



The Fiscal Crunch Confronting the South

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The Council of State Governments
Southern Legislative Conference

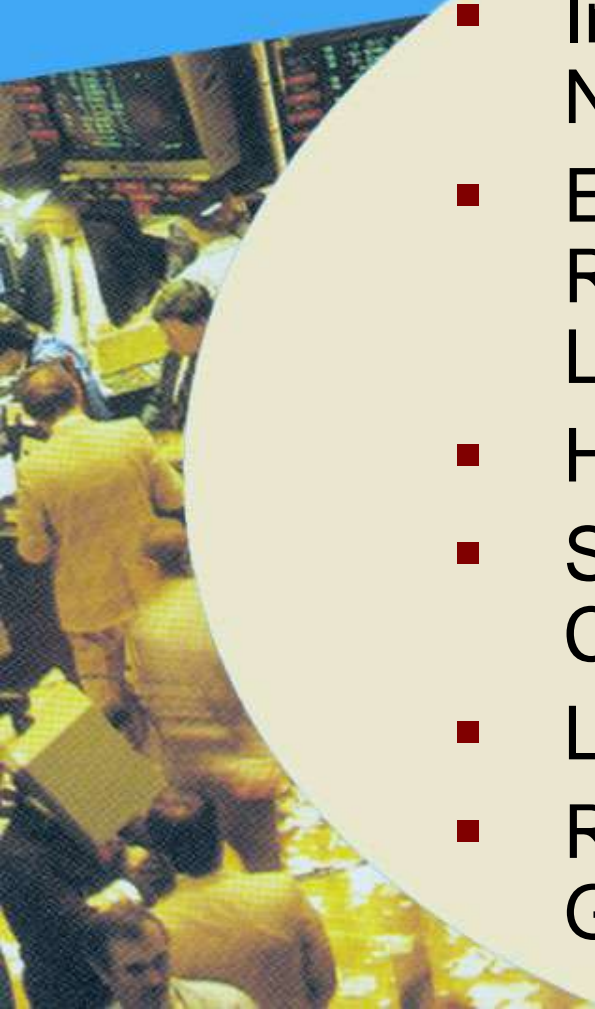
Kentucky General Assembly
Joint Hearing of the Appropriations and Revenue Committees
Frankfort, Kentucky
January 14, 2003

Presentation's **Five** Main Parts

1. Where We Were
2. Where We Are
3. What these New Conditions Mean for States
4. What Measures States Have Taken
5. What Can We Expect

I. Some Measures of the Boom Years

- Impressive GDP Growth at both the National and State Levels
- Extremely Favorable Unemployment Rates at both the National and State Levels
- High-Flying Stock Market
- Soaring Personal Incomes and Corporate Profits
- Low Inflation Rates
- Rising Revenue Flows to All Levels of Government-Federal, State and Local



I. Focus on the Specifics:

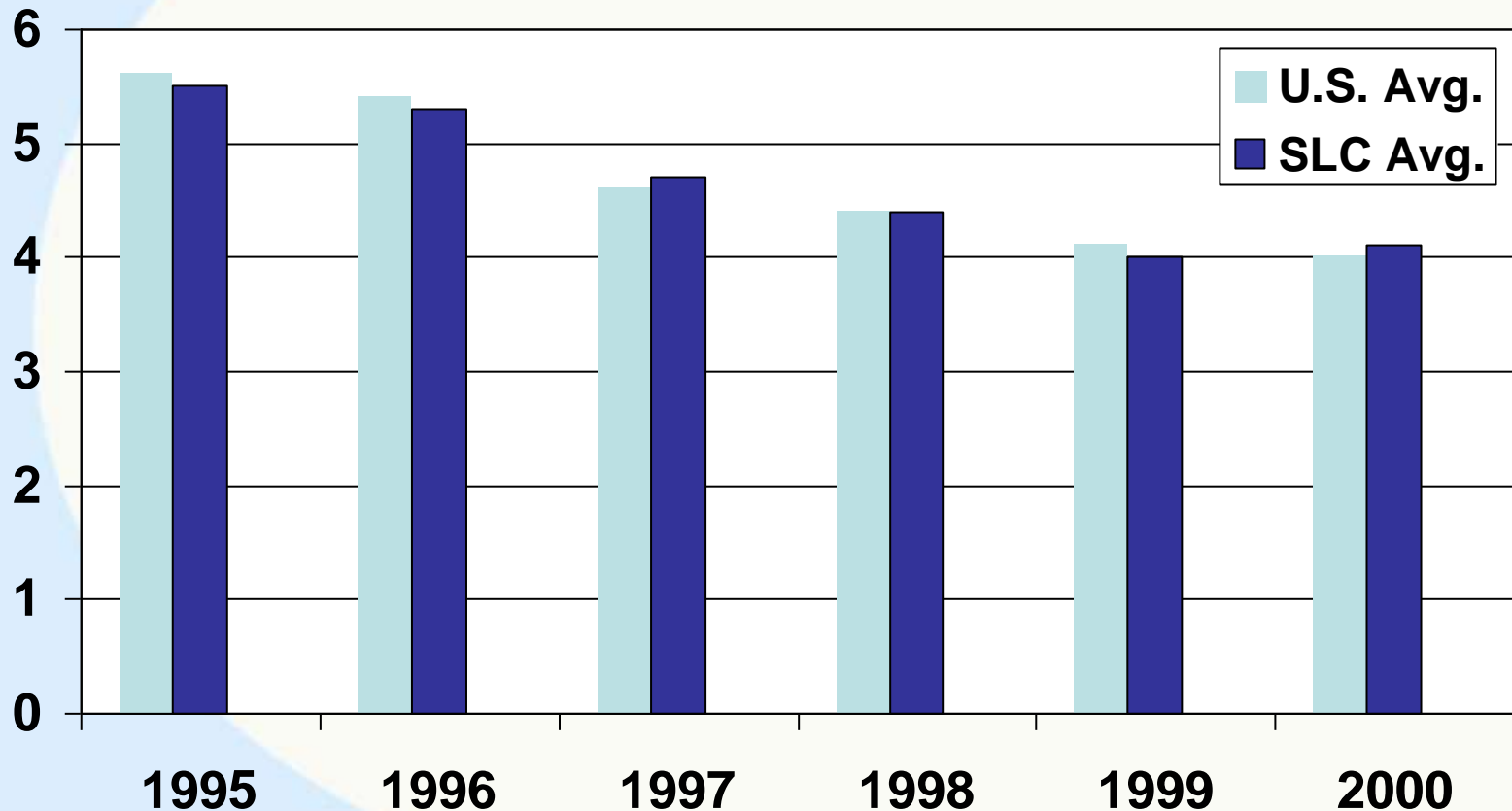
GDP

- National GDP Growth
1991 = -0.5% 1994 = 4.0%
1997 = 4.4% 2000 = 3.8%
- SLC States Average GDP Growth
1998 = 5.3% 1999 = 5.6%
2000 = 6.1%
- In 2000, Virginia = 8.6%; Texas = 8.4%;
North Carolina = 8.1%
- Actual GDP in 2000 (Current Dollars)
Texas = \$742.3 Billion; Florida = \$472.1 Billion
Georgia = \$296.1 Billion; North Carolina =
\$281.7 Billion; Kentucky = \$118.5 Billion

I. Focus on the Specifics:


Unemployment Rate (Percent),
1995 to 2000


US and SLC State Unemployment Rates (Percent),
Nov. 1995 to Nov. 2000





I. Focus on the Specifics:


Low Unemployment Rates in SLC States, November 2000 (Percent)

 AL = 4.6%

 AR = 4.2%


 FL = 3.6%

 GA = 3.4%


 KY = 4.1%


 LA = 6.0%


 MD = 3.8%


 MS = 5.6%


 MO = 3.5%

 NC = 3.9%

 OK = 2.9%

 SC = 3.3%

 TN = 4.2%

 TX = 4.0%

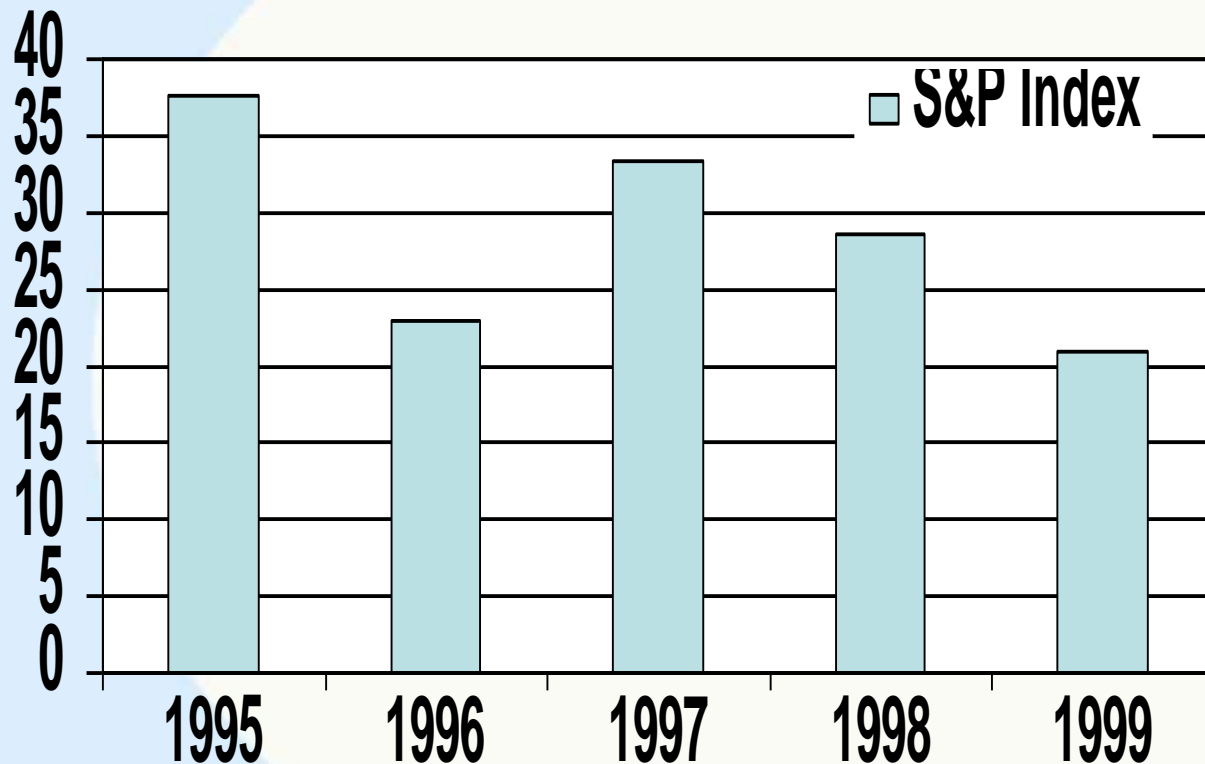
 VA = 2.1%

 WV = 5.6%

I. Focus on the Specifics:

Total Returns on the S & P 500 Stock Index

Average Growth = 29% Between 1995-99



Stock Market's Growth Brought in Tremendous Revenue Flows into Government Coffers with Increased Capital-Gains Taxes and Withholding Taxes

II. Current Predicament:

Federal

- Federal Budget Deficits Loom (FFY)

1992 = \$-290.4 Billion	1996 = \$-107.5 Billion
1998 = \$69.2 Billion	1999 = \$125.5 Billion
2000 = \$125.5 Billion	2001 = \$127.1 Billion
2002 = \$-159 Billion	2003 = \$-350 Billion(?)
- In January 2001, CBO predicted a federal budget surplus of \$5.6 Trillion between 2002 and 2011
- In late 2002, that surplus shriveled to only about \$1 Trillion between 2003 and 2012

II. Current Predicament:

State

- At least 46 states struggled to close a cumulative budget gap of \$37 Billion in FY 2002
- For FY 2003, the estimated cumulative budget gap is almost \$68 Billion
- For FY 2004, the estimated shortfall is a staggering \$60 billion to \$85 billion, some 13 to 18 percent of all state expenditures
- Highlights from outside the region:
 - California faces an almost \$35 billion shortfall in the next 18 months
 - New York City alone faces a budget gap of \$7.5 billion in the next 18 months

II. Current Predicament:

Selected SLC State FY 2004 Deficit

State	Deficit (Millions)	% of Budget
Alabama	\$1,300	24.2%
Arkansas	\$223	7.0%
Florida	\$2,000	10.1%
Georgia	\$900	5.8%
Maryland	\$1,200	11.0%
N. Carolina	\$1,700 to \$2,000	12.4% to 14.6%
Oklahoma	\$800	15.9%
S. Carolina	\$700	13.6%
Virginia	\$1,116	9.3%
W. Virginia	\$200	7.1%

II. Current Predicament:

Signs of the Weakening Economy: Subdued GDP Growth

Two Consecutive Quarters of Negative GDP Growth in 2001 Met the Technical Requirements for a Recession

2001				2002		
Qtr.1	Qtr.2	Qtr.3	Qtr.4	Qtr.1	Qtr.2	Qtr.3
1.5%	-0.1%	-0.4%	0.1%	1.4%	2.2%	3.2%

II. Current Predicament:

Other Signs of Weakening Economy

- Plummeting Consumer Confidence, Nine-Year Low in October 2002
- Number of People Below the Federal Poverty Threshold in 2001 stood at 32.9 Million, or 11.7% of Total Pop., first increase since 1991/92 recession
- Plunging Stock Market-Worst Bear Market in Since World War II

III. Implications for State

Finances: Anemic Revenue Inflows

- AL Total Revenues increased by 9% between Dec. 2001 and Dec. 2002 and increased by 5% between the first three months of FY 2002 and FY 2003
- AR Net General Revenues increased by 4% between the first six months of FY 2002 and FY 2003 (July-Dec. 2001 vs. July-Dec. 2002)
- FL Net Revenue increased by 2% between the first five months of FY 2002 and FY 2003 (July-Nov. 2001 vs. July-Nov. 2002)
- GA Net Revenue decreased by 4% between the first six months of FY 2002 and FY 2003 (July-Dec. 2001 vs. July-Dec. 2002)
- KY Tax Receipts increased by 6% between the first five months of FY 2002 and FY 2003 (July-Nov. 2001 vs. July-Nov. 2002)
- MD Between Nov. 2001 and Nov. 2002, Sales and Use Taxes decreased by 2% but increased by 2% for the first four months of FY 2003 and FY 2004 (Aug.-Nov. 2001 vs. Aug.-Nov. 2002)
- MS Total General Fund Revenue Transfers increased by 2% between the first five months of FY 2002 FY 2003 (July-Nov. 2001 vs. July-Nov. 2002)
- MO Between Dec. 2001 and Dec. 2002, General Revenue collections decreased by 1% and decreased by 3% between the first six months of FY 2002 and FY 2003 (July-Dec. 2001 vs. July-Dec. 2002)

III. Implications for State

Finances: Anemic Revenue Inflows

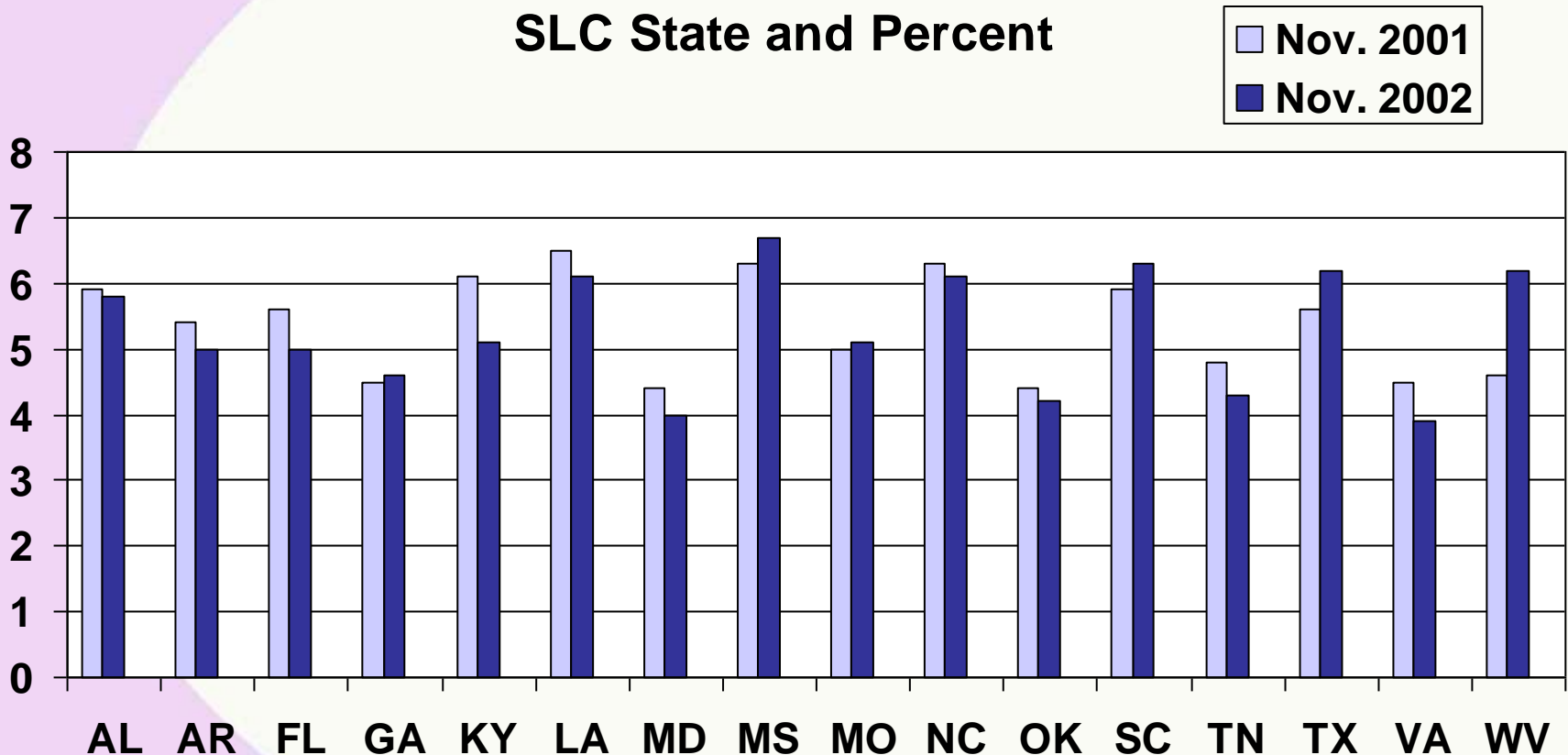
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- NC State Tax Revenue collections for Nov. 2002 decreased by 7% over Nov. 2001. Between the first five months of FY 2002 and 2003, Tax Revenue collections increased by 11%
- OK Total General Revenues barely increased (0.3%) between Nov. 2001 and Nov. 2002. Between the first five months of FY 2002 and 2003 (July-Nov. 2001 vs. July-Nov. 2002), total General Revenue declined by 8%
- SC Total Revenue increased by 2% between the first five months of FY 2002 and 2003 (July-Nov. 2001 and July-Nov. 2002).
- TN Total Revenues increased by 8% between Nov. 2001 and Nov. 2002
- TX State Sales Tax Net Collections decreased by 1% between Dec. 2001 and Dec. 2002 (Texas has no Income Tax)
- VA Total General Fund Revenues decreased by 4% between Nov. 2001 and Nov. 2002. Between the first five months of FY 2002 and FY 2003 (July-Nov. 2001 vs. July-Nov. 2002) revenues declined by 1%
- WV Revenues for Dec. 2002 were \$4 million over estimates and \$1 million over estimates for the first six months of FY 2003

III. Implications for State

Finances: Rising SLC State Unemployment Rates (Percent), November 2001 and November 2002

SLC State and Percent



III. Implications for State Finances:

Rising Unemployment Rates (Percent),
November 2001 and November 2002 (Cont.)

- Average SLC Unemployment Rate Still Lower than National Rate in November 2002 (5.3% vs. 6%). They were 5.3% and 5.4% respectively in November 2001
- SLC States Most Hard Hit in November 2002: Louisiana, Mississippi, North Carolina, South Carolina, Texas and West Virginia, all above 6%

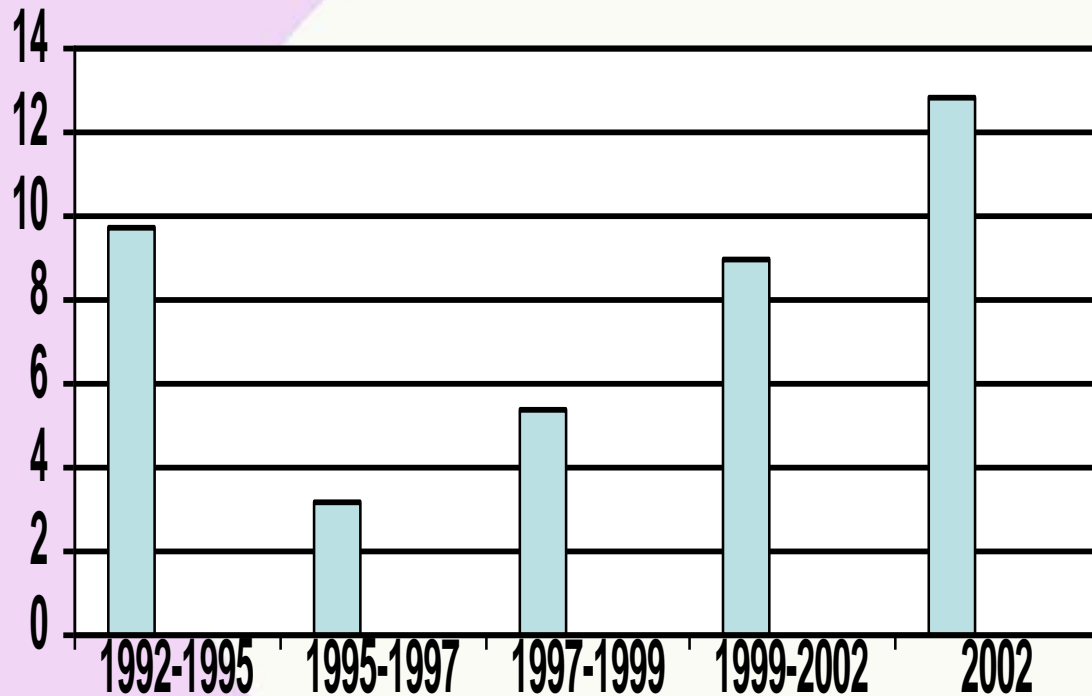
III. Implications for State

Finances: Exploding Medicaid Costs

- Major Reasons Cited by States for Exploding Medicaid Budgets: Prescription Drugs (44 states) and Increased Enrollment (39 states)
- Some Cost Containment Actions Taken by SLC States in FY 2002:
 - Pharmacy Controls (12 states)
 - Provider Payment Reductions (8 states)
 - Clamp Down on Fraud/Abuse (6 states)
- Similar Measures Can Be Expected in FY 2003 along with cutbacks in Medicaid eligibility

III. Implications for State

Finances: Exploding Medicaid Costs (Cont.)



- Average annual growth rates of total Medicaid spending has been rising
- The almost 13% increase in 2002 is the highest in almost a decade
- After dropping from the high of 27% in the early 1990s to 3.2% in the mid 1990s, the rates are rising again
- Almost all the SLC states have seen double-digit increases in enrollment between Dec. 1997 and Dec. 2001

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls

- Slash Spending
- Tap Rainy Day Funds
- Utilize Tobacco Settlement Monies
- Raise Taxes
- Hike Cigarette Taxes
- Establish State Lotteries

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Slash Spending

- LA imposes across-the-board cuts of \$75 million followed by an additional \$82 million
- TX seeks input from agencies on cutting 3% to 5%
- VA cuts \$858 million in spending with agencies facing budget reductions of 11%-15% with another \$400 million in cuts to follow
- OK makes across-the-board cuts totaling 9%
- GA agencies face budget reductions totaling 5%
- MD considering a number of measures including cutting all employee pay by 1 percent, withholding aid to local governments, scaling back scholarships, raising income taxes on the wealthy and hiking the state's sales tax and property tax rates
- MO laid-off almost 900 workers and is looking at further layoffs

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Tap Rainy Day Funds

- In FY 2002, 19 states around the country tapped into their rainy day funds to close out their budget gaps
- It is estimated that in FY 2003, 12 states would resort to this strategy
- In FY 2002, Oklahoma, utilized \$268 million from its rainy day fund; in the past five years, OK has used \$571 million
- North Carolina drew down its rainy day fund from \$522 million in FY 1999 to \$125 million in FY 2002
- In Louisiana, Governor Foster secured \$86 million of the \$263 million currently in rainy day fund
- Governor Glendening in Maryland decides to use \$190 million from rainy day fund

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Deploy Tobacco Settlement Monies

- In FY 2002, 12 states used the proceeds of securitizing their tobacco settlement monies to address mounting budget gaps in their budgets
- In FY 2003, it is estimated that 16 states would do so
- Missouri tapped \$139 million of its funds to offset its shortfall and hopes to use another \$350 million
- Alabama secured \$30 million of its funds for Medicaid
- Tennessee used \$368 million of its funds to close the shortfall in fiscal year 2002. In addition, the legislature decided to count \$160 million to be received every year under the agreement for the next 20 years as “recurring revenue” in its budget deliberations

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Raise Taxes

- Personal Income Taxes went up in OK because of an automatic trigger adopted as part of a tax reduction act in 1998
- AL increased Business Taxes by \$58 million by taxing interstate long-distance telephone calls
- Sales Taxes went up in TN and NC. In certain counties in TN, the sales tax is 9.75%, the highest in the country. In NC, the sales tax could be as high as 7.5%
- AR's governor, after re-election, proposed raising state's sales tax and generating \$474 million in new revenue
- MO, MD and AR reviewing a number of corporate exemptions to bring in additional revenue
- New Speaker in AR wants to remove the income and capital gains tax cuts passed in 1997 and 1999

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Hiking Cigarette Taxes

- 19 states implemented higher cigarette taxes in 2002
- 27 states have not increased their cigarette taxes for at least five years
- Four SLC states increased their cigarette taxes in 2002: Arkansas (34 cents, Louisiana (36 cents), Maryland (100 cents) and Tennessee (20 cents)
- Governor Wise in VW has proposed increasing his state's cigarette tax to at least 55 cents per pack and using the all revenue from the increase to bail out the state's Medicaid program
- Proposals in GA, TX and SC to raise the cigarette tax and secure additional revenue

IV. Measures Adopted by SLC States to Deal with Budget Shortfalls: Establishing State

Lotteries

- Tennessee became the latest state to move closer towards establishing a state lottery to pay for specific education initiatives
- New Governor in Maryland campaigned on slots at the racetracks as a source of additional funding (possibly \$800 million per year) for the state
- South Carolina voters approved a state lottery to finance education initiatives a few years ago
- In North Carolina, during the 2002 session, a measure to place a referendum on the ballot on introducing a state lottery to fund education initiatives was defeated

V. What Can We Expect?

- Both the federal government and states will face significant budgetary problems in the next few years
- The economy is not expected to begin generating jobs in a substantial manner for the next 12-15 months
- Yet, there are several positive features of the current economy which should not be disregarded
 - (1) Inflationary pressures are minimal
 - (2) The economy is still expanding
 - (3) Record-low interest rates, lowest in some 40 years
 - (4) American productivity gains continue to be very impressive

V. What Can We Expect?

- (1) Inflationary pressures remain minimal with the CPI expected to rise by just 2.6% in 2002
- (2) GDP growth for the U.S. economy is expected to be close to 2.7% in 2002; in 2003, it is expected to be close to 3%
- (3) Low mortgage rates have sustained the explosive growth pattern of the housing market as more and more Americans purchase their first homes and re-finance their existing mortgages. Between May 1998 and January 2003, rates on a 30-Year fixed mortgage plunged with the U.S. average declining from 6.9% to 5.6%; the SLC average also dropped from 6.9% to 5.6%

V. What Can We Expect?

(4) Productivity Improvements

- Federal Reserve Bank Chairman Alan Greenspan has been a fervent proponent of the theory that the American economy has entered an era of stronger productivity growth based on the technological advances reached in the 1990s
- American productivity has continued to post impressive gains recently and the 4 percent growth in productivity in the third quarter of 2002 brings the annual rate over the past year to a remarkable 5.3 percent, the best performance in nearly two decades



For More Information

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