

State Budgets -- Update

TOTAL SHORTFALLS EXPECTED FOR FISCAL YEAR 2002:

Approximately \$15 billion
(as of October 31, 2001)

A preliminary review conducted by the National Association of State Budget Officers (NASBO) of projected state budget shortfalls expected for fiscal year 2002 indicates that net state budget shortfalls currently amount to at least \$15 billion.

Current Budget Information

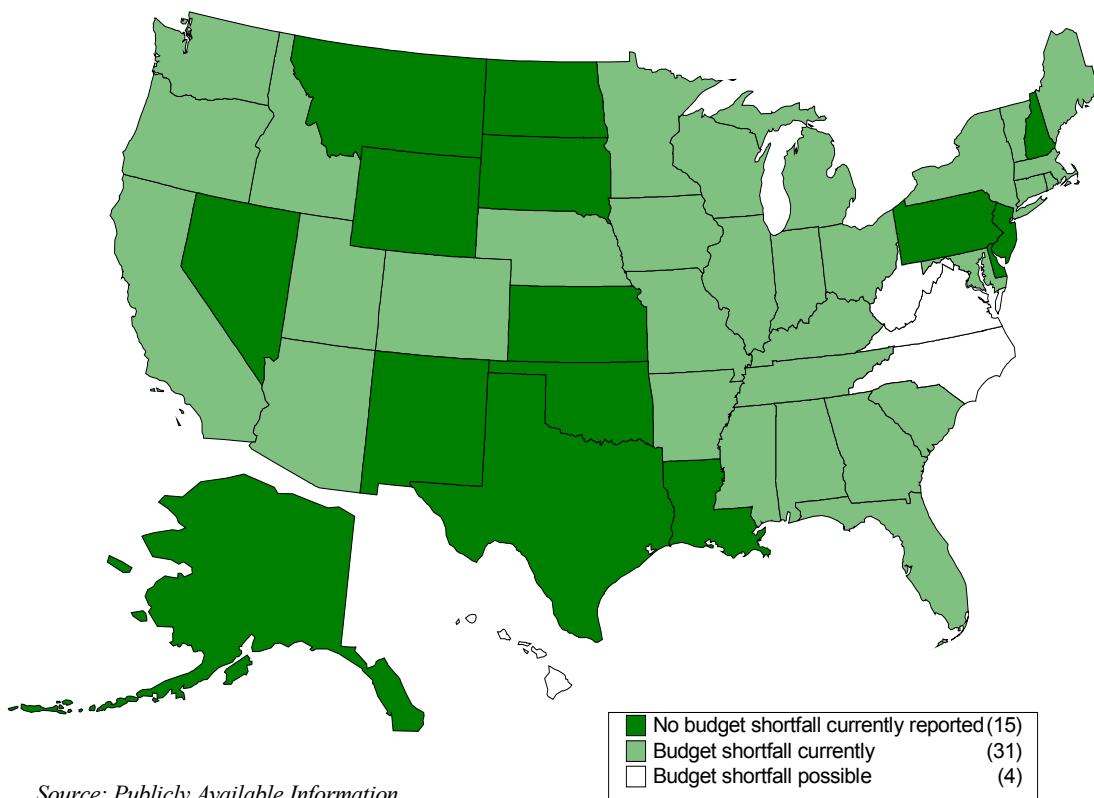
Budget Shortfalls Caused by Slowing Economy and Attack on America

As states continue to analyze the slowing economy and examine the additional effects of the September 11 attacks, that figure is anticipated to grow, and could reach as high as \$15 billion or more. The shortfalls represent nearly one-third of what states earlier estimated their year-end fiscal 2002 balances would be. When states experienced large revenue shortfalls in 1991, they were forced to cut their budgets by \$7.6 billion.

Several states announced budget shortfalls in the spring and late summer as the slowing economy began to take hold. The additional economic fallout of the September 11 attacks now has affected most states. More specifically, the severe current economic conditions mean that state revenues have fallen far below their original estimates, leading to budget shortfalls in a majority of states.

More directly related to the September 11 attacks, the increase in layoffs (mostly in the airline and tourism industries) has led to a decline in personal income tax revenues as wage withholding has dropped. The layoffs also have stressed state unemployment insurance funds. Slowing retail activity has led to a decrease in sales tax revenues. Corporate income taxes, already suffering amidst lackluster corporate profits throughout the summer, also have fallen. State employee pension funds, many invested heavily in the stock market, also have been hard hit as well.

Elements of the economic stimulus package proposed by the Administration and Congress may also affect state budgets. In particular, some changes in federal tax law may affect state taxes whose definitions are tied to federal ones.



Source: Publicly Available Information

| State | Estimated Budget Shortfall | Comments |
|----------------|----------------------------|---|
| Alabama | \$78+ million | |
| Arizona | \$1.6 billion/2 years | Budget cuts of 4%. |
| Arkansas | \$19.7 million | |
| California | \$3.1-\$10 billion | Cuts of \$150 million ordered; agencies asked to cut 15% from their proposed budgets for the next fiscal year. Hiring frozen. |
| Colorado | \$385 million | Vacancies will go unfilled. |
| Connecticut | \$87.8 million | |
| Florida | \$1.4 billion | Perhaps elimination or delaying some previously enacted cuts; delaying intangibles tax phase-in. |
| Georgia | 2%/\$600 million | Cuts of \$164-\$330 million this year: 1%-2%. 2.5%, 5% for next year. |
| Idaho | \$36 million | Cuts made of 2%/\$36 million. |
| Illinois | \$300-\$450 million | Cuts are \$50 million; additional 2% of budget possible. |
| Indiana | \$450-\$600 million | Cuts of 7%. |
| Iowa | \$108 million | 7%, additional 4.3%/\$108 million. Some layoffs. |
| Kentucky | \$429 million | Cuts total \$326 million. |
| Maine | \$30 million | Cuts total \$10 million. |
| Maryland | \$124 million | Cuts are \$205 million over two years. Hiring frozen. |
| Massachusetts | \$1.1 billion | \$600 million in spending cuts, \$300 million in reserve funds, \$200 million by using 100% of annual tobacco settlement funds. Hiring frozen. |
| Michigan | \$514-\$826 million | |
| Minnesota | \$99 million | |
| Mississippi | \$80 million | Agencies asked to allocate no more than 45% in first half of year, and 55% in second half, leaving 5% available in second half if cuts are necessary. |
| Missouri | \$324 million | Cuts equal \$156 million. |
| Nebraska | \$57+ million | |
| New York | \$3 billion | |
| Ohio | \$1.5 billion | Some increases are being explored. |
| Oregon | \$208 million | |
| Rhode Island | \$80 million-\$100 million | |
| South Carolina | \$500 million | Layoffs. |
| Tennessee | >\$100-300 million | |
| Utah | \$177 million | |
| Vermont | \$35-\$50 million | 1%/\$8.7 million. |
| Washington | \$200 million-\$1 billion | Large agencies have been asked to identify up to 15% of their budgets for possible cuts in FY 2003. New capital projects have been suspended while awaiting the November revenue forecast to avoid exceeding statutory limits on debt service based on general revenues. Fee increases are being considered, tax increases are not. |
| Wisconsin | \$780 million by 2004 | 5% cuts in new budget. |

Economic Information

National Governors Association Report

See the [National Governors Association website](#) for a recent economic update on the outlook for state revenues by Mark Zandi of Economy.com. The economic report, entitled "The Outlook for State Tax Revenues," can be found under recent news on the NGA website.

NGA has released a series of proposals that will help states through this extremely difficult fiscal situation. Among actions it suggests be included in the legislative stimulus package are: expanding unemployment insurance eligibility; increasing funding for dislocated workers; extending TANF supplemental grants; increasing infrastructure investment; providing flexibility for targeted federal programs; and enhancing airport capital investment.

Outlook for State Tax Revenue – A summary of a report by Mark Zandi of Economy.com prepared for the nation’s Governors. Please see [National Governors Association website](#) for the report and more information.

According to the report, the economic slowdown many states were feeling in the spring and summer now has become more pronounced. The September 11 attacks, current concerns about bioterrorism, and the ongoing military response have substantial short-term economic effects and even more significant long-term ones. Across the country, economies are in recession, illustrated by falling jobs, profits and retail sales. Indeed, in the year ending with the second quarter of 2001, state and local tax revenue growth was slightly more than 4 percent, the slowest rate of growth since the Bureau of Economic Analysis began keeping track in the late 1950s.

Economic Growth

The economic output lost as a result of the attacks is even more remarkable, totaling approximately \$50 billion. That figure translates to a one percentage point drop in real gross domestic product (GDP) in the third quarter. While third quarter growth before the attack was estimated to be 0.8 percent, it is now expected to decline that amount, representing the first decline in GDP since the first quarter of 1993.

Consumer Confidence

The short-term indicators of the economy’s weakened condition are dramatic. The University of Michigan and Conference Board surveys of consumer confidence fell between 10 percent and 15 percent in September compared to August. Since the September 11 attacks there have been 250,000 corporate layoffs, and small businesses report that they anticipate sales will be down dramatically, forcing them to plan to scale back hiring and capital spending.

Confidence generally reflects economic conditions rather than influences them. Changes in unemployment, inflation, stock and housing values help explain changes in confidence. This is not true during times of crisis when steep declines in confidence signal a retrenchment of consumer spending, invariably leading to recession.

Post-Attack Economic Forecasts

Economy.com has devised three economic scenarios to examine the US and state economies, each with a different perspective regarding future terrorist attacks, the success of the military response, changes in the federal funds rate, levels of federal government aid, and oil prices.

Regardless of the near-term economic outlook, the long-term economic picture is severe. Global outlays on the military and domestic security will be substantial, and the recently predicted federal budget surpluses will not likely exist.

Regional Economies

Economy.com predicts “recession-like” conditions for the Northeast and Midwest and much slower growth in the West and South during the next year. Under the baseline scenario, the recession is relatively short and mild, with GDP growth falling to 1.1 percent for 2001 and 1.2 percent for 2002, but rebounding to 4.5 percent for 2003.

Before September 11 economic tightening generally was limited to industrial states. While the attacks likely will push those states into deeper recessions, the greatest effect of the attacks is to significantly undermine the regional economies that were the strongest before September 11. The fallout in travel—devastating the airline, hotel, and restaurant industries—will be felt harshly in tourist-heavy regions. The nation’s border economies are at risk as cross border trade has been disrupted. An exception will be economies invested heavily in military activity, which will benefit from increased production of weapons and equipment. However, regional differences in economic performance will be less pronounced during this recession than they were during the last one.

State Tax Revenues

The report also states that total state tax revenues are expected to be flat in the current fiscal year compared to the last, significantly off from the 6.5 percent revenue growth of fiscal 2001 and 8 percent growth of fiscal 2000. Personal income and sales taxes will see small growth while corporate income taxes will continue to decline.

Sales tax revenues have been affected most strongly by the September 11 events. Retail sales plunged in the weeks immediately after the attacks and although they seemed to stabilize in October, this is due largely to price-cutting,

particularly by automakers, airlines, and hotels. While retail volumes are holding up, sales dollars are not. Dollar Christmas sales this year may fall below last year's, the first decline since Christmas 1953 in the immediate wake of the Korean War.

Personal income is expected to grow only approximately 3 percent during fiscal 2002 compared to 5 percent in fiscal 2001 and more than 7 percent in fiscal 2000. Capital gains realizations peaked in 2000 at nearly \$700 billion and are projected to have fallen to just more than \$400 billion in 2001 and \$350 billion in 2002. Because of the lag between when capital gains are realized and when they impact tax receipts, the decline in realizations is expected to have its greatest impact on personal income tax collections in the current fiscal 2002 year.

Finally, the Economy.com report stated that gasoline demand and gas tax revenues are expected to remain stable as a result of the decline in air travel. Low mortgage rates and the lack of overbuilding in most of the nation will support housing prices and property tax revenues. Alcohol and tobacco taxes historically are insensitive to changing economic conditions.