State Budget Outlook and Implications

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The National Conference of State Legislatures'(NCSL) latest budget survey asked legislative fiscal officers for general assessments of their state economies. The responses overall indicated that most states are experiencing or anticipate experiencing problems in the housing, financial, and manufacturing sectors. This is especially true for housing in Arizona, Florida, and Nevada; finance in Delaware and New York; and manufacturing in Michigan and Ohio.

The survey noted that from Puerto Rico to Maine to Illinois to Oregon, legislative fiscal officers point to housing, financial, and manufacturing sectors as worrisome. Furthermore, construction, manufacturing, financial, and real estate activities accounted for more than a third of gross domestic product (GDP)in 2007. These sectors link to the economy in ways that can promote growth when they perform well and exacerbate slowdowns when they do not.

The report states that housing is one example of this.

> Housing troubles affect American consumers—whose purchases account for more than 70 percent of US economic growth. Fewer home purchases mean fewer sales of "durable goods" to fill them such as washing machines, furniture, etc. In addition, many Americans accustomed to borrowing on their homes now have less access to credit—credit that is often used to shop for items not limited to home decor. (p. 11)

And, since most states fund their education programs through property taxes, and property tax revenue generates a significant portion of a state's general funds, the impact on state legislatures' ability to increase appropriations for education is impacted by the condition of the housing market. The bottom line is that, for states, problems in the general economy mean declining sales tax revenue going into state treasuries.

According to a July 2008 report by the Security Industry & Financial Markets Association, state tax revenues are heading toward budget deficits for FY 2009 totaling $40.3 billion.

Alabama — $784M
Arizona — $1.9B
Arkansas — $107M
California — $22.2B
Connecticut — $150M
Delaware — $217M
District of Columbia — $96M
Florida — $3.4B
Georgia — $650M
Hawaii — no estimate of size of shortfall
Illinois — $1.8B
Indiana — Though the budget in Indiana is currently in the black, there is an expectation that an effort to implement a sales tax on services will emerge.
Iowa — $350M
Kentucky — $266M
Maine — $124M
Maryland — $808M
Massachusetts — $1.2B
Michigan — $472M
Minnesota — $935M
Mississippi — $90M
Nevada — $898M
New Hampshire — $200M
New Jersey — $2.5–3.5B
New York — 2009–2010 $6.545B
2010–2011 $9.532B (11%)
2011–2012 $10.862B (12%)
Ohio — Forced to do a midbudget correction this year on their two-year operating budget, which had a gap of $733M–1.3B (2.4–4.7%). The cuts were achieved via state spending cuts.
Oklahoma — $114M
Pennsylvania — No shortfall estimate yet. Taxes and budgeting in Pennsylvania are substantially based upon the tax year 2 years prior, so the state is always late to respond to a slowdown.

Rhode Island — $430M
South Carolina — $245M
Tennessee — $468–585M
Texas — Though Texas is currently in the black, that can be misleading since the state has a biannual budget process, and can only roughly estimate due to the recent implementation of the margins tax. There should be updated revenue estimates in the late fall as the Legislature begins work on the 09 and 10 budget. A lot of attention will be focused on the corporate and margins taxes when the Legislature convenes in Regular Session in January 2009.
Utah — $100M, which is expected to rise substantially by the end of the year.
Vermont — $59M
Virginia — $1.2B
Wisconsin — $652M

Until the recent problems in the country's financial and credit markets, a few bright spots could be found in the energy-producing and agricultural states. Ten states reported strong performance from oil, gas, or mining sectors. High fuel prices translated into strong state economies for states like Texas and Alaska with increased corporate profits, job creation, increased demand for housing, increased demand for ethanol, and large contributions to state revenue surpluses.

Health care, education, tourism, and trade sectors were other bright spots in the NCSL survey.

> Ten states reported health care as an industry with strong performance. Six listed the education sector as strong—five of those specifically noting expansion in employment in education. Both of these sectors seem poised for further growth. Demand for health care services is expected to increase as the demographic shift described as the “graying of America” at NCSL's 2008 Legislative Summit begins to accelerate. If personal spending on education continues to steadily increase as it has over the past 20 years (seen in data from the Bureau of Economic Analysis) then this sector is also likely to continue to grow.

> States also pointed to tourism and trade as sectors with strong growth. Eleven states from almost every region of the country listed tourism as performing well. Florida and Vermont both specifically identified international tourism as strong, although the former notes that it "represents a small portion of the economy." A notable exception to robust tourism was the traditional hotspot of Hawaii, reportedly down due to increasing travel costs.
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> International trade was listed by only two states as one of their strongest performing sectors. This may represent an opportunity that states have yet to realize or take advantage of. Now might be a particularly opportune time to focus on exports as the US dollar remains weak and economic growth in many developing countries is at record levels. In the short term, increases in exports may help to offset some of the effects of the current domestic downturn. In the long term, states establishing more ties to expanding areas of the global economy will be better positioned to compete in and benefit from international trade. (p. 11–12)

However, again, with the dramatic downward change in fortunes in the financial and credit markets, mostly associated with complicated, unregulated, high-risk investment transactions, which have devastated all sectors of the economy, possibly resulting in a doubling of the annual federal budget deficit for FY 2009 and a doubling of the national debt over a short 8 year period, these bright spots are likely temporary.

If the current trend continues, state legislatures will be forced to make tough budget and appropriations decisions (as the new 111th Congress and Administration will have to do at the national level). Of course, state legislatures (with the exception of Vermont) are required by their constitutions to operate "pay-as-you-go" governments. Projected deficits must be paid for with current revenues through increased state taxes or reduced spending or both.

Traditionally, when faced with this dilemma, higher education is usually the victim. Most state legislatures generously fund their higher education systems when times are good (some to the tune of 25%–30% of the state's annual budget) because of the collateral benefits generated by a strong higher education sector. An educated population generates increased tax revenue, attraction for businesses locating in the state, federal research dollars, etc. However, in times of a lagging economy, reduced tax collections, and projected budget deficits, state legislatures choose to reduce spending in lieu of, or at least before, increasing taxes. Consequentially, higher education is first to "pay the piper."

Since conditions have worsened as state lawmakers are developing their FY 2009, 2010, and 2011 budgets, a growing number are facing projected imbalances not existent in recent years. Until the national and global fiscal and monetary issues are resolved, or at least until clear progress can be seen, state support for higher education will be tenuous at best. However, with challenges there are opportunities. Higher education associations and advocates are front and center in identifying and proposing those changes which will allow higher education to both adapt and progress.