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State Budgetary Assumptions in 2002 – The Economic Forecast Roller Coaster

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Highlights

- ❖ Economic forecasts underlying state budgets have become out of date as the economy has strengthened. The median state forecast of 0.5 percent growth in real gross domestic product was well below the current consensus of 2.6 percent.
- ❖ Private forecasts have been steadily improving since the beginning of the year.
- ❖ After overestimating economic growth last year, states appear to have underestimated it this year.
- ❖ State economic forecasts that were somewhat conservative when first prepared now appear very pessimistic, due to the improving economy.
- ❖ State revenues are not improving as fast as the general economy.

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Introduction

This is the Rockefeller Institute of Government’s seventh annual survey of key economic and caseload assumptions underlying state budgets. The forecasts described below generally were used by states to develop the fiscal year 2002-03 budgets that governors released in January 2002 or thereafter. States developed their forecasts between November 2001 and March 2002. (For more on forecasts and this survey see the box: Economic Forecasts and The Survey.)

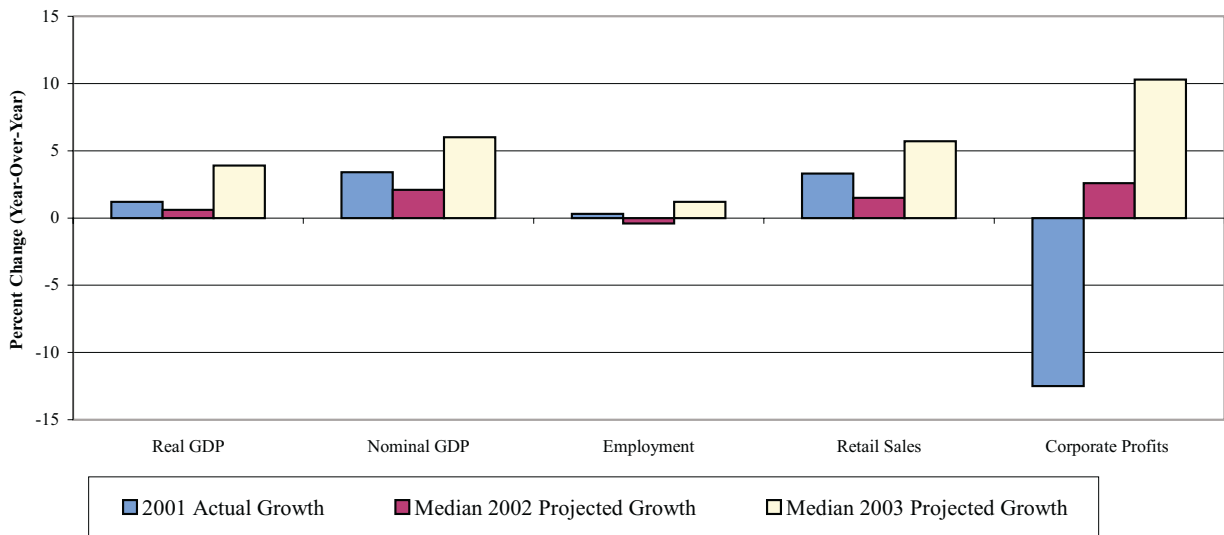
State governments’ budgets include forecasts of revenue and spending, and these forecasts crucially depend on economic and caseload assumptions. For example, a state may use projections of retail sales to help forecast sales tax revenue, or projections of the prison population to help forecast expenses for corrections. These assumptions can have far-reaching implications for policy decisions and budget management. If revenue forecasts are too low, a state may have an embarrassment of riches and may miss opportunities to cut taxes or expand services. If revenue forecasts are too high, a state may have to scramble to close an unanticipated budget gap.

In five of our previous six surveys, state governments underestimated economic growth in the nation and in their own states. They were in good company: the economy was consistently outperforming the predictions of public and private forecasters in the late 1990s and

into 2000. The extremely strong economy aided by sharply rising stock prices, led to much better-than-expected revenue growth, which allowed states to cut taxes *and* increase spending. Even after tax cuts and spending increases, states had large surpluses due in part to their generally conservative approach to forecasting. These surpluses helped states build “rainy-day” funds or other budget reserves to 20-year highs, providing a modest cushion against potential revenue shortfalls, which might lead to unpopular tax increases or spending cuts. In 2001, the pattern was broken. The economy was weakening as states were making the economic projections upon which they based their budgets. Private economic forecasters were sharply reducing their projections during the same period that most states adopted their fiscal 2002 state budgets. Eventhough the recession that started after March 2001 seems to have had only a relatively mild effect on the overall economy, and may be quite brief, it still opened very large gaps in the budgets of nearly every state.

Now states face another kind of problem. Their initial forecasts for economic growth for the next budget year were very conservative, anticipating a slow recovery from the recession. However, over the last few months, private economic forecasters have been revising their projections upwards. This pattern is much like that of the late 1990s. The difference, however, is that the recovery will come too late to close the large budget gaps left from the sharp revenue decline of the last year. Therefore, the states will have to find some way to close

Figure 1
States Expect National Economy to Slow in 2002 and Recover in 2003



the existing budget deficits before they can look to the possibility of a sunnier future.

States' Forecasts of the National Economy

The median state official forecast called for economic growth in 2002 to be even slower than the growth in 2001, followed by a recovery in 2003 to approximately the rate of growth seen prior to the recession. In comparing state forecasts, the most useful measure is real gross domestic product (GDP), since it is the broadest measure of the national economy. The latest estimate of real GDP growth in 2001 was 1.2 percent, with only the third quarter showing actual decline.¹ The median state forecast was for growth in 2002 of only 0.6 percent, and then recovery to 3.9 percent in 2003.

The pattern is similar when we look at other measures. Employment grew by 0.3 percent in 2001; the state median prediction for 2002 was for a decline of 0.4 percent, and then a recovery to 1.2 percent in 2003. Retail sales grew by 3.3 percent in 2001; the median projection for 2002 was for growth of only 1.5 percent, and then recovery to strong growth of 5.7 percent in 2003. Corporate profits are an exception to this trend, they were down by 12.5 percent in 2001, the median state prediction was that they would recover to 2.6 percent growth in 2002, and more strongly to 10.3 percent growth in 2003.² (See Table 1 for state-by-state and

median forecasts of key national economic variables and see Figure 1 for selected variables.)

States' Forecasts of Their Own Economies

State economies generally follow the national economy, and this is reflected in most states' predictions. The median state estimate of retail sales growth in 2001 was 2.6 percent, the median state prediction was that sales would decline to 2.1 percent in 2002 and then improve to 3.7 percent in 2003. Employment, personal income, and wages and salaries follow the same pattern: states project that growth in 2002 will be slower than in 2001, and 2003 will show a recovery. Comparatively few states make capital gains forecasts, which show a median estimated 15 percent drop in 2001, and median projections of a four percent drop in 2002 and no change in 2003. (See Table 2 and Figure 2.)

Figure 3 shows the regional pattern in state employment growth forecasts for 2002. The median projections in every region — except the Plains states — was lower than in 2001, and that in turn was lower than the previous pattern. The national median projection was for no growth in employment in 2002, but there was considerable variation between regions. The Southwest had the highest growth projected at 1.6 percent. The Great Lakes states had a median projected decline of one percent. Arizona was still projecting robust growth of 2.3 percent, the highest in the nation, while

Figure 2
State Economies Also Expected to be Slow in 2002 and Pick Up in 2003

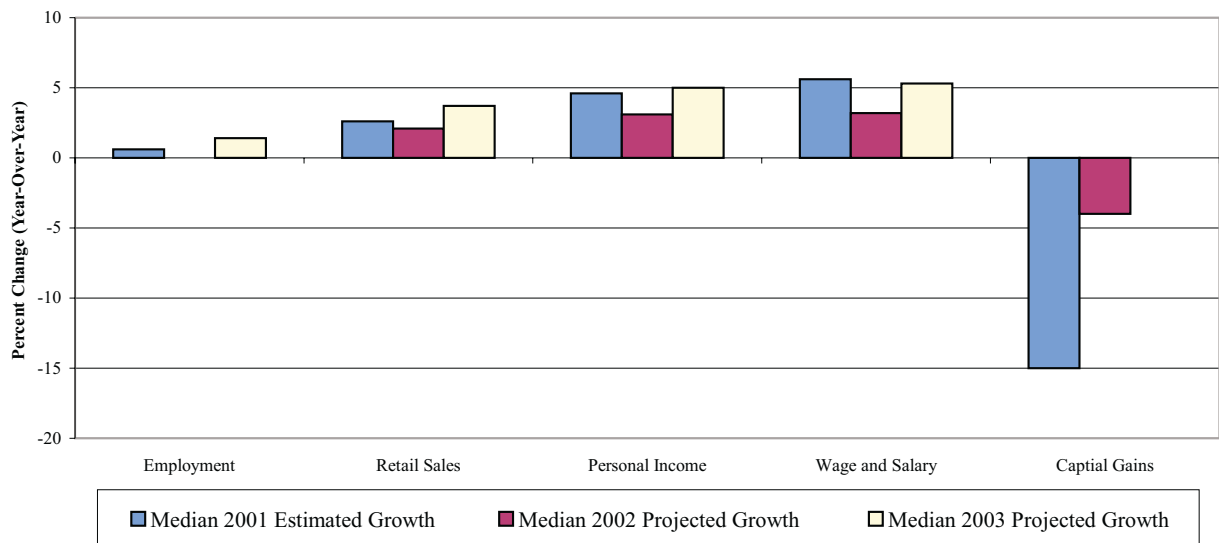


Table 1. Forecasts of National Economic Variables
year-over-year percentage changes (except unemployment rate)

	<i>Real GDP</i>		<i>Nominal GDP</i>		<i>Employment</i>		<i>Retail Sales</i>		<i>Personal Income</i>	
	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003
New England										
Connecticut	(0.1)	2.5	1.8	4.1	(0.4)	0.4	—	—	2.7	3.7
Maine	—	—	—	—	—	—	—	—	—	—
Massachusetts	0.5	4.4	2.7	6.7	(0.3)	2.1	(0.5)	1.0	2.8	5.1
Rhode Island	—	—	—	—	—	—	—	—	—	—
Vermont	0.5	4.1	2.6	6.4	(0.5)	1.9	2.2	5.7	2.1	4.6
Mid-Atlantic										
Delaware	0.6	3.7	2.0	6.0	0.3	0.9	—	—	2.2	5.2
Maryland	0.7	4.5	—	—	(0.3)	2.1	—	—	3.0	5.2
New York	1.6	3.6	2.7	5.5	(0.3)	1.6	—	—	3.0	5.9
Pennsylvania	0.6	3.7	1.9	6.0	(0.4)	0.9	(0.1)	6.0	2.2	5.2
Great Lakes										
Illinois	(0.1)	2.5	1.8	4.1	(0.4)	0.4	—	—	2.7	3.7
Michigan	0.4	3.1	1.6	—	—	—	—	—	2.7	4.9
Ohio	3.3	3.5	5.3	5.6	—	—	—	—	4.5	4.7
Plains										
Iowa	1.5	3.5	1.4	1.8	—	—	—	—	—	—
Kansas	1.1	—	3.4	—	4.8	—	1.5	—	2.6	—
Missouri	0.2	2.8	—	—	(0.7)	0.8	—	—	3.5	4.5
Nebraska	0.6	3.7	2.9	5.9	(0.4)	1.5	1.5	1.1	4.8	2.2
North Dakota	3.7	3.4	—	—	1.3	1.5	4.6	4.2	3.0	2.8
South Dakota	1.0	4.0	0.3	3.7	(0.4)	1.6	—	—	2.5	5.3
Southeast										
Alabama	0.4	4.4	2.0	6.0	(0.3)	1.1	—	—	2.6	5.6
Arkansas	0.1	3.6	1.9	5.6	0.0	0.5	1.4	4.8	3.5	4.6
Florida	0.2	2.8	2.0	4.3	(0.7)	0.9	2.1	3.2	2.9	4.0
Kentucky	0.4	4.4	2.0	6.6	(0.4)	1.0	0.5	6.2	2.6	5.6
Mississippi	1.3	4.3	3.0	6.6	0.1	0.9	—	—	3.2	5.8
South Carolina	1.3	4.3	4.0	6.2	0.2	0.8	—	—	6.7	5.7
Tennessee	0.4	4.4	2.1	6.6	(0.4)	1.0	—	—	2.6	5.6
Virginia	(0.5)	2.6	1.6	3.8	(0.5)	0.3	—	—	3.2	3.3
West Virginia	1.3	4.3	3.6	6.7	0.1	1.5	4.2	4.8	3.4	5.9
Southwest										
Arizona	0.6	3.7	—	—	—	—	—	—	—	—
New Mexico	0.4	3.9	—	—	—	—	—	—	—	—
Texas	1.6	4.0	3.7	6.4	0.1	1.5	0.8	5.7	3.4	5.9
Rocky Mountain										
Colorado	0.4	4.4	2.0	6.6	(0.4)	1.0	—	—	2.6	5.6
Idaho	0.4	4.4	2.0	6.6	(0.4)	1.0	—	—	2.6	5.6
Utah	1.0	4.0	2.2	3.4	(0.4)	1.6	2.2	5.7	2.5	5.3
Far West										
California	0.5	4.4	2.1	6.6	(0.5)	1.1	2.8 ¹	6.3 ¹	2.6	5.6
Hawaii	0.1	2.7	1.4	4.6	—	—	—	—	—	—
Oregon	0.6	3.7	1.9	6.0	(0.4)	0.9	(0.1)	6.0	2.2	5.2
Washington	1.0	4.0	2.3	6.0	(0.4)	1.6	0.8	5.7	2.5	5.3

Table 1. Forecasts of National Economic Variables (Continued)
year-over-year percentage changes (except Unemployment Rate)

	<i>Wage and Salary</i>		<i>Corporate Profits</i>		<i>Inflation (CPI-U)</i>		<i>Unemployment Rate</i>	
	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>
New England								
Connecticut	<u>2.9</u>	<u>4.0</u>	—	—	<u>2.1</u>	<u>2.4</u>	<u>5.6</u>	<u>6.2</u>
Maine	—	—	—	—	2.0	2.0	4.3	4.6
Massachusetts	3.3	6.2	2.6	12.7	1.8	2.5	6.1	5.7
Rhode Island	—	—	(5.8)	7.7	1.7	2.2	—	—
Vermont	2.7	5.8	(1.9)	11.6	1.7	2.3	6.1	5.7
Mid-Atlantic								
Delaware	2.5	4.8	4.0	11.6	1.9	2.6	6.2	5.9
Maryland	—	—	2.6	12.7	1.8	2.2	6.1	5.7
New York	2.7	6.8	1.5	8.7	1.5	2.3	6.2	6.0
Pennsylvania	2.5	4.8	4.2	9.8	1.9	2.6	6.2	5.9
Great Lakes								
Illinois	2.9	3.8	(11.5)	11.5	2.1	2.4	5.6	6.2
Michigan	2.1	5.2	(7.6)	0.5	1.9	3.0	6.4	6.2
Ohio	—	—	—	—	2.5	2.8	4.5	4.5
Plains								
Iowa	—	—	—	—	1.5	2.4	6.0	5.6
Kansas	—	—	—	—	2.0	—	6.2	—
Missouri	—	—	(16.4)	<u>4.8</u>	<u>2.1</u>	<u>2.3</u>	—	—
Nebraska	2.5	4.8	2.6	11.8	2.9	1.9	—	—
North Dakota	—	—	5.1	5.2	2.3	2.5	4.7	4.9
South Dakota	—	—	—	—	1.4	2.4	6.0	5.8
Southeast								
Alabama	2.5	6.0	1.2	8.6	1.9	2.4	6.2	5.7
Arkansas	3.6	4.3	1.0	9.9	2.3	2.2	5.0	5.1
Florida	3.1	3.9	(9.7)	9.3	0.0	0.0	—	—
Kentucky	2.6	5.3	—	—	1.9	2.4	6.2	5.7
Mississippi	—	—	—	—	2.0	2.4	5.9	5.4
South Carolina	—	—	—	—	2.6	2.7	5.3	5.3
Tennessee	—	—	—	—	1.6 ²	2.0 ²	6.2	5.8
Virginia	3.8	3.6	—	—	1.9	1.6	5.7	6.8
West Virginia	4.7	5.8	7.2	4.3	2.3	2.4	5.9	5.5
Southwest								
Arizona	—	—	—	—	1.9	2.6	—	—
New Mexico	—	—	—	—	1.6	2.3	—	—
Texas	3.3	6.1	3.3	10.4	2.3	2.4	5.9	5.5
Rocky Mountain								
Colorado	—	—	1.2	8.6	1.9	2.4	6.2	5.7
Idaho	2.6	5.3	—	—	1.9	2.4	—	—
Utah	2.6	5.1	4.2	10.3	1.5	2.4	6.2	5.7
Far West								
California	2.7	5.2	(3.5)	14.3	1.8	2.2	6.2	5.7
Hawaii	—	—	—	—	—	—	—	—
Oregon	2.5	4.8	2.6	11.7	1.9	2.6	6.2	5.9
Washington	2.6	5.1	3.3	10.4	1.4	2.4	—	—

— Data not available.
 Note: Underlined number indicates forecast is for fiscal year rather than calendar year.
 1 Consumption
 2 GDP Implicit Deflator

Table 2. Forecasts of State Economic and Caseload Variables
year-over-year percentage change (except Unemployment Rate)

	<i>Employment</i>		<i>Retail Sales</i>		<i>Personal Income</i>		<i>Wage and Salary</i>		<i>Unemployment Rate</i>	
	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003
New England										
Connecticut	(1.0)	<u>0.3</u>	—	—	<u>3.5</u>	4.3	<u>3.2</u>	<u>3.8</u>	<u>3.8</u>	<u>4.4</u>
Maine	0.5	1.2	—	—	5.0	5.0	6.4	5.6	4.0	3.8
Massachusetts	(1.3)	1.7	1.5	5.4	1.1	4.4	0.8	5.4	5.3	4.9
Rhode Island	(0.9)	1.0	—	—	2.9	4.4	3.0	4.8	6.3	5.9
Vermont	(0.2)	1.8	1.8	5.3	1.7	4.2	2.4	5.6	3.8	3.6
Mid-Atlantic										
Delaware	(0.9)	1.6	—	—	2.1	6.0	2.3	5.8	—	—
Maryland	0.0	1.4	—	—	3.6	5.0	4.1	5.6	4.6	4.2
New York	(1.2)	0.9	—	—	1.1	3.8	(1.5)	4.4	6.5	6.4
Pennsylvania	(0.1)	1.0	1.8	3.4	2.2	4.9	3.2	6.3	5.2	4.9
Great Lakes										
Illinois	(1.2)	0.5	1.7	2.7	1.5	3.5	1.4	3.5	5.8	6.1
Michigan	(0.7)	1.7	—	—	2.4	5.3	1.9	5.9	6.5	6.1
Ohio	—	—	—	—	4.5	4.7	—	—	—	—
Plains										
Iowa	(0.2)	1.9	—	—	3.5	5.1	4.8	5.5	—	—
Kansas	0.7	—	3.7	2.7	3.0	—	3.0	—	0.3	—
Missouri	<u>(0.7)</u>	<u>0.8</u>	<u>0.6</u>	<u>4.5</u>	<u>3.2</u>	<u>4.2</u>	<u>3.2</u>	<u>4.2</u>	—	—
Nebraska	—	—	2.4	2.6	4.7	5.7	1.9	4.4	—	—
North Dakota	1.8	0.9	—	—	5.2	5.3	—	—	3.2	3.4
South Dakota	1.0	2.2	2.1	4.6	5.0	6.4	7.1	7.5	3.2	3.0
Southeast										
Alabama	0.3	0.8	—	—	2.5	5.0	2.0	5.5	5.5	4.7
Arkansas	(0.8)	(0.1)	—	—	4.5	4.2	4.8	3.2	4.4	5.1
Florida	0.4	1.9	—	—	4.1	4.3	0.0	5.4	—	—
Kentucky	0.1	1.6	—	—	2.6	5.4	4.9	5.2	—	—
Louisiana	(0.4)	0.0	—	—	1.6	2.4	—	—	—	—
Mississippi	0.0	1.3	—	—	3.9	5.3	3.8	5.3	5.9	5.7
South Carolina	<u>(0.2)</u>	<u>1.5</u>	<u>2.5</u>	<u>4.5</u>	<u>2.8</u>	<u>5.0</u>	<u>3.0</u>	<u>3.0</u>	5.7	5.4
Tennessee	0.2	1.5	0.5	3.3	4.2	5.2	3.4	5.1	5.6	5.1
Virginia	0.5	0.9	—	—	3.5	3.3	4.2	3.9	3.5	4.0
West Virginia	0.1	0.7	2.1	3.5	3.5	4.0	3.7	3.9	5.7	5.7
Southwest										
Arizona	2.3	3.1	4.6	5.8	5.5	6.4	—	—	4.8	4.6
New Mexico	1.4	1.1	—	—	4.8	3.5	4.0	4.1	4.0	—
Texas	1.6	2.3	3.7	8.5	5.4	7.3	5.3	7.0	5.5	5.2
Rocky Mountain										
Colorado	1.0	2.4	3.3	4.0	4.7	7.5	5.1	7.6	4.4	4.2
Idaho	0.5	1.9	—	—	3.7	6.3	4.3	6.1	—	—
Utah	0.0	2.1	2.4	4.8	2.2	5.2	2.5	5.0	5.0	4.5
Wyoming	0.5	1.6	<u>3.5</u>	<u>3.5</u>	2.7	6.5	8.4	6.2	4.5	4.5
Far West										
Alaska	1.4	1.3	—	—	—	—	—	—	—	—
California	0.8	1.9	0.8	7.5	2.6	7.5	3.1	8.9	6.2	5.9
Hawaii	(0.7)	2.0	—	—	<u>1.5</u>	<u>4.5</u>	1.7	4.5	—	—
Oregon	(0.7)	2.2	—	—	2.7	6.5	2.8	6.4	—	—
Washington	(1.3)	1.4	(1.5) ²	<u>3.7</u> ²	1.3	5.0	0.4	4.7	—	—

State Budgetary Assumptions in 2002 – The Economic Forecast Roller Coaster

Table 2. Forecasts of State Economic and Caseload Variables (Continued)
year-over-year percentage changes (except Unemployment Rate)

	<i>Capital Gains</i>		<i>Medicaid Caseload</i>		<i>TANF Caseload</i>		<i>Prison Population</i>	
	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>	<i>2003</i>
New England								
Connecticut	—	—	<u>6.0</u>	<u>6.0</u>	(4.2)	(5.7)	<u>3.7</u>	<u>3.0</u>
Maine	—	—	—	—	—	—	—	—
Massachusetts	—	—	—	—	—	—	—	—
Rhode Island	—	—	—	—	(4.0)	(4.0)	<u>0.5</u>	<u>0.0</u>
Vermont	(46.6)	(6.2)	2.2	1.3	(1.6)	4.3	1.9	(2.5)
Mid-Atlantic								
Delaware	(22.6)	(6.4)	7.6	(6.2)	1.7	0.3	5.0	5.0
Maryland	(5.0)	0.0	<u>5.1</u>	<u>4.4</u>	(3.5)	<u>1.0</u>	<u>1.1</u>	<u>0.0</u>
New York	15.0	—	4.1	3.2	1.4	—	(3.3)	0.0
Pennsylvania	—	—	<u>3.1</u>	<u>1.5</u>	(4.6)	(4.4)	(1.6)	(0.3)
Great Lakes								
Illinois	—	—	6.6	2.9	(20.3)	(11.0)	(1.5)	1.8
Michigan	—	—	<u>9.0</u>	(1.1)	<u>13.6</u>	<u>16.6</u>	3.5	3.5
Ohio	—	—	—	—	—	—	—	—
Plains								
Iowa	—	—	<u>11.2</u>	<u>3.8</u>	<u>3.0</u>	<u>1.5</u>	3.5	0.8
Kansas	—	—	<u>15.1</u>	12.0	9.6	7.1	1.6	(1.1)
Missouri	(20.0)	(5.0)	<u>4.6</u>	<u>1.4</u>	<u>0.0</u>	<u>0.0</u>	<u>4.4</u>	<u>4.2</u>
Nebraska	5.4	11.1	5.0	5.0	9.0	9.0	2.2	4.9
North Dakota	—	—	2.5	2.4	8.9	5.3	6.7	7.8
South Dakota	—	—	2.8	1.4	7.0	0.0	4.4	4.4
Southeast								
Alabama	—	—	—	—	—	—	—	—
Arkansas	—	—	13.7	13.7	1.2	1.2	4.0	3.7
Florida	—	—	7.4	8.1	0.3	10.3	1.8	1.7
Kentucky	—	—	0.4	0.0	(2.2)	3.0	1.8	2.7
Louisiana	—	—	10.7	11.1	(6.4)	19.1	2.3	(0.7)
Mississippi	—	—	5.2	1.1	3.0	3.0	(2.0)	(2.0)
South Carolina	—	—	8.1	7.7	19.0	0.0	—	—
Tennessee	—	—	6.2	23.4	<u>4.2</u>	(3.2)	<u>9.9</u>	<u>0.0</u>
Virginia	—	—	1.9	(0.3)	(0.7)	(0.7)	1.9	0.9
West Virginia	0.0	5.0	—	—	—	—	—	—
Southwest								
Arizona	—	—	<u>20.6</u>	<u>15.3</u>	<u>21.3</u>	<u>13.5</u>	6.0	5.0
New Mexico	—	—	—	—	—	—	—	—
Texas	—	—	4.5 ²	2.5 ³	4.0	(0.3)	(2.1)	(0.1)
Rocky Mountain								
Colorado	—	—	<u>5.8</u>	<u>4.7</u>	—	—	—	—
Idaho	—	—	<u>28.1</u>	<u>16.2</u>	6.7	0.6	10.3	8.6
Utah	(14.0)	(9.0)	6.1	7.0	5.1	8.3	(2.8)	0.0
Wyoming	—	—	0.0	0.0	0.0	0.0	3.2	3.1
Far West								
Alaska	—	—	—	—	—	—	—	—
California	12.4	7.0	<u>17.2</u>	<u>4.9</u>	(1.4)	<u>2.3</u>	(2.2)	(0.4)
Hawaii	—	—	<u>7.1</u>	<u>5.0</u>	(5.0)	(8.3)	<u>5.3</u>	<u>4.1</u>
Oregon	(3.0)	0.5	9.8	6.2	18.1	5.0	4.8	3.1
Washington	—	—	<u>3.2</u>	<u>3.7</u>	(1.7)	(0.1)	0.8	1.1

— Data not available.

Note: Underlined number indicates forecast is for fiscal year rather than calendar year.

1 Total Jobs

2 Taxable Sales

3 Recipient Months

Massachusetts and Washington tied at 1.3 percent for the sharpest projected decline.

Caseload Predictions

Medicaid and Temporary Assistance for Needy Families (TANF) caseloads, as well as state prison populations, are variables that may affect state spending. The picture here was somewhat mixed. Median state Medicaid caseloads grew by five percent in 2001. States projected that this will increase slightly to 5.2 percent in 2002, and then slow to 3.4 percent in 2003. State TANF caseloads have declined for several years now and the estimated median decline in 2001 was 2.3 percent. States projected that TANF caseloads will increase by 1.4 percent in 2002, and by 0.8 percent in 2003.

States projected slowing state prison population growth over the next two years. Estimated median growth was 3.2 percent in 2001, and states projected that this will slow to 1.9 percent in 2002 and one percent in 2003. Idaho projected a 10.3 percent increase in 2002, while New York projected a 3.3 percent decline in prison populations in 2002.

States Overestimated Economic Growth in Last Year's Survey

The recession that began after March 2001 caught both private and public sector economic forecasters by surprise. (See Figure 4.) Last year's median state forecast for real GDP growth in 2001 was 3.2 percent, while the January 2001 Blue Chip consensus forecast was 2.6 percent. (The Blue Chip consensus is a widely followed monthly survey of the forecasts of approximately 50 economists. The "consensus" is the median of these forecasts.) Actual GDP growth in 2001 was only 1.2 percent. The median state prediction for corporate profits growth was 1.1 percent, the Blue Chip consensus was 2.5 percent, while in fact corporate profits declined by 12.5 percent. Inflation and the unemployment rate were only a little higher than private and public forecasters predicted.

As may be expected, state-level economic indicators in 2001 also were weaker than states predicted a year ago. (See Figure 5.) States projected employment growth of 1.2 percent, but it was only 0.6 percent, due to the general slowing in the economy. Some of these factors can translate directly into state revenue. Retail sales grew by only 2.6 percent, instead of the median projection of 4.4 percent, that translates into slower growth in the sales tax. Personal income grew by only

Figure 3
Forecasts of 2001 State Employment Growth by Region

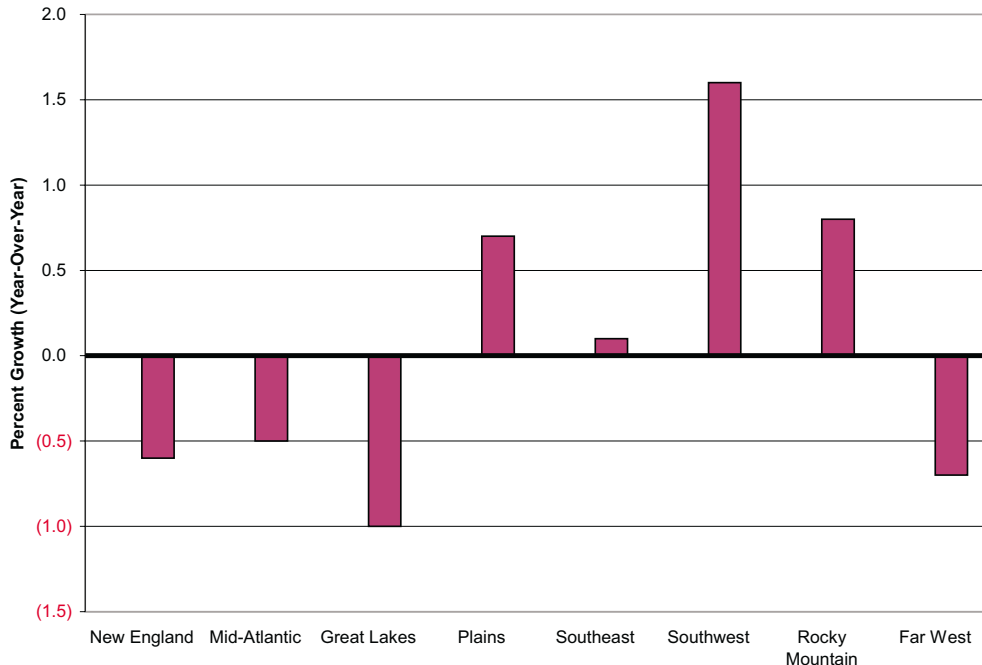


Figure 4
The Economic Downturn in 2001 Was More Severe Than Either States or Private Forecasters Predicted

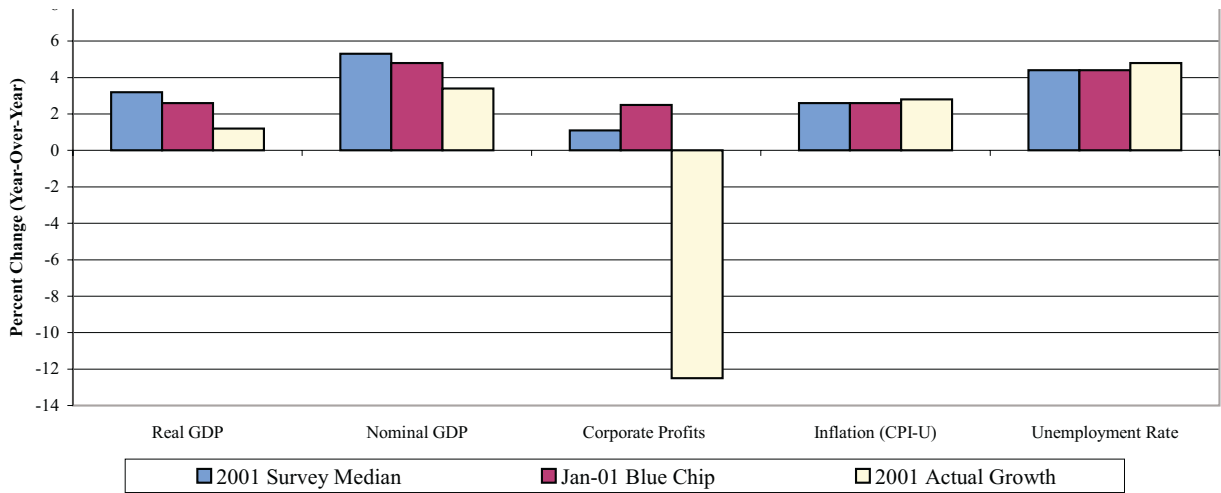
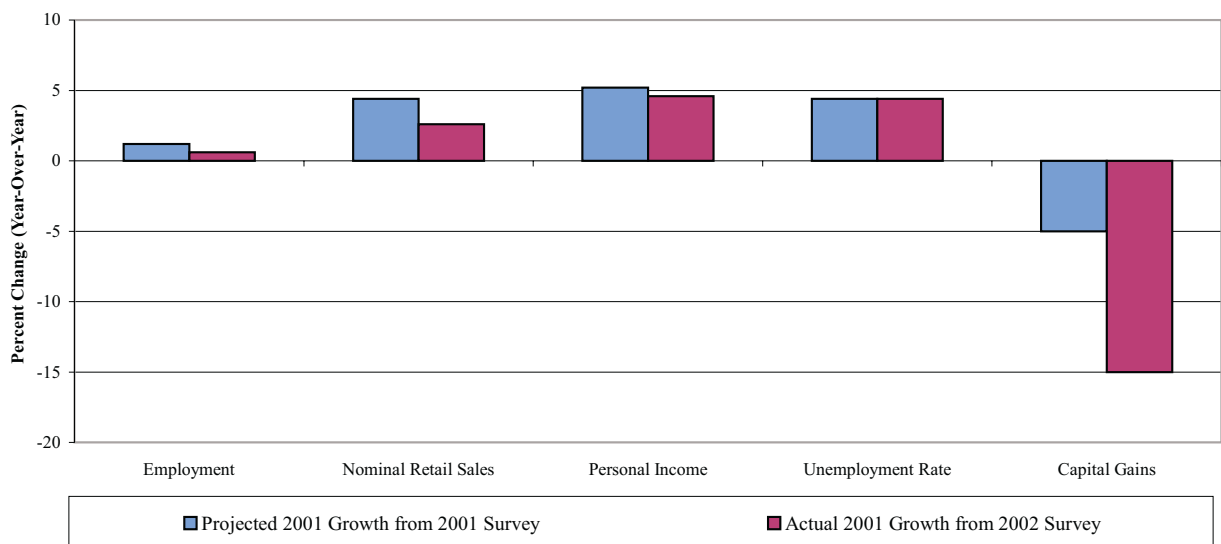


Figure 5
State Economic Growth in 2001 Was Also Worse Than Projected



4.6 percent, instead of the projected 5.2 percent, and capital gains declined by 15 percent — even worse than the projected 5 percent decline, these factors helped explain why income tax collections were declining year-over-year by the end of 2001.

As can be seen in Figure 6, the median state Medicaid caseload grew by five percent instead of the four percent that states had projected. Meanwhile TANF caseloads declined by 2.3 percent, instead of the three percent decline projected by the states. The states were not off by much in either case, but the higher caseloads meant states had to pay more for these programs even as their revenues were drying up. Prison populations grew by 3.2 percent, just as states had projected.

For several years before 2001, states had underestimated the growth of the economy and therefore underestimated revenue. In fiscal 2000, states underestimated revenues by almost \$18 billion. The economic weakness that appeared in fiscal 2001 nearly wiped out these surpluses. The recession did not hit simultaneously in all parts of the country, but started in the Southeast and Midwest, and then spread to the other regions. Some states were already dealing with revenue shortfalls in fiscal 2001, while others did not start to experience shortfalls until after fiscal 2002 began. According to The National Association of State Budget Officers 24 states reported that total revenue collections for fiscal 2001 were lower than original estimates, while 18 states reported collections were higher — the remainder were on target. Preliminary numbers for fiscal 2002 indicate that

38 states are below their original revenue estimates, with only four states higher than estimates and eight on target.³

State Economic Forecasts in the Context of Recession and Recovery

State economic forecasts for calendar year 2001 were high, predicting only a slight slowing of growth instead of the drastic slowing that actually took place. However, private forecasters also overestimated how much growth there would be in late 2000 and early 2001 — the time that states were making their forecasts. The Blue Chip forecast for real GDP growth declined steadily through this period.⁴ (See Figure 7.) If fact, the national economy was slipping into recession even as the states' forecasts were being made.

The pattern this year seems to be the reverse of last year. States began to prepare economic forecasts in the aftermath of the September 11th terrorist attacks, with the earliest forecast from November of 2001. In November, the National Bureau of Economic Research officially declared that March 2001 had been a business-cycle peak, after which the nation entered a recession.⁵ The state median forecast for growth in 2002 was only a bit more pessimistic than the Blue Chip consensus forecasts from the same period. However, the Blue Chip consensus began to move sharply upward in February, in response to unexpectedly strong growth in the GDP in the fourth quarter of 2001, and other

Figure 6
Medicaid and TANF Caseload Were Higher Than Predicted,
Prison Populations As Predicted

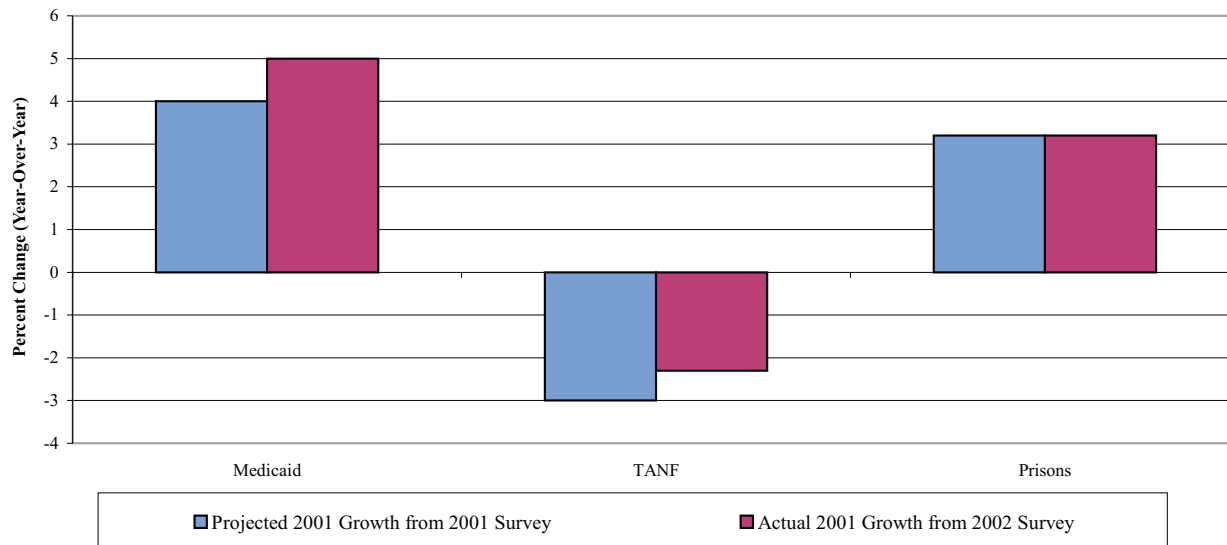
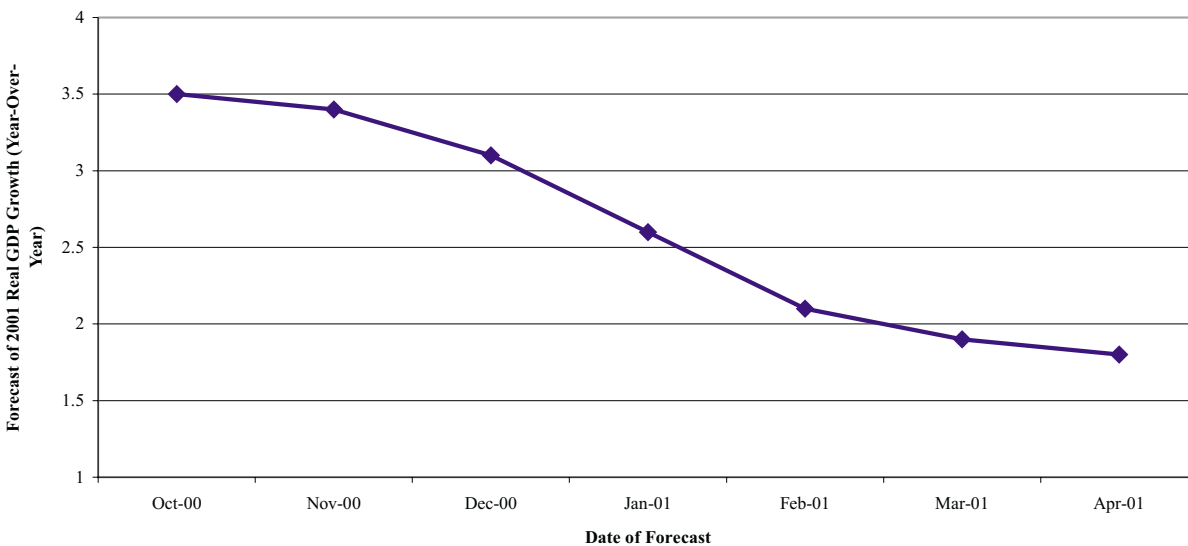


Figure 7
Blue Chip Consensus Went Down in Early 2001



positive economic news. (See Figures 8 and 9.) By April, the Blue Chip consensus for 2002 had reached a level of growth that reflected the current widespread belief that the recession is over. The very strong preliminary GDP numbers for the first quarter of 2002 — a 5.6 percent real increase — seemed to support this belief.⁶

Figure 10 arrays the states by their forecasts of real GDP growth in 2002. The two high outliers — North Dakota and Ohio — were states that have biennial budgets. Their latest forecasts were over a year ago, when much more robust growth was expected for 2002. For instance, the January 2001 Blue Chip consensus was for 3.4 percent growth in 2002.

Generally, states were only slightly on the conservative side in their forecasts. The January 2002 Blue Chip consensus was for one percent growth, not much higher than the median state forecast of 0.5 percent growth.⁷ However, private forecasters became more

optimistic as the year progressed; the April 2002 Blue Chip consensus was for 2.6 real GDP growth. Figure 10 suggests that while states may forecast conservatively, this under-prediction is modest compared to the speed at which the economic environment can change.

The Improving Economy and Declining Revenues

While the general economy seemed to be improving in early 2002, there were some ominous signs that continued to trouble state budget forecasters. One is that the unemployment rate continued to rise — reaching six percent in April.⁸ However, the largest problem is that state tax revenues declined for the last two quarters of 2001 and the first quarter of 2002. This decline affected every section of the country and most states. Table 3 shows the magnitude of this decline. Even if the predictions of economic recovery in 2002 come true, it will

Table 3
Year-Over-Year Change in Quarterly State Tax Revenue by Major Tax

	<i>PIT</i>	<i>CIT</i>	<i>Sales Tax</i>	<i>Total</i>
2001				
July-September	(3.7)	(24.0)	0.0	(3.1)
October-December	(2.7)	(31.8)	1.0	(2.7)
2002				
January-March(p)	(14.4)	(18.4)	(1.0)	(8.0)

p Preliminary.

take states some time to be able to close the budget gaps opened by these revenue declines.⁹

Conclusion

Many state legislatures are still working on their budgets for fiscal year 2003. Signs that their economic forecasts for the coming year were too low may encourage budget officials. However, state tax revenue continues to lag behind forecasts. This will make it difficult to increase future revenue forecasts, since it reduces the base from which they are determined. It will be difficult for states to balance fiscal 2003, and new tax cuts and/or spending increases are probably going to be rare. Spending cuts and some tax increases are much more likely.

Endnotes

- 1 Bureau of Economic Analysis, Economics and Statistics Administration, *United State Department of Commerce News*,” May 24, 2002.
- 2 2001 employment data from Bureau of Labor Statistics, United State Department of Labor, *Current Labor Statistics*, ; 2001 retail sales data from United State Census Bureau, *Service Sector Statistics*; 2001 corporate profits data from Bureau of Economic Analysis, May 24, 2002.
- 3 National Governors Association and National Association of State Budget Officers, *Fiscal Survey of the States, December 2001 and May 2002*, (Washington, DC).
- 4 All Blue Chip consensus forecasts are from: *Blue Chip Economic Indicators*, Vol. 26, No. 4, April 10, 2001 and Vol. 27, No. 4, April 10, 2002.
- 5 National Bureau of Economic Research, “The Business-Cycle Peak of March 2001,” November 26, 2001, <http://www.nber.org/cycles/november2001/>.
- 6 Bureau of Economic Analysis, Economics and Statistics Administration, *United State Department of Commerce News*,” May 24, 2002.
- 7 Leaving aside North Dakota and Ohio, the forecasts were made between November 2001 and March 2002.

**Figure 8
Predictions for 2002 Getting Better**

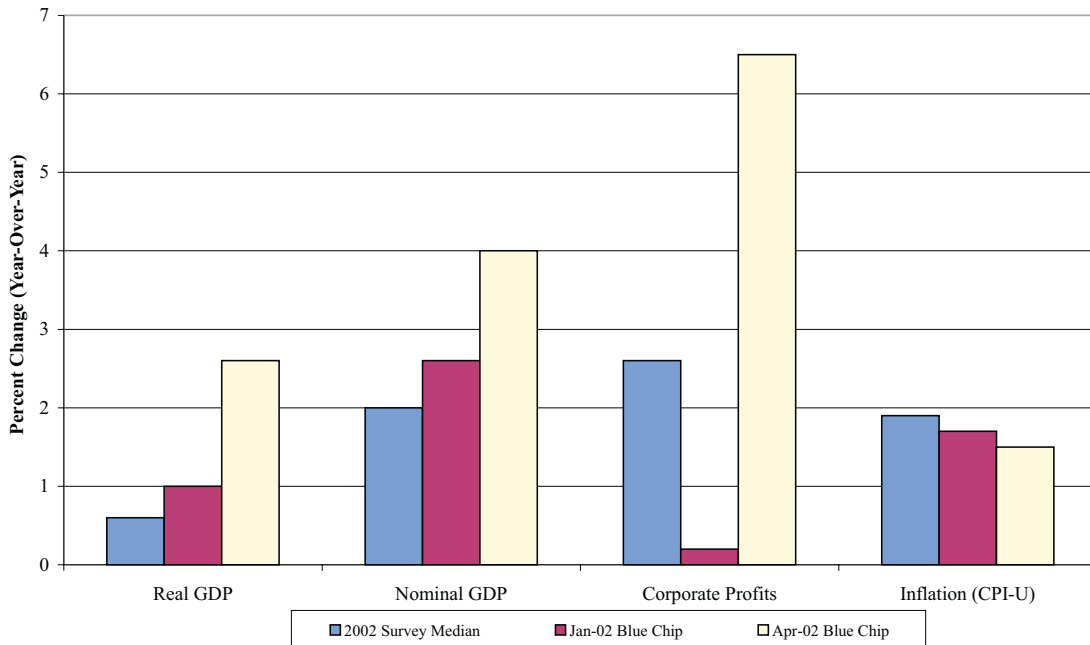
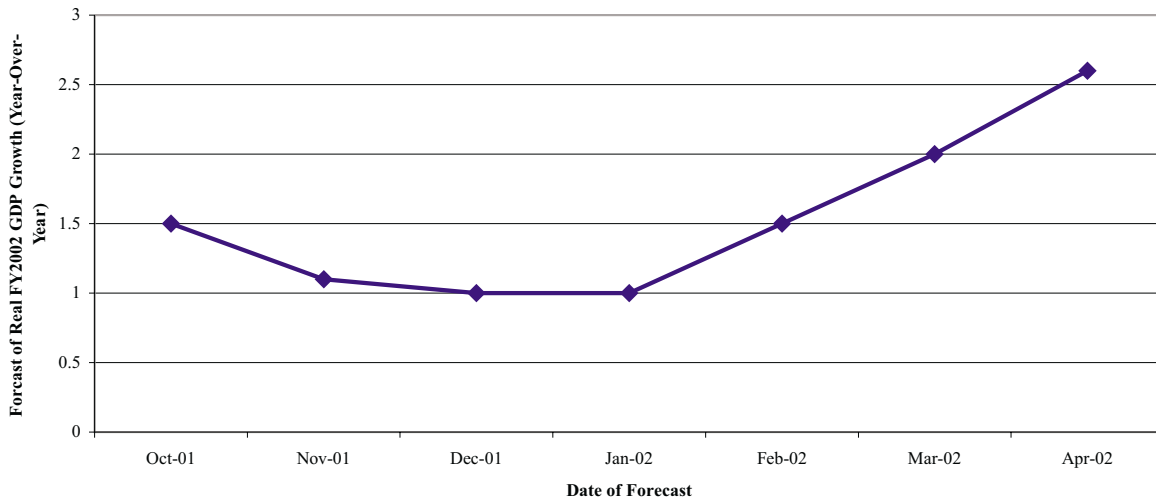


Figure 9
Blue Chip Consensus Is Heading Up in 2002



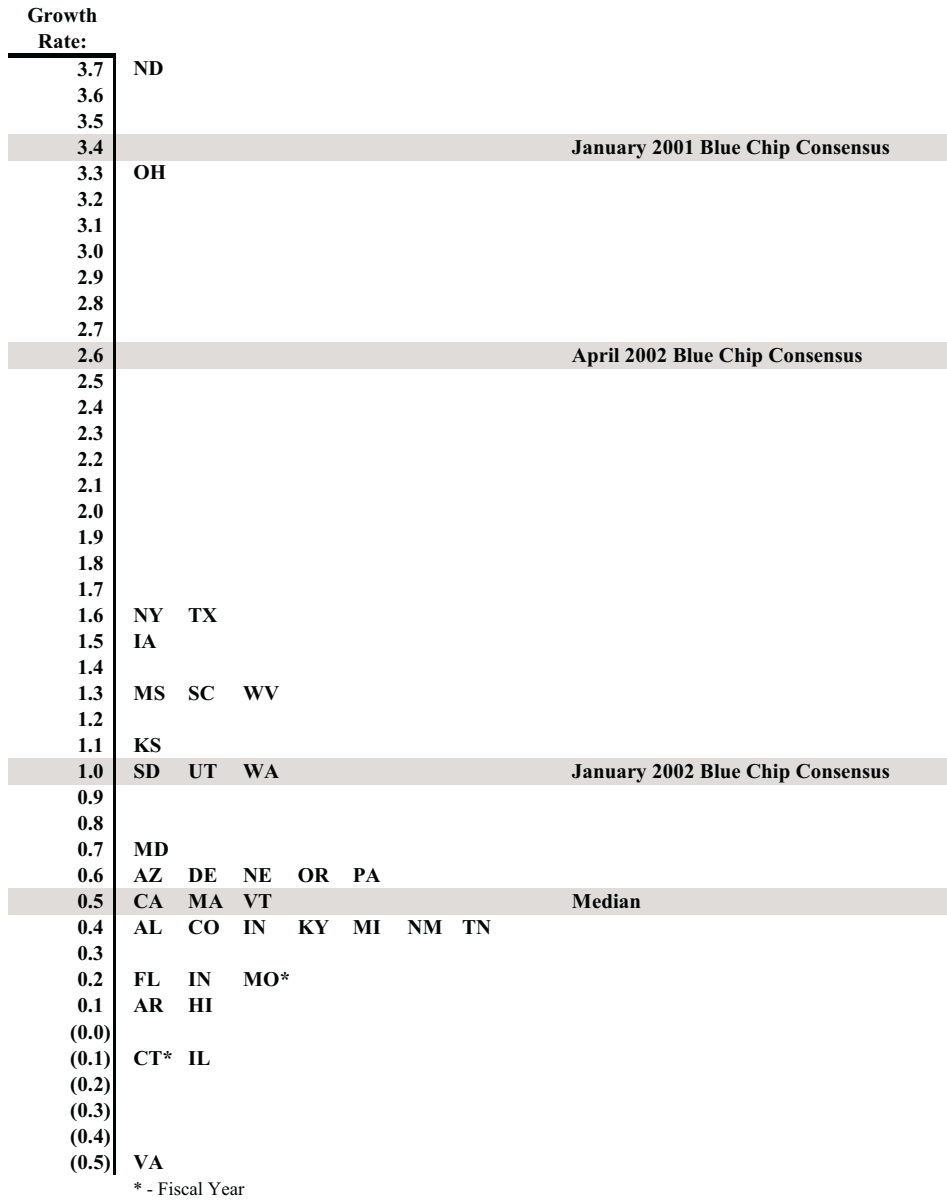
Economic Forecasts and The Survey

We received 43 responses to our survey this year. Of the 35 states that reported the date of their forecast, all but four were prepared in February or earlier, generally for use in preparing official executive budget projections for fiscal year 2002-2003. Two of the forecasts were nearly a year old, both in states with biennial budgets. States update their forecasts on varying schedules, according to their resources; with most updating them again at least once before passage of a final budget. Ten of the 31 states reporting their next forecast date, however, reported that the next forecast will be at the end of the year or early next year – in time for the fiscal year 2003-2004 budget.

One of the most common ways to forecast state economic variables is to start by forecasting elements of the national economy. A state can then use this information in developing forecasts of its own economic future, such as employment, income and unemployment. Some states base their national economic forecasts upon forecasts by private firms, such as DRI-WEFA, or Economy.com. Other states develop their own forecasts, although they often use published sources as a guide. Some forecasts are developed by a single state agency, perhaps with outside advice, and others are the products of a forecasting advisory board or commission.

Not all states forecast every variable we requested in our survey. Of the national variables, almost all forecasted real gross domestic product (GDP) and inflation, and most forecasted the unemployment rate, employment, personal income and nominal GDP as well. State variables included both demographic and economic factors. Almost all states forecast state prison population, Medicaid and welfare caseloads, personal income and employment. Most forecast wages and the unemployment rate as well.

Figure 10
State Forecasts of Real GDP Growth for 2002



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This Report

This report was written by Nicholas W. Jenny, Senior Policy Analyst at the Rockefeller Institute. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design, with assistance from Michele Charbonneau. Anna Hakobyan, a Graduate Research Assistant, helped collect and compile the data.

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