral-rich states — such as New Mexico, Alaska, and Montana — saw revenue growth as a result of high oil prices. However, the recent decline in oil prices has begun to affect revenues in some of these states. The economies of a handful of other states have so far been less affected by the national economic problems.

In states facing budget gaps, the consequences are severe in many cases — for residents as well as the economy. As the 2009 fiscal year ended and states planned for 2010, budget difficulties have led some 41 states to reduce services to their residents, including some of their most vulnerable families and individuals.[3]

For example, at least 27 states have implemented cuts that will restrict low-income children's or families' eligibility for health insurance or reduce their access to health care services. Programs for the elderly and disabled are also being cut. At least 24 states and the District of Columbia are cutting medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities, or significantly increasing the cost of these services.

At least 25 states are cutting or proposing to cut K-12 and early education; several of them are also reducing access to child care and early education, and at least 34 states have implemented cuts to public colleges and universities.

In addition, at least 42 states and the District of Columbia have made cuts reducing the size or work time of state government employees. Such cuts not only often result in reduced access to services residents need, but also add to states' woes because of the impact on the economy from less consumer activity.

If revenue declines persist as expected in many states, additional spending and service cuts are likely. Budget cuts often are more severe later in a state fiscal crisis, after largely depleted reserves are no longer an option for closing deficits.

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, 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

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[3] For more detailed information see "An Update on State Budget Cuts," http://www.cbpp.org/cms/?fa=view&id=1214.

TABLE 1: STATES WITH FY2010 BUDGET GAPS				
	FY2010 before budget adoption	FY2010 mid year gap	FY2010 Total	FY2010 Total – % of General Fund Budget
Alabama	$1.2 billion	0	$1.2 billion	16.7%
Alaska	$1.3 billion	0	$1.3 billion	30.0%
Arizona	$4.0 billion	0	$4.0 billion	41.1%
Arkansas $14	6 million	0	$146 million	3.2%
California*	$26.0 billion	$19.5 billion	$45.5 billion	49.3%
Colorado	$1.0 billion	$384 million	$1.4 billion	18.6%
Connecticut	$4.2 billion	0	$4.2 billion	23.9%
Delaware $55	7 million	0	$557 million	17.6%
District of Columbia	$650 million	$150 million	$800 million	12.7%
Florida	$5.9 billion	0	$5.9 billion	22.8%
Georgia	$3.1 billion	$1.0 billion	$4.1 billion	23.8%
Hawaii	$682 million	$297 million	$978 million	19.1%
Idaho $41	1 million	0	$411 million	16.4%
Illinois*	$13.2 billion	0	$13.2 billion	37.7%
Indiana	$1.1 billion	0	$1.1 billion	7.5%
Iowa $77	9 million	0	$779 million	13.2%
Kansas	$1.4 billion	$183.2 million	$1.6 billion	25.6%
Kentucky	0	$1.1 billion	$1.1 billion	11.3%
Louisiana	$1.8 billion	0	$1.8 billion	21.6%
Maine	$640 million	0	$640 million	21.4%
Maryland	$1.9 billion	$700 million	$2.6 billion	18.7%
Massachusetts	$5.0 billion	0	$5.0 billion	17.9%
Michigan	$2.8 billion	0	$2.8 billion	12.4%
Minnesota	$3.2 billion	0	$3.2 billion	21.0%
Mississippi $48	0 million	0	$480 million	9.6%
Missouri	$923 million	0	$923 million	10.3%
Nebraska $15	0 million	0	$150 million	4.3%
Nevada	$1.2 billion	0	$1.2 billion	37.8%
New Hampshire	$250 million	0	$250 million	16.2%
New Jersey	$8.8 billion	0	$8.8 billion	29.9%
New Mexico	$345 million	$432.6 million	$777.6 million	14.1%
New York	$17.9 billion	$2.1 billion	$20.0 billion	36.1%
North Carolina	$4.6 billion	0	$4.6 billion	21.9%
Ohio	$3.3 billion	0	$3.3 billion	12.3%
Oklahoma	$777 million	0	$777 million	13.6%
Oregon* 0		0	0	0.0%
Pennsylvania	$4.8 billion	0	$4.8 billion	18.0%
Rhode Island*	$590 million	$65 million	$655 million	21.3%
South Carolina	$725 million	0	$725 million	12.5%
South Dakota	$32 million	0	$32 million	2.9%
Tennessee	$1.0 billion	0	$1.0 billion	9.7%
Texas	$3.5 billion	0	$3.5 billion	9.5%
Utah	$721 million	$279 million	$1.0 billion	19.8%
Vermont	$278 million	$28 million	$306 million	27.3%
Virginia	$1.8 billion	$1.5 billion	$3.3 billion	20.1%
Washington	$3.4 billion	$195 million	$3.6 billion	23.3%
West Virginia	$184 million	0	$184 million	4.9%
Wisconsin	$3.2 billion	0	$3.2 billion	23.2%
Wyoming 0		$32 million	$32 million	1.7%
Total	**$139.4 billion**	**$27.9billion**	**$167.6 billion**	**24.3%**

Notes**:** States in italics had not adopted FY2010 budgets as of the date of this report.
Some or all of the pre-budget shortfalls have already been addressed.
*The mid-year shortfall shown for **California** ($19.5 billion) differs from the often-cited $26.3 billion figure because it does not include the $5.8 billion of potential revenues affected by the May ballot measures to avoid double counting and does not include $1 billion to be deposited in reserve. At least $3.2 billion of the $13.2 billion gap in **Illinois** has not been closed.
Oregon has a two-year budget. The size of the projected shortfall is shown in Table 2. **Rhode Island's** mid-year shortfall of $65 million is a deficit carried over from FY2009.

TABLE 2: STATES WITH PROJECTED FY2011 BUDGET GAPS		
	Size of Gap	**Percent of FY2010 General Fund Budget**
Alabama DK		na
Alaska $677	million	15.3%
Arizona $2.6	billion	26.7%
California $15	billion	16.3%
Colorado $1.3	billion	16.9%
Connecticut $4.4	billion	25.0%
Florida $5.0	billion	19.3%
Georgia $1.3	billion	7.2%
Hawaii $320	million	6.2%
Illinois $10.4	billion	28.2%
Indiana $316	million	2.2%
Iowa DK		na
Kansas $412	million	6.7%
Kentucky $598	million	6.2%
Maryland $1.2	billion	8.7%
Massachusetts DK		na
Michigan $2.7	billion	11.9%
Mississippi $544	million	10.9%
Nebraska $150	million	4.3%
New Hampshire	$250 million	16.2%
New Jersey	$6.0 billion	20.4%
New Mexico	$318 million	5.8%
New York	$4.6 billion	8.4%
North Carolina	$4.4 billion	21.0%
Ohio $1.1	billion	4.1%
Oklahoma $725	million	12.7%
Oregon $4.2	billion	29.0%
Pennsylvania $4.1	billion	15.4%
Rhode Island	$197 million	6.4%
Utah $700	million	13.9%
Vermont $82	million	7.3%
Virginia DK		na
Washington DK		na
West Virginia	$243 million	6.4%
Wisconsin D	K	na
Wyoming $147	million	8.0%
Total	**$73.9 billion**	**15.0%**

Notes: An entry of "DK" in Size of Gap means that an estimate of the size of the projected gap in that state is not yet available.
For some states, these estimates reflect projected deficits after taking use of federal stimulus funds into account.

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 — though to the extent these increases are on upper-income residents that effect is minimized because much of the money comes from savings and so does not diminish economic activity.

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

The current situation has been made more difficult because many states never fully recovered from the fiscal crisis of the early part of the decade. This heightens the potential impact on public services of the shortfalls states now are projecting.

State spending fell sharply relative to the economy during the 2001 recession, and for all states combined it still remains below the fiscal year 2001 level. In 18 states, general fund spending for fiscal year 2008 — six years into the economic recovery — remained 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 were suffering even as states turned to budget cuts to close the new budget gaps. Spending as a share of the economy declined in fiscal year 2008 and is projected to decline further in 2009 and again in 2010.

One way states can avoid making deep reductions in services during a recession is to build up rainy day funds and other reserves when the economy is growing. At the end of fiscal year 2006, state reserves — general fund balances and rainy day funds — totaled 11.5 percent of annual state spending. 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. In this recession, states have already drawn down much of their available reserves; the available reserves in states with deficits are likely to be depleted in the near future.

Federal Assistance Crucial

Federal assistance can lessen the extent to which states need to take pro-cyclical actions that can further harm the economy. The American Recovery and Reinvestment Act recognizes this fact and includes substantial assistance for states. The amount in ARRA to help states maintain current activities is about $135 billion to $140 billion — or less than half of projected state shortfalls. Most of this money is in the form of increased Medicaid funding and a "Fiscal Stabilization Fund." This money has reduced to a degree the depth of state spending cuts and moderated state tax and fee increases. There are also other streams of funding in the economic recovery act flowing through states to local governments or individuals, but this will not address state budget shortfalls.

TABLE 3: SIZE OF TOTAL FY2009 BUDGET GAPS				
	Gap before budget was adopted	Additional mid-year gap	Total	Total Gap as Percent of FY2009 General Fund
Alabama		$1.1 billion	$1.1 billion	12.7%
Alaska		$360 million	$360 million	6.8%
Arizona[1]	$1.9 billion	$1.8 billion	$3.7 billion	36.8%
Arkansas	$107 million		$107 million	2.4%
California	$22.2 billion	$14.9 billion	$37.1 billion	36.7%
Colorado		$1.1 billion	$1.1 billion	14.2%
Connecticut	$150 million	$2.5 billion	$2.7 billion	15.5%
Delaware	$217 million	$226 million	$443 million	12.2%
District of Columbia	$96 million	$583 million	$679 million	10.8%
Florida	$3.4 billion	$2.3 billion	$5.7 billion	22.2%
Georgia[1]	$245 million	$2.2 billion	$2.4 billion	11.5%
Hawaii		$417 million	$417 million	7.3%
Idaho		$452 million	$452 million	15.3%
Illinois	$1.8 billion	$2.5 billion	$4.3 billion	15.1%
Indiana		$1.2 billion	$1.2 billion	9.1%
Iowa	$350 million	$134 million	$484 million	7.6%
Kansas		$186 million	$186 million	2.9%
Kentucky	$266 million	$456 million	$722 million	7.8%
Louisiana		$341 million	$341 million	3.7%
Maine	$124 million	$140 million	$265 million	8.6%
Maryland	$808 million	$691 million	$1.5 billion	10.0%
Massachusetts	$1.2 billion	$4.0 billion	$5.2 billion	18.5%
Michigan	$472 million	$1.5 billion	$2.0 billion	8.5%
Minnesota	$935 million	$654 million	$ 1.6 billion	9.2%
Mississippi[1]	$90 million	$363 million	$453 million	8.9%
Missouri		$542 million	$542 million	6.0%
Nevada	$898 million	$561 million	$1.6 billion	19.9%
New Hampshire	$200 million	$50 million	$250 million	8.0%
New Jersey[1]	$2.5 billion	$3.6 billion	$6.1 billion	18.8%
New Mexico		$454 million	$454 million	7.5%
New York	$4.9 billion	$2.5 billion	$7.4 billion	13.2%
North Carolina		$3.2 billion	$3.2 billion	14.9%
Ohio[1]	$733 million	$1.9 billion	$2.6 billion	9.4%
Oklahoma	$114 million		$114 million	1.7%
Oregon		$442 million	$442 million	6.6%
Pennsylvania		$3.2 billion	$3.2 billion	11.3%
Rhode Island	$430 million	$442 million	$872 million	26.6%
South Carolina	$250 million	$871 million	$1.1 billion	16.3%
South Dakota		$27 million	$27 million	2.2%
Tennessee[1]	$468 million	$1.0 billion	$1.5 billion	13.4%
Utah		$620 million	$620 million	10.4%
Vermont	$59 million	$82 million	$141 million	11.6%
Virginia	$1.2 billion	$1.1 billion	$2.3 billion	13.8%
Washington		$1.3 billion	$1.3 billion	8.5%
Wisconsin	$652 million	$1.0 billion	$1.7 billion	11.7%
Wyoming		$119 million	$119 million	6.8%
TOTAL	**$46.8 billion**	**$63.1 billion**	**$109.9 billion**	**15.2%**

[1]Only the low end of the estimated FY09 gap for these states — ones that provided a range of estimates — is shown in this table. For more detail see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.

Note: In most cases these shortfalls have already been addressed.

TABLE 4 – SOURCE OF GAP ESTIMATES

State	Source
Alabama	Legislative Fiscal Office/ Arise Policy Project
Alaska	Legislative Finance Division Overview of proposed budget
Arizona	Joint Legislative Budget Committee, Financial Advisory Committee, NCSL
Arkansas	Governor’s proposed budget
California	Governor’s budget and Legislative Analysts Office
Colorado	Colorado Fiscal Policy Institute/Bell Policy Center/Colorado Children’s Campaign
Connecticut	Connecticut Voices for Children analysis of Office of Fiscal Analysis data
Delaware	Governor’s proposed budget
District of Columbia	Chief Financial Officer
Florida	Revised revenue projections
Georgia	State budget, Georgia State University/ FY11: Georgia Budget and Policy Institute
Hawaii	Council on Revenues forecast
Idaho	Legislative summary of adopted budget
Illinois	State budget/Voices for Illinois Children analysis
Indiana State	Budget Committee
Iowa	Fiscal Services Division
Kansas	State Budget and Legislative Research Department
Kentucky Governor’s	office
Louisiana	Revenue Estimating Conference /Commissioner of Administration
Maine	Office of Fiscal and Program Review – Note: In FY11 (the second year of a 2 year budget cycle) Maine closed a projected $765 million gap.
Maryland	Department of Legislative Services
Massachusetts Governor’s	Office
Michigan	Consensus Revenue Forecast, Michigan League for Human Services
Minnesota	Management and Budget forecast
Missouri	Governor’s proposed budget and Missouri Budget Project
Mississippi	Governor’s proposed budget
Nebraska	Tax Rate Review Committee
Nevada	Board of Examiners and May Economic Forum
New Hampshire	Budget Director
New Jersey	Governor’s office, New Jersey Policy Perspectives
New Mexico	Consensus Revenue Estimate, New Mexico Voices for Children,
New York	Division of Budget
North Carolina	North Carolina Fiscal Research Division
Ohio	Office of Budget and Management
Oklahoma	State Tax Commission projections/FY11: Oklahoma Policy Institute
Oregon	Joint Committee on Ways and Means
Pennsylvania	Legislative Caucus and Budget Director
Rhode Island	House Fiscal Advisory Staff
South Carolina	State Budget and Control Board and revised revenue projections
South Dakota	Governor’s proposed budget
Tennessee	Press reports of State Funding Board meeting
Texas	Center on Public Policy Priorities analysis of Legislative Budget Board, Comptroller and HHS Commission data.
Utah	Governor’s proposed budget, Legislative Fiscal Analyst, press reports
Vermont	State budget and Joint Fiscal office
Virginia Governor’s	office
Washington	Washington Budget and Policy Center
West Virginia	Governor’s budget
Wisconsin Legislative	Fiscal Bureau
Wyoming	Consensus Revenue Estimating Group

For source information for the original shortfall estimates, see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009* available at http://www.cbpp.org/1-15-08sfp.htm.