State Budgets for 2002: Economic Slowdown Led States to Cut Spending and Draw on Reserves, But Tax Increases Were Rare

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State tax revenue growth slowed dramatically in 2001. While this slowing is still mild compared to what states faced in the depths of the last recession, it has been a significant change for many states from the previous several years of strong revenue growth. Since almost all states have a constitutional or statutory requirement to balance their budgets, this slowdown in revenue growth presented a problem as states enacted their fiscal year 2002 budgets. Most states have now completed their budgets, and this issue of *State Fiscal News* reviews some of the more significant actions states have taken.

States generally managed to avoid any major increases in taxes, and used other methods to close budget gaps. Below are some of the ways that states found to balance their budgets within the present fiscal constraints. (See Table 1)

Surpluses or Reserves. Several states used surpluses from the 2001 fiscal year, rainy day funds, or other budget reserves to balance their FY 2002 budgets. The states listed in Table 1 took explicit action to tap the prior year's surplus or reserve fund. Not counted here are states that use the previous year's surplus as without explicit action: for instance California rolled $3.7B of its FY 2001 surplus into the FY 2002 budget, and other states took similar steps.

Tobacco Settlement. Some states used the funds provided by the 1998 settlement with the tobacco companies to help balance their FY 2002 budgets, instead of committing them to special funds or particular programs as was done in many states.

Tax/ Fee Increases and Tax Cut Suspensions. Most states avoided tax increases, and the few that did increase taxes generally avoided raising any major taxes. In addition to the tax actions listed in Table 1, two states are notable for what they did not do. Ohio will not be using a surplus to reduce its personal income tax rates for 2001 as it has for the last five years, since it did not have a surplus in 2001. In South Carolina, Governor Hodges (D) vetoed a 1 percentage point reduction in the sales tax on groceries, to restore $39 million in spending to higher education.

Spending Cuts. States that cut spending significantly in 2001 include Arizona, Arkansas, Delaware, Iowa, Indiana, Kentucky, Michigan, North Carolina, Pennsylvania, South Carolina, Virginia, and West Virginia. See Table 2. Details were in *State Fiscal News* Vol. 1, No 1.

Table 1.
Budget Balancing Techniques

Explicit Use of Surpluses and Reserves	
Connecticut	Used $175M of FY 2001 surplus in FY 2002 budget, dedicated to school construction and road projects.
Indiana	Used $73 million of its rainy day fund and $344 million of its “Build Indiana” capital improvements fund – derived from gambling revenue – to balance the FY 2002-2003 biennial budget.
Michigan	Used $77 million from its rainy day fund to balance the FY 2001 budget and $155 million more to help balance the FY 2002 budget.
Oregon	Is constitutionally required to pay out most of any year-end surplus as “kicker” rebates. Moved $106 million in federal Medicaid funds out of the general fund, which reduced the FY 2001 official year-end surplus and reduced the “kicker” rebates by that much.
Washington	Used $450 million in reserve funds to balance FY 2002-2003 biennial budget.
Use of Tobacco Settlement	
Michigan	Redirected $72 million of its settlement payment to the FY 2002 general fund budget.
Tennessee	Over Governor Sundquist’s (R) veto, the legislature passed a budget which used all of the settlement money that the state has collected to date, plus that expected in the next year - $560 million total – to help balance the budget.
Wisconsin	Sold its prospective payments for $1.3 billion and used $450 million of this to help balance its FY 2002-2003 biennial budget.
Use of Tax/Fee Increases and Suspension of Tax Cuts	
Indiana	Suspended a tax credit for farmers and small business, providing $340 million for FY 2002-2003 biennial budget.
Maine	Cigarette tax increased by 20 cents a pack.
Nevada	Increased fee on car rentals, raising $24 million, and corporate filing fees, raising $29 million.
New Jersey	Required out-of-state limited liability companies to pay corporate income tax, raising $420 million in FY 2002.
Ohio	Delayed start of research and job training tax credits for two years, providing $50 million/year more revenue.
Wisconsin	Cigarette tax increased by 18 cents a pack, raising $130 million in the biennium.

State Spending Growth

The growth in budgeted general fund expenditures in the FY 2002 budgets reflected these problems in balancing budgets. Table 2 makes use of data on budget growth from the National Conference of State Legislature's annual survey. The data for FY 2002 is still preliminary, but gives a general sense of how budgets are increasing or decreasing. The national average growth was 4.4 percent, and when adjusted for population growth and inflation the increase is only 0.7 percent. With the adjustments, 13 states have smaller real per-capita expenditures than last year.

The state with the largest decrease in general fund expenditures was Delaware, with a planned 2.7 percent decrease. There were still some states, however, that substantially increased expenditures in their FY 2002 budgets – for example, Hawaii and Montana still had increases of more than 10%, even after adjusting for population increases and inflation.

Table 2.

Increase in Enacted General Fund Budget Expenditures, FY 2001 to FY 2002

State	Percent Change	Adjusted for Population Growth and Inflation
Alabama	1.3%	(1.8)%
Alaska	7.4%	3.8%
Arizona	8.3%	2.9%
Arkansas	3.9%	0.6%
California	(0.1)%	(4.1)%
Colorado	11.6%	6.3%
Connecticut	5.4%	2.3%
Delaware	(2.7)%	(6.5)%
Florida	0.9%	(3.1)%
Georgia	7.2%	2.3%
Hawaii	12.9%	10.3%
Idaho	13.3%	8.4%
Illinois	4.2%	0.9%
Indiana	31.0%	0.1%
Iowa	(0.9)%	(3.8)%
Kansas	2.3%	(1.0)%
Kentucky	4.2%	0.7%
Louisiana	6.6%	3.5%
Maine	(2.1)%	(5.1)%
Maryland	6.9%	3.3%
Massachusetts	ND	ND
Michigan	(1.7)%	(4.7)%

State	Percent Change	Adjusted for Population Growth and Inflation
Minnesota	0.9%	(2.8)%
Mississippi	(1.3)%	(4.5)%
Missouri	4.1%	0.7%
Montana	22.5%	18.7%
Nebraska	8.2%	4.9%
Nevada	11.3%	4.3%
New Hampshire	8.1%	3.9%
New Jersey	7.0%	3.5%
New Mexico	11.7%	8.3%
New York	ND	ND
North Carolina	ND	ND
North Dakota	5.3%	3.1%
Ohio	6.8%	3.7%
Oklahoma	4.4%	1.0%
Oregon	7.9%	4.0%
Pennsylvania	2.2%	(0.4)%
Rhode Island	9.8%	6.6%
South Carolina	(0.1)%	(4.0)%
South Dakota	6.8%	3.6%
Tennessee	ND	ND
Texas	9.9%	5.2%
Utah	8.7%	4.3%
Vermont	5.4%	2.1%
Virginia	0.0%	(3.9)%
Washington	5.5%	1.5%
West Virginia	3.3%	0.8%
Wisconsin	3.3%	0.0%
Wyoming	6.1%	3.4%
Average of 46 States	**4.4**%	**0.7**%

Notes: Projected budget expenditures based on data from the National Conference of State Legislatures.

Projections for population growth for the states in 2002 are not available, so we used estimated growth for 1999 from the Census Bureau as a proxy.

Inflation estimate from: Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011*, January 31, 2001.

ND - no data (budget not enacted in time for NCSL survey).

Parentheses indicate negative values.

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