

State Finances in 2008: Return to Red Ink Rising?

Sujit M. CanagaRetna

The Council of State Governments (CSG)

Southern Legislative Conference (SLC)

Presentation at the
2008 Legislative Symposium

Birmingham, Alabama

January 18, 2008

Five Main Parts

1. National Economic Trends and State Finances
 2. Structural Issues Confronting States
 3. Looming Expenditure Categories
 4. Strategies Deployed/Proposed to Fund these Sizable Expenses
 5. Bright Sparks on the State Economic Horizon
-

1. National Economic Trends and State Finances

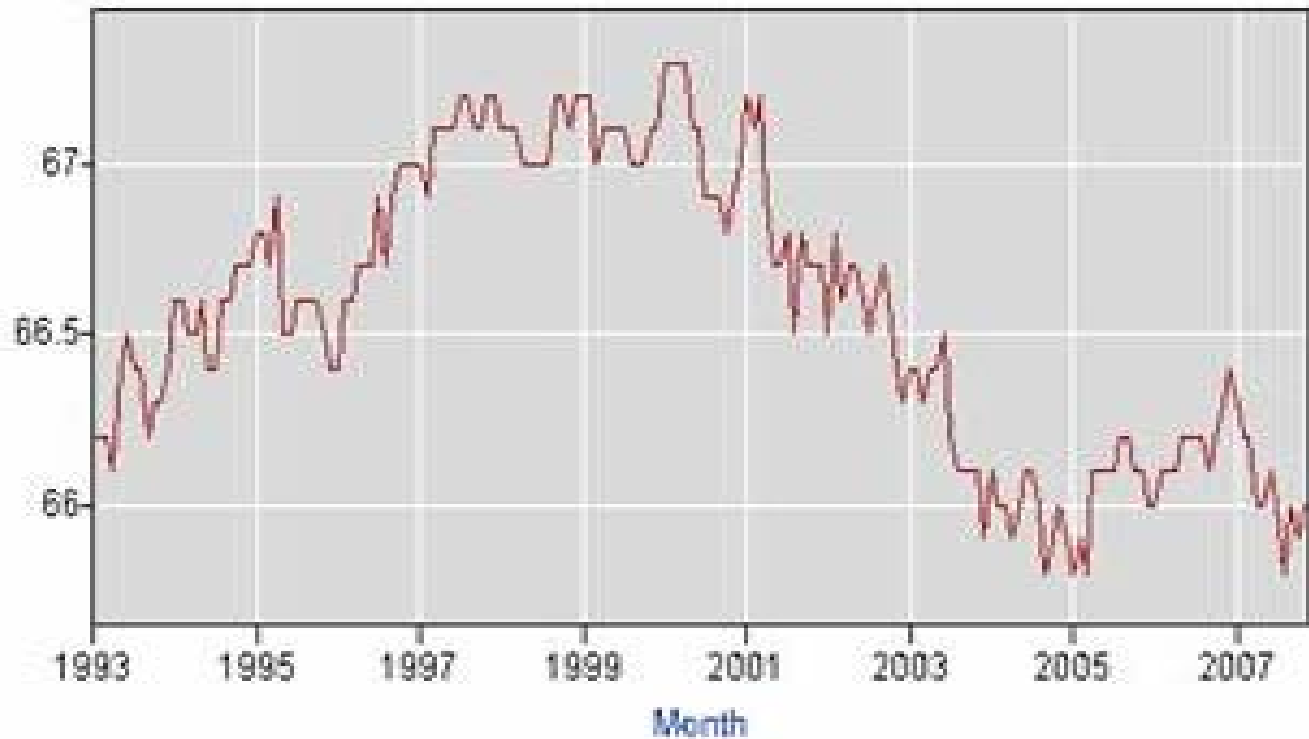
- ❑ Weakening Labor Market
 - ❑ Slipping Housing Prices
 - ❑ Tightening Credit
 - ❑ Rising Fuel Costs
 - ❑ Declining Manufacturing Output
 - ❑ Drooping Consumer Confidence
-

1. National Economic Trends and State Finances – Unemployment Rate



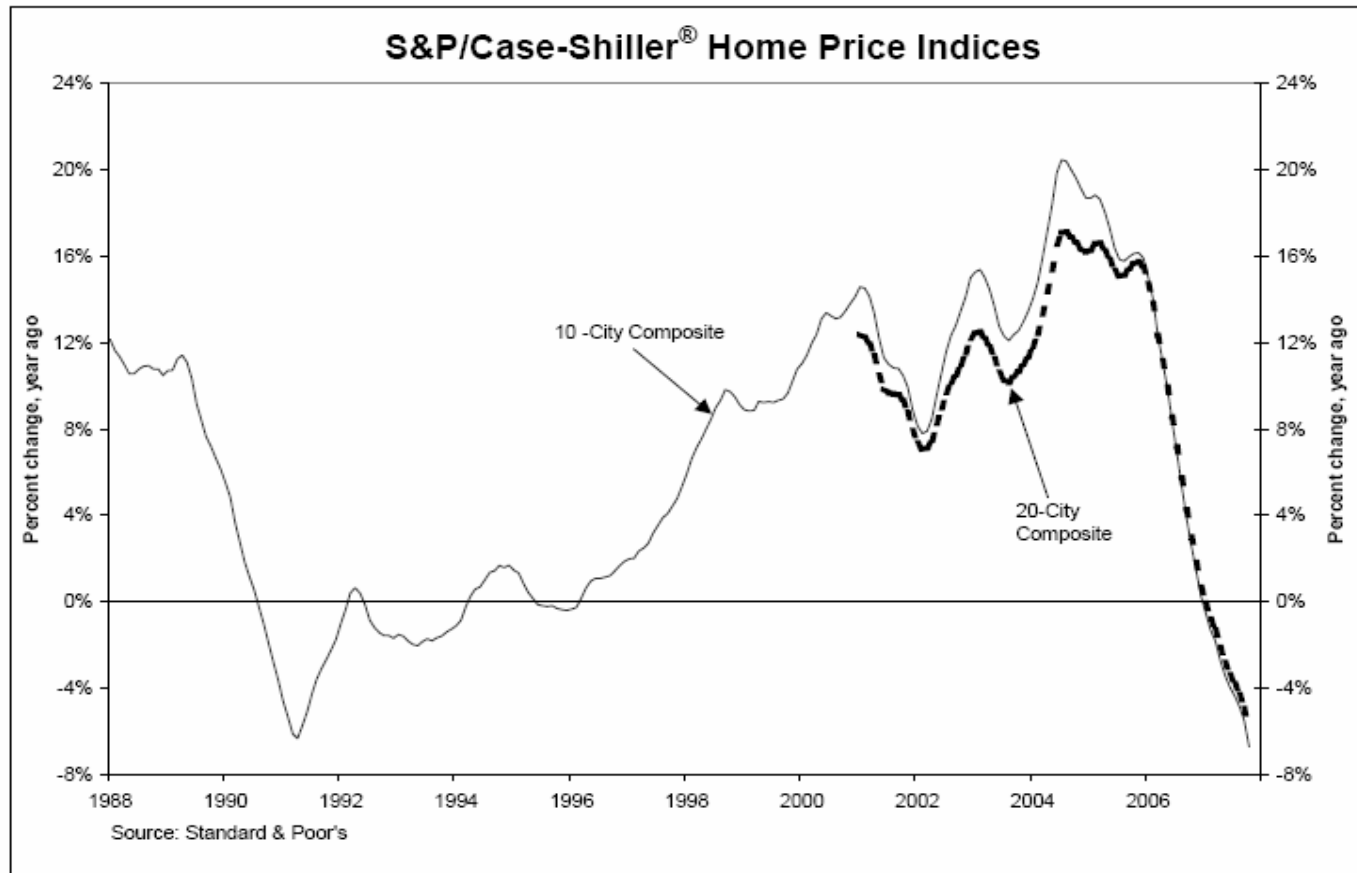
1. National Economic Trends and State Finances

– Labor Force Participation Rate (Percent)



1. National Economic Trends and State Finances

- Record Declines in Home Prices (Dec. 2007)



1. National Economic Trends and State Finances – Inflation, Consumer Confidence

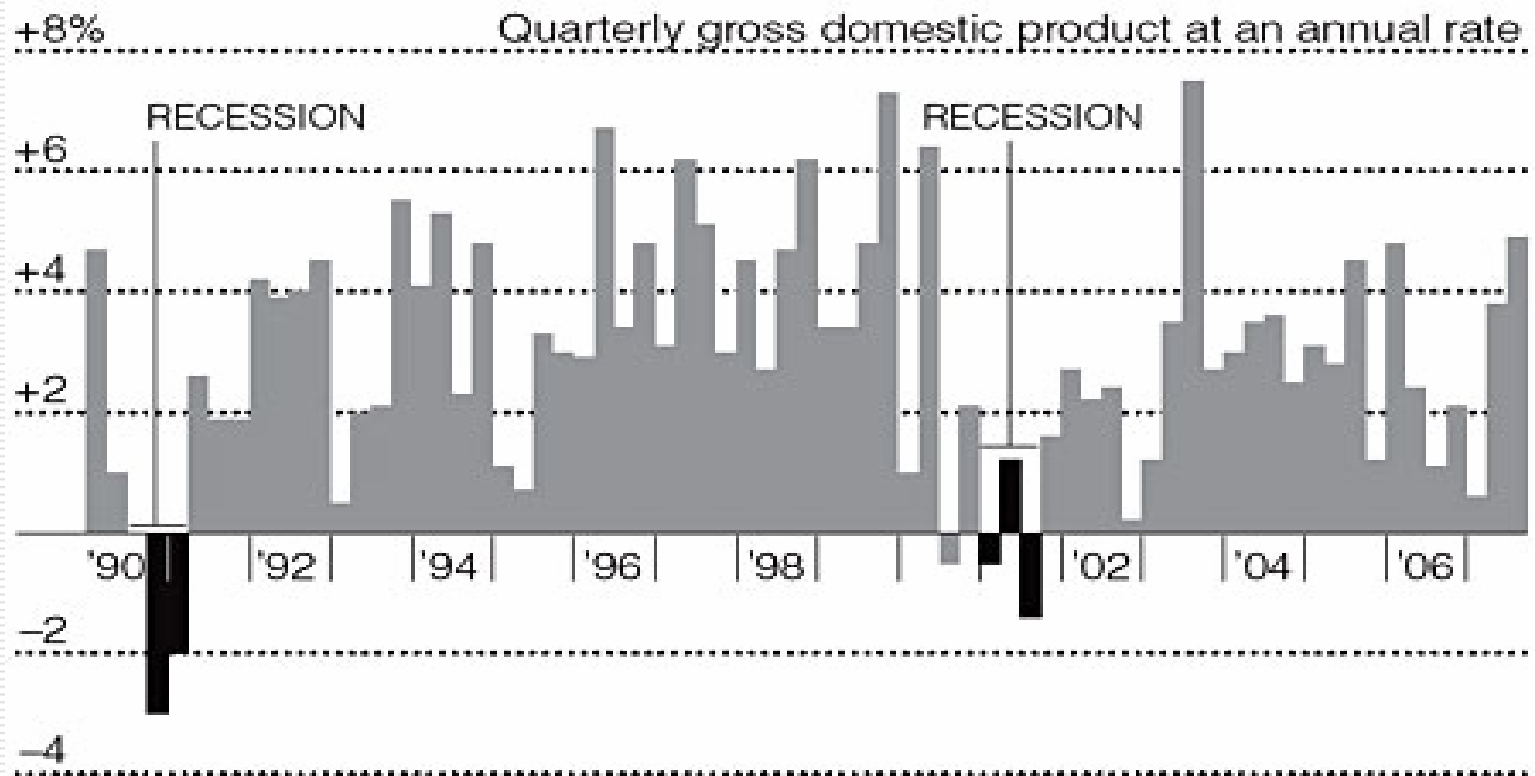
□ In 2007:

- ✓ Wholesale inflation increased by 6.3 percent, the largest amount in 26 years
 - ✓ Consumer prices, driven by food and energy prices, rose by 4.1 percent, the largest amount in 17 years
 - ✓ Consumer satisfaction with the economy plunged to a 15-year low
-

1. National Economic Trends and State Finances – Inflation in 2007

- ❑ Bread rose by 7.4%
 - ❑ Eggs rose by 29.2%
 - ❑ Milk rose by 13.1% (23% since July)
 - ❑ Health insurance rose by 10.1%
 - ❑ Medical care rose by 5.8%
 - ❑ Gasoline rose by 8.2% (30% since Oct.)
 - ❑ Home heating oil rose by 7.4% (27% since Oct.)
 - ❑ College tuition rose by 6.2%
-

1. National Economic Trends and State Finances – GDP Growth



Source: Bureau of Economic Analysis, via Haver Analytics

THE NEW YORK TIMES

1. National Economic Trends and State Finances – 2008 GDP Growth

❑ Federal Reserve Bank Downgrades

- Down from 2.5%/2.7% to 1.8%/2.5%

❑ Blue Chip Economic Forecasters Downgrades

- Down from 2.6% to 2.4%

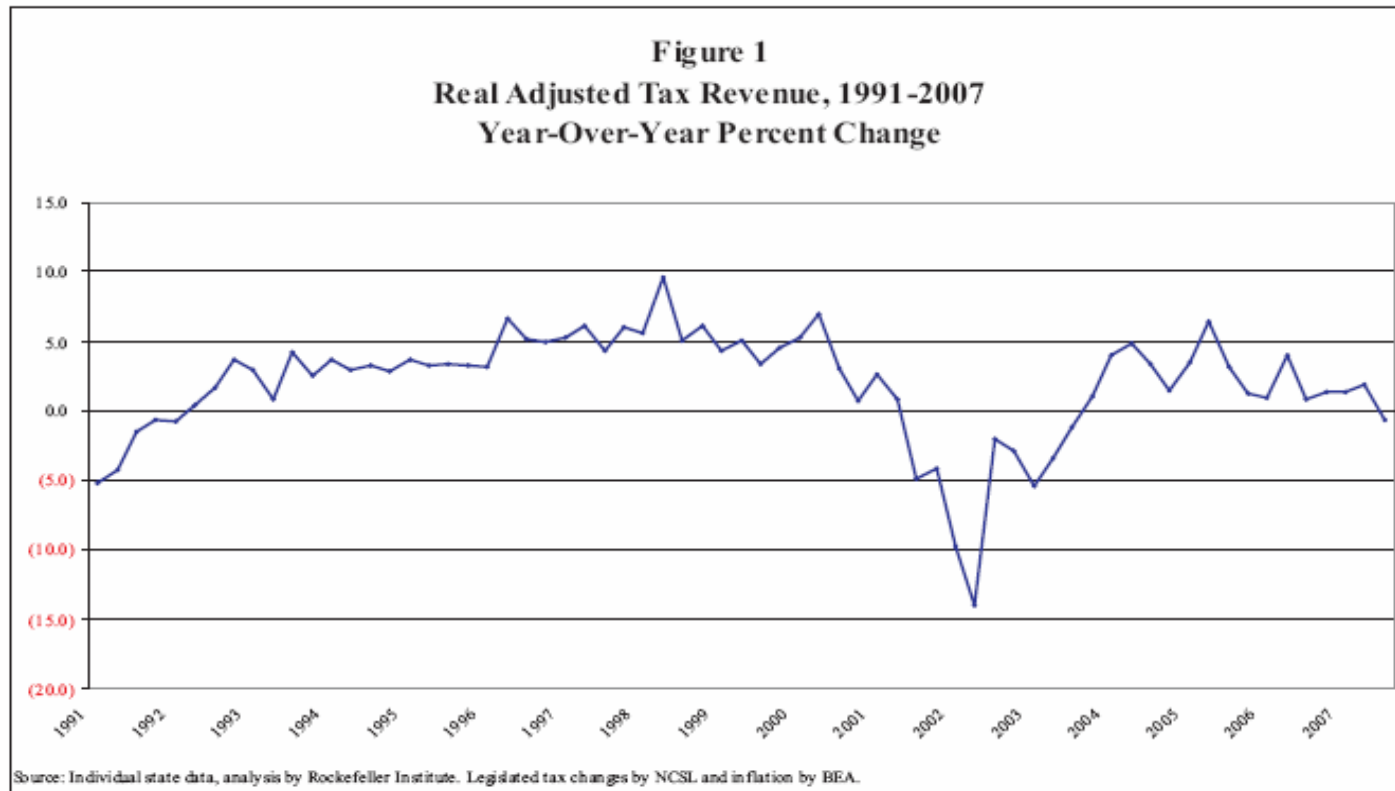
❑ *The Economist* Forecast

- Decline from 2.1% in 2007 to 1.5% in 2008
-

1. National Economic Trends and State Finances – State Tax Collections

- ❑ In FY 2007, revenues exceeded estimates in 38 states, were on target in 4 states and were below expectations in 8 states
 - ❑ For FY 2008, 18 states are “concerned” about meeting their revenue targets
 - ❑ For FY 2008, estimates call for an increase of just 2.9 percent (3.4 percent more in sales and income taxes and 1.4 percent less in corporate income taxes)
-

1. National Economic Trends and State Finances – State Revenues Falter



1. National Economic Trends and State Finances – Declining Year-End Balances

	Total Funds	Rainy Day Funds	Cash on Hand
FY 2002	\$19.7 B	\$11.7 B	\$ 8.0 B
FY 2003	\$17.2 B	\$ 9.6 B	\$ 7.5 B
FY 2004	\$34.0 B	\$18.3 B	\$15.7 B
FY 2005	\$46.4 B	\$23.2 B	\$23.2 B
FY 2006	\$81.0 B	\$31.5 B	\$49.5 B
FY 2007	\$66.8 B	\$29.1 B	\$37.7 B
FY 2008	\$51.2 B	\$31.7 B	\$19.5 B

1. National Economic Trends and State Finances – States with Projected Budget Shortfalls in 2009

	Amount	% of '08 General Fund
Arizona	\$830 M - \$1.8 B	7.8 % - 16.9%
California	\$9.8 B - \$14 B	9.4% - 13.4%
Florida	\$1.4 B - \$2.4 B	4.5% - 7.8%
Kentucky	\$212 M	2.3%
Maine	\$57 M	1.8%
Massachusetts	\$1.2 B	4.2%
Minnesota	\$373 M	2.2%
Nevada	\$286 M	8.6%
New Jersey	\$2.5 - \$3.5 B	7.6% - 10.6%
New York	\$4.3 B	7.9%
Rhode Island	\$400 M - \$450 M	11.8% - 13.2%
South Carolina	\$430 M	6.4%
Virginia	\$1.2 B	6.9%

1. National Economic Trends and State Finances

– States with Projected Budget Shortfalls in 2008

- ❑ TN estimates a shortfall between \$147 M and \$250 M
 - ❑ KY is looking at a \$434 M hole
 - ❑ MD and MI already raised taxes
 - ❑ Number of states have either cut or are proposing cuts (FL, KY, MD, RI, WI, VA)
 - ❑ Governor in CA proposes several major cuts
-

2. Structural Issues: Service-Based Economy

- ❑ Economic activity in the U.S. has moved markedly to a service-based economy
 - ❑ U.S. economy continues to be powered by service sector: In first six months of 2007, without the benefit of 815,000 service jobs, the economy would have had a net loss of 106,000 jobs
 - ❑ However, state sales taxes, often the primary source of revenue for states, relies on a manufacturing-based economy
-

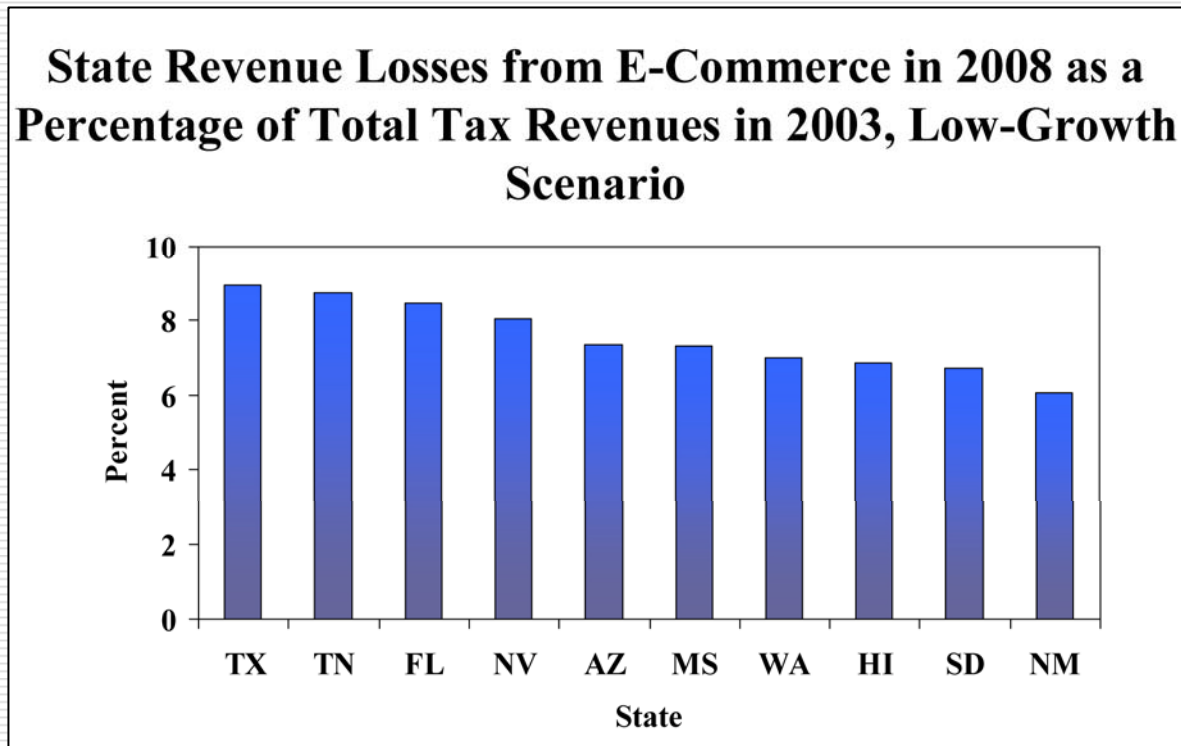
2. Structural Issues: Service-Based Economy

- ❑ Federation of Tax Administrators (FTA) tracks state sales taxes on services such as:
 - ✓ Business Services
 - ✓ Personal Services
 - ✓ Admissions/Amusements
 - ✓ Fabrication, Repair and Installation
 - ✓ Utilities
 - ✓ Computer Services
 - ✓ Professional Services
 - ✓ Other
 - ❑ The latest FTA report lists a total of 168 taxes on services
-

2. Structural Issues: Service-Based Economy

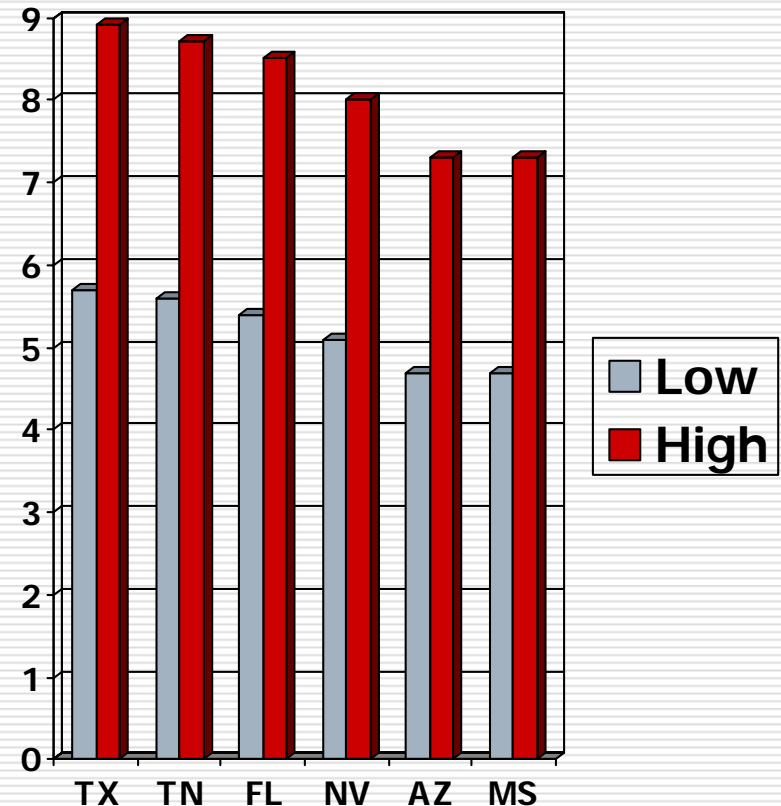
- ❑ Six states (DE, HI, NM, SD, WA, WV) tax more than 100 services
 - ❑ One state (AK) taxes a single service and another (OR) does not tax a single service
 - ❑ 23 states tax between 10 and 50 services
 - ❑ 19 states tax between 51 and 100 services
-

2. Structural Issues: Revenue Erosion from e-Commerce



2. Structural Issues: Revenue Erosion from e-Commerce

- By 2008, state and local government revenue losses from taxable e-Commerce transactions are estimated to range between \$21.5 billion (low) and \$33.7 billion (high)



3. Looming Expenditures:

- Healthcare
 - Public Pensions
 - Corrections
 - Education
 - Transportation and Infrastructure
 - Emergency Management
-

3. Looming Expenditures:

Healthcare

- ❑ National health spending topped \$2 trillion in 2006, the latest year available
 - ❑ This amounted to 16 percent of U.S. GDP, \$7,000 per person on average and an increase from the \$1 trillion spent in 1995
 - ❑ U.S. national health spending, adjusted for inflation, has grown 64 percent in 11 years (1995 to 2006)
 - ❑ Medicaid spending was nearly \$311 billion
 - ❑ Retail spending on prescription drugs rose to nearly \$217 billion
-

3. Looming Expenditures: Healthcare

- ❑ Elderly population in every state will grow faster than the total population (3.5 times faster)
 - ❑ Seniors will outnumber school-age children in 10 states in the next 25 years
 - ❑ 26 states will double their populations of people older than 65 by 2030
 - ❑ FL, PA, VT, WY, ND, DE, NM, MT, ME and WV will all have fewer children than elderly
-

3. Looming Expenditures: Public Pensions

- ❑ Every element in our nation's retirement architecture—Social Security/Medicare; Corporate and Public Pensions; Personal Savings—face serious challenges
 - ❑ From 2005 to 2030, the 65-and-over population will nearly double, to 71 million; its share of the population will rise to 20 percent from 12 percent
 - ❑ Declining worker to beneficiary ratio:
 - 1950 = 16.5 to 1
 - Today = 3.3 to 1
 - In next 40 years = 2 to 1
-

3. Looming Expenditures: Public Pensions

- ❑ The December 2007 Pew Center on the States report documented that states have promised at least \$2.73 trillion in pension, health care and other retirement benefits for public employees over the next three decades
 - ❑ Report noted that while states have saved enough to cover about 85 percent of their long-term pension costs, they only have 3 percent of the funds needed for promised retiree health care and other non-pension benefits
-

3. Looming Expenditures: Public Pensions (Other Studies)

- ❑ 2004 50-State SLC Report – 73 percent or 68 of the 93 plans unfunded
 - ❑ 2007 (Feb) Standard & Poor's report – mean funded ratio declined from an average of over 100 percent in 2000 to 81.8 percent in 2005
 - ❑ 2007 (March) Wilshire Report – actuarial funding ratio declined from 103 percent in 2000 to 88 percent in 2006
 - ❑ 2007 (July) NASRA Report – average funding level at 85.8 percent with a cumulative unfunded liability of \$380.9 billion
-

3. Looming Expenditures: Public Pensions and OPEB

- ❑ GASB Statement 45 requires that state and local governments account for and report the annual cost of OPEB (*Other Post-Employment Benefits*) – mostly health care -and the outstanding obligations and commitments related to OPEB in the same manner as they do for pensions
-

3. Looming Expenditures: Public Pensions (OPEB Estimates)

<input type="checkbox"/> AL = \$10B	<input type="checkbox"/> NJ = \$58B
<input type="checkbox"/> AK = \$500M	<input type="checkbox"/> NY = \$47B - \$54B
<input type="checkbox"/> CA = \$40B - \$70B	<input type="checkbox"/> NC = \$14B
<input type="checkbox"/> CO = \$925M	<input type="checkbox"/> NV = \$1.75B - \$4.4B
<input type="checkbox"/> DE = \$3B	<input type="checkbox"/> RI = \$550M
<input type="checkbox"/> MD = \$20B	<input type="checkbox"/> UT = \$540M
<input type="checkbox"/> MA = \$13B	<input type="checkbox"/> VA = \$5B
<input type="checkbox"/> MI = \$30B	<input type="checkbox"/> VT = \$2.59B

3. Looming Expenditures:

Prisons

- ❑ FY 2007 state corrections budgets amounted to nearly \$38 billion
 - ❑ The country's prison and jail population has never been higher, having risen 2.8 percent from July 2005 to July 2006 to 2.2 million, according to recent federal statistics
 - ❑ Estimates contend that the nation's prison population will grow by another 192,000 in the next five years
 - ❑ Chronic prison overcrowding has corrections officials in a number of states (HI, AL, CA, AZ) looking increasingly across state lines for scarce prison beds, usually in prisons run by private companies
-

3. Looming Expenditures: Transportation

- ❑ In order to maintain U.S. global competitiveness, experts emphasize the need for an expanding and efficient transportation network
 - ❑ Enhancing our nation's transportation network involves substantial enhancements to all transportation modes including surface (highways, bridges), rail, ports and airports
 - ❑ U.S. infrastructure network is aging
-

3. Looming Expenditures: Transportation and Aging Infrastructure

- ❑ One in four of America's nearly 600,000 bridges need significant repair
 - ❑ A third of the country's major roadways are in substandard condition
 - ❑ Traffic jams waste 4 billion hours of commuter time and nearly 3 billion gallons of gasoline a year
 - ❑ Number of dams that could fail has grown 134 percent since 1999
-

3. Looming Expenditures: Transportation (Crumbling Infrastructure and MN I-35W Bridge Collapse, 2007)



3. Looming Expenditures: Transportation

Many states have already signaled huge transportation shortfalls, including

- Georgia (\$7.7 billion shortfall in coming years)
 - New Hampshire (35 years and \$4.5 billion to complete a 10-year plan to construct and repair bridges and highways)
 - Nevada (\$3.8 billion highway construction shortfall)
 - Oregon stands to lose \$1.7 billion in income annually due to reduced transportation improvements
 - The city of Chicago needs \$6 billion to bring its subways into a “state of good repair”
 - Texas (state Department of Transportation reports a \$86 billion gap over next generation)
 - Louisiana (road needs backlog totals \$14 billion)
-

4. Strategies Deployed/Proposed:

- ❑ Raising taxes continues to be **politically radioactive**
 - ❑ Consequently, policymakers are pursuing a range of other strategies, including
 - ✓ Selling/leasing major state assets
 - ✓ Opting for toll roads
 - ✓ Expanding gaming
 - ✓ Increasing fees
 - ✓ Raising tobacco taxes
 - ✓ Issuing debt
-

4. Strategies Deployed/ Proposed: Leasing State Assets

- ❑ Highways (NJ, IN, PA, VA, TX, Chicago)
 - ❑ Lotteries (CA, IL, IN, IO, MD, NJ, NY, TX)
 - ❑ Student Loan Portfolios (MO, IL)
 - ❑ Liquor Stores (PA)
 - ❑ Commuter Railroads (South Bend, IN/Chicago, IL)
 - ❑ Airports (NY, IL)
 - ❑ Advertising Space on Bus Shelters, Newsstands, Garbage Cans (NYC)
 - ❑ Naming Rights to Stadiums (San Francisco, Boston), Transit Stations (CT) and University Buildings (NC)
-

4. Strategies Deployed/Proposed: Pros of Leasing Highways and Toll Roads

- Tolls not taxes;
 - Private equity versus public debt;
 - Expedited completion times;
 - Project cost savings;
 - Enhanced quality and system performance;
 - Substituting private resources and personnel for limited public resources;
 - Access to new sources of private capital.
-

4. Strategies Deployed/Proposed: Cons of Leasing Highways and Toll Roads

- ❑ Lack of in-house public sector expertise to negotiate complex P3 agreements;
 - ❑ States lose control/access of key public infrastructure assets;
 - ❑ P3 toll facilities may be insufficiently regulated sufficiently to protect the public from unreasonably high toll rates or excessive profits;
 - ❑ Non-compete clauses;
 - ❑ Length of the terms of agreements;
 - ❑ Role of the federal government in approval process;
 - ❑ Solicited (or unsolicited) P3 projects might result in adverse fiscal outcomes for states.
-

4. Strategies Deployed/Proposed: Leasing State Assets (Pocahontas Parkway, Virginia)



- ❑ First new construction project under *Public Private Transportation Act of 1995*
 - ❑ Original Financing:
 - \$353 million Toll Revenue Bonds
 - \$18 million SIB Loan
 - \$9 million Federal funding
 - ❑ Transurban and DEPFA (Australian consortium) proposed acquiring the right to collect tolls, operate and manage Parkway for profit
 - ❑ Transurban & VA DOT negotiated a 99-year agreement for project for \$611 million
-

4. Strategies Deployed/Proposed: Leasing State Assets & Best Practices from Virginia



- ❑ Ensure Complete Transparency
 - ❑ Focus on Business Considerations
 - ❑ Employ Skilled Public Sector Staff
 - ❑ Engage the Public at Every Stage
 - ❑ Respect for Customers/Consumers
-

4. Strategies Deployed/ Proposed: Expanding Gaming

❑ State Lottery Sales and Profits

✓ Sales = \$52.6 billion (FY 05); \$57.4 billion (FY 06)

✓ Profits = \$16.4 billion (FY 05); \$17.1 billion (FY 06)

❑ Commercial Casino Gaming Revenue

✓ \$30.29 billion (2005); \$32.42 billion (2006)

4. Strategies Deployed/Proposed: Expanding Gaming

- ❑ Except, UT and HI, every other state has some form of gaming
 - ❑ NC, OK and TN latest to introduce education lotteries
 - ❑ AR seeking voter approval for lottery
 - ❑ A number of states (IL, KY, MD, MA, FL, CA) are pushing to expand gaming through casinos and slot machines
-

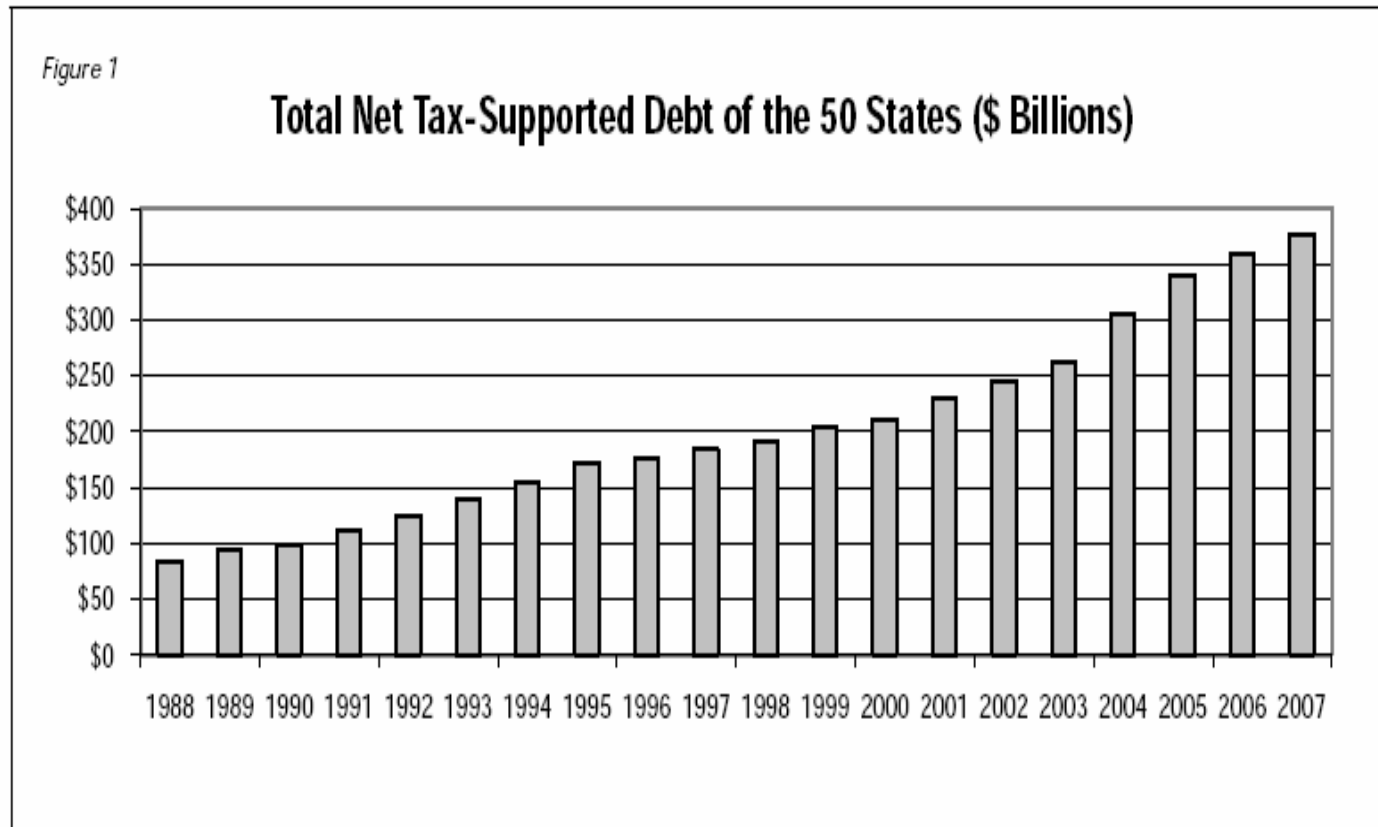
4. Strategies Deployed/Proposed: Hiking Tobacco Taxes

- ❑ As of July 1, 2007:
 - ✓ Overall State Cigarette Tax Average = 107.3 cents per pack
 - ✓ Major Tobacco States' Average = 33.5 cents
 - ✓ Other States' Average = 117.1 cents per pack
 - ❑ In 2007, 11 states hiked their cigarette tax rates
-

4. Strategies Deployed/Proposed: Hiking Tobacco Taxes (2007)

- ❑ AK (by 20 cents; tax now \$2.00)
 - ❑ AZ (by 80 cents; tax now \$2.00)
 - ❑ CT (by 49 cents; tax now \$2.00)
 - ❑ DE (by 60 cents; tax now \$1.15)
 - ❑ HI (by 20 cents; tax now \$1.80)
 - ❑ IO (by 100 cents; tax now 1.36)
 - ❑ IN (by 44 cents; tax now 99.5 cents)
 - ❑ NH (by 28 cents; tax now \$1.08)
 - ❑ SD (by 100 cents; tax now \$1.53)
 - ❑ TN (by 42 cents; tax now 62 cents)
 - ❑ TX (by 100 cents; tax now \$1.41)
-

4. : Strategies Deployed/Proposed: States Issuing More Debt (Moody's)



4. Strategies Deployed/Proposed: States Issuing More Debt (Top Five Net Tax-Supported Debt Per Capita – Moody's)

State	Per Capita	Rating
(1) MA	\$4,153	Aa2
(2) CT	\$3,713	Aa3
(3) HI	\$3,630	Aa2
(4) NJ	\$3,317	Aa3
(5) NY	\$2,694	Aa3

5. Bright Sparks:

Auto Industry in the South

- ❑ U.S. auto industry is a study in stark contrasts:
 - On the one hand, the Big Three (General Motors, Chrysler and Ford) domestic automakers — domiciled mostly in the Midwest — hemorrhage vast amounts of cash and battle a range of structural problems
 - On the other hand, an increasing roster of foreign automakers — located mostly in the South — thriving financially and generating a panoply of positive economic benefits, locally and regionally
-

5. Bright Sparks:

Auto Industry in the South

- ❑ Alabama (Mercedes; Honda; Toyota; Hyundai; Isuzu)
 - ❑ Georgia (Kia)
 - ❑ Kentucky (Toyota)
 - ❑ Mississippi (Nissan; Toyota)
 - ❑ South Carolina (BMW)
 - ❑ Tennessee (Nissan)
 - ❑ Texas (Toyota)
 - ❑ Virginia (Volvo)
 - ❑ West Virginia (Toyota)
-

5. Bright Sparks: Auto Industry in the South

- ❑ Mercedes Vehicles Manufactured at Plant in Vance, Alabama



V. Bright Sparks: Major Economic Development Projects

- ❑ ThyssenKrupp, EADS, National Rail Car, all announced major projects in AL
 - ❑ Numerous states (CA, NC, FL, NY, CT, NJ, IL, TX) expanding bio technology facilities, including
 - CA (\$3 billion over 10 years)
 - NC (\$1.5 billion project to convert a 350-acre site in a former mill town to a cutting-edge bio tech center)
 - FL (\$310 million in funds to lure Scripps to open a facility in Palm Beach County)
 - ❑ In Berkeley County, SC, Google will spend about \$600 million to build a data center
 - ❑ AZ and UT major technology centers
-

5. Bright Sparks: Ports, Top 10

U.S. Ports by Cargo Volume, 2005

Rank	Port/State	Cargo (Tons)
1	South Louisiana, LA	212,245,241
2	Houston, TX	211,665,685
3	New York/New Jersey	152,131,674
4	Huntington, WV,OH,KY	83,888,903
5	Long Beach, CA	79,857,710
6	Beaumont, TX	78,886,680
7	Corpus Christi, TX	77,646,945
8	New Orleans, LA	65,875,811
9	Baton Rouge, LA	59,293,661
10	Texas City, TX	57,839,378

5. Bright Sparks: Ports and Automobiles (BMW's at the Port of Charleston, SC)



5. Bright Sparks: Film Industry

- ❑ Hollywood's new Backlot: The U.S.?
 - ❑ States enacting various incentives to attract the motion picture industry
 - ❑ Louisiana's 2002 landmark legislation
 - ❑ Industry's sizable economic impacts:
 - ✓ Louisiana: output of \$1 billion (2005)
 - ✓ New Mexico: financial effect of \$428 million (FY 2006)
 - ✓ California: economic activity of \$42.2 billion (2005)
 - ✓ Georgia: economic impact of \$448.3 million (2006)
 - ✓ Florida: \$3.9 billion industry (2007)
 - ✓ North Carolina: \$300 million in spending (2006)
-

State Finances in 2008: Return to Red Ink Rising?

Thank you

For more information, please contact

Sujit M. CanagaRetna

404/633-1866

or

scanagaretna@csg.org

www.slcatlanta.org