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State Budgetary Assumptions in 2001 — States Will Be Lowering Their Economic Forecasts

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Highlights

❖ Economic forecasts underlying state budgets have become out of date as the economy has weakened. The median state forecast of 3.2 percent growth in real gross domestic product is well above the current consensus of 1.8 percent.

❖ Almost every state reporting a forecast for real GDP is higher than the April Blue Chip consensus. Only North Dakota is below the consensus.

❖ After five consecutive years of underforecasting economic growth and state revenue, states now appear likely to overestimate economic growth and revenue.

❖ State forecasts that were conservative when first prepared now appear very optimistic, due to the deteriorating economy. States' well-known conservatism in forecasting has provided only a small buffer in a time of sharp economic slowing.

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Introduction

This is the Rockefeller Institute of Government's sixth 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 2001-02 budgets that governors released in January 2001 or thereafter. States developed their forecasts at different times, but all were developed between October 2000 and March 2001. (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 depend crucially 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 each of our previous five surveys, state governments underestimated economic growth in the nation and in their own states. They were in good company: the economy has consistently outperformed the predictions of public and private forecasters over the last five years. The unexpectedly strong economy aided by sharply rising stock prices led to much better-than-expected revenue growth, allowing 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 nearly 20-year highs, providing a cushion against potential revenue shortfalls and the need for unpopular tax increases or spending cuts.

This year is different. The 2001 survey illustrates starkly the difficulties states face in developing financial forecasts and managing budgets under economic uncertainty. The national economy weakened significantly during the period when many states were preparing budget forecasts, and private economists reduced their economic forecasts sharply. States that developed economic forecasts later in the period had opportunity to reflect some of this weakness in their budgets, but even these states' forecasts now are well above the consensus. Partly as a result, many states have reduced revenue forecasts and announced budget gaps after their budgets were published. Although these new, lower, revenue forecasts may implicitly presume slower economic growth, states generally have not formally reduced economic forecasts from the numbers reported here.

States' Forecasts of the National Economy

States' official forecasts call for much slower economic growth in 2001 than last year's rapid pace, followed by a modest recovery in the 2002 "outyear" that is still slower than 2000. Real gross domestic product (GDP) is the broadest measure of the national economy and is useful for comparing across states. In 2000, real GDP grew by a very high 5.0 percent, and the survey shows that the median state expected growth to slow to 3.2 percent in 2001, followed by a modest recovery to 3.5 percent in 2002. Other measures of the national economy show a similar pattern. Employment grew at a 2 percent clip in 2000, but states' median prediction for 2001 was a sharply slower 1.1 percent followed by 1.2 percent in 2002. Retail sales growth was a brisk 7.8 percent in 2000, but the median prediction for 2001 was 2.5 percent and 4.6 percent for 2002. Corporate profits grew 10.5 percent in 2000, but the median prediction for 2001 was 1.1 percent and 5.6 percent for 2002.

Although talk of recession is common in the press now, no state except perhaps North Dakota was predicting a recession in its budget forecast. (North Dakota predicted a 0.6 percent decline in real GDP in 2001, but it anticipated considerable growth in other variables such as employment and real income, and so it clearly was not anticipating a recession in the classic sense.) States predicted that the good times will still roll, but somewhat less quickly in 2001. (See Table 1 for state-by-state and median forecast of key national economic variables and see Figure 1 for selected variables.)

States' Forecasts of Their Own Economies

All else being equal, a slowing national economy generally leads to a slowing state economy, and that is what most states are predicting. The median state estimate of actual retail sales growth in 2000 was 6.5 percent; the median prediction was 4.4 percent in 2001 and 5.2 percent in 2002. Employment, personal income, and wages and salaries show the same pattern: 2001 growth is expected to be slower than 2000, followed by a moderate recovery in 2002. The eight states that reported capital gains estimates show an extreme version of the same pattern. (See Table 2 and Figure 2.)

Figure 3 demonstrates the regional pattern in state employment growth forecasts, which is generally consistent with recent patterns in regional growth. The

Table 1. National Economic Forecasts

year-over-year percent changes

	Real GDP		*Nominal GDP*		*Employment*		*Retail Sales*		*Personal Income*	
	2001	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*
Median of All States	**3.2**	**3.5**	**5.3**	**5.6**	**1.1**	**1.2**	**2.5**	**4.6**	**5.5**	**5.2**
New England										
Connecticut	4.0	3.2	6.4	5.0	1.6	1.2	—	—	6.1	5.1
Maine	—	—	—	—	—	—	—	—	—	—
Massachusetts	—	—	—	—	1.4	1.2	—	—	—	—
Rhode Island	3.3	3.7	5.7	5.7	1.2	1.3	4.2	4.8	6.3	6.2
Mid-Atlantic										
Delaware	2.0	3.2	3.9	4.7	0.7	0.9	—	—	4.5	4.8
Maryland	3.3	3.7	—	—	1.2	1.3	—	—	6.3	6.2
New York	2.2	3.5	3.3	4.6	0.9	1.5	—	—	4.8	4.7
Pennsylvania	3.2	3.5	5.4	5.0	1.2	1.3	—	—	5.5	5.1
Great Lakes										
Illinois	3.5	3.0	5.8	5.0	1.4	1.2	—	—	5.7	5.0
Michigan	2.5	4.3	4.9	6.6	—	—	—	—	4.8	5.7
Ohio	3.3	3.3	5.5	5.3	1.2	1.3	—	—	5.9	5.2
Wisconsin	2.5	4.3	4.6	6.0	1.3	0.9	2.2	4.6	4.7	5.4
Plains										
Iowa	1.9	3.4	1.8	2.0	—	—	—	—	2.3[3]	3.4[3]
Kansas	3.3	3.5	5.7	5.6	—	—	—	—	5.6	5.6
Minnesota	2.1	4.0	4.2	6.4	0.7	0.6	1.9	4.6	4.7	4.9
Missouri	3.7	2.9	—	—	0.9	0.7	6.5[1]	4.9[1]	6.0	5.1
Nebraska	3.3	3.1	4.9	4.7	1.3	0.8	5.2	4.8	3.7	3.0
North Dakota	(0.6)	1.3	2.0	3.7	0.8	1.3	2.5	4.6	5.5	5.6
South Dakota	2.5	4.3	—	—	0.0	1.1	—	—	4.7	5.4
Southeast										
Arkansas	4.2	3.7	6.8	5.8	0.7	0.6	1.7	4.3	6.1	5.6
Florida	3.2	2.8	5.4	4.7	0.6	0.0	4.0	3.2	4.5	5.6
Kentucky	2.1	4.0	4.2	5.7	0.7	0.6	1.9	4.6	4.7	4.9
Louisiana	2.2	3.1	—	—	1.9	1.6	—	—	6.1	5.5
Mississippi	3.2	3.4	5.4	5.0	1.2	1.3	—	—	5.5	5.1
North Carolina	2.1	4.0	4.1	5.7	0.7	0.6	1.9	4.6	4.7	4.9
South Carolina	4.2	3.3	7.4	5.9	2.0	1.7	6.7	5.5	6.5	5.9
Tennessee	3.2	3.5	5.4	5.0	1.2	1.3	4.5[2]	5.3[2]	5.6	5.0
Virginia	3.6	3.4	5.7	5.0	1.4	1.3	—	—	5.8	5.0
West Virginia	3.1	4.1	5.4	5.9	0.9	1.0	3.4	5.1	5.4	5.6
Southwest										
Arizona	3.2	3.5	—	—	—	—	—	—	—	—
New Mexico	3.1	3.4	—	—	1.4	1.4	—	—	6.1	5.3
Oklahoma	2.5	4.3	4.7	6.0	0.1	0.9	0.3	(0.9)	4.7	5.4
Texas	3.9	3.5	—	—	—	—	—	—	—	—
Rocky Mountain										
Colorado	2.1	4.0	4.2	5.7	0.7	0.6	1.9	4.6	4.7	4.9
Idaho	3.6	4.3	5.5	6.0	1.1	1.2	—	—	5.8	5.6
Utah	2.0	3.2	3.9	4.6	0.7	0.9	2.5	4.6	4.5	4.9
Wyoming	3.3	3.7	—	—	1.2	1.3	—	—	6.3	6.3
Far West										
Alaska	—	—	—	—	—	—	—	—	—	—
California	3.0	4.3	5.5	6.5	0.4	1.2	—	—	5.5	5.6
Hawaii	—	—	5.3	5.0	—	—	—	—	—	—
Oregon	2.5	4.3	4.7	6.0	0.1	0.9	—	—	4.7	5.4
Washington	2.1	3.5	4.3	5.9	0.8	0.7	2.2	4.8	4.9	5.2

Table 1. National Economic Forecasts
year-over-year percent changes **(Continued)**

	Wage and Salary		*Corporate Profits*		*Inflation (CPI-U)*		*Unemployment Rate*	
	2001	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*
Median of All States	**5.3**	**4.9**	**1.1**	**5.6**	**2.6**	**2.4**	**4.4**	**4.8**
New England								
Connecticut	—	—	—	—	3.2	2.4	4.2	4.6
Maine	—	—	—	—	2.5	2.5	—	—
Massachusetts	—	—	9.0	2.1	—	—	—	—
Rhode Island	6.5	5.9	3.5	5.4	2.5	2.5	4.3	4.8
Mid-Atlantic								
Delaware	5.0	4.4	1.7	2.0	2.7	2.6	4.7	5.1
Maryland	—	—	3.5	5.4	2.5	2.5	4.3	4.8
New York	5.5	5.1	1.5	3.9	2.7	2.2	4.5	4.6
Pennsylvania	5.2	4.7	5.5	4.8	2.7	2.5	4.4	4.5
Great Lakes								
Illinois	5.9	4.7	8.0	3.0	3.1	2.4	4.4	4.8
Michigan	5.4	6.4	1.1	10.9	2.7	2.8	4.5	4.4
Ohio	—	—	6.0	6.0	2.7	2.5	4.2	4.4
Wisconsin	5.1	5.5	(1.4)	11.2	2.6	1.6	4.7	5.0
Plains								
Iowa	—	—	—	—	2.8	2.4	4.5	4.6
Kansas	—	—	0.0	4.0	2.8	2.5	4.4	—
Minnesota	5.3	4.9	(4.0)	12.8	2.4	1.8	4.9	5.3
Missouri	—	—	3.9	0.6	3.2	2.5	4.0	4.4
Nebraska	5.3	4.7	(0.3)	2.1	2.3	2.4	—	—
North Dakota	6.2	6.0	—	—	2.6	2.4	4.4	4.7
South Dakota	5.1	4.5	—	—	2.7	1.8	4.6	4.6
Southeast								
Arkansas	5.3	4.9	(4.0)	12.8	2.4	1.8	4.9	5.3
Florida	6.2	4.7	1.1	6.2	3.0	2.0	4.3	5.3
Kentucky	5.3	4.9	—	—	2.4	1.8	4.9	5.3
Louisiana	—	—	—	—	2.5	2.3	4.0	—
Mississippi	—	—	—	—	2.7	2.5	4.4	4.5
North Carolina	5.3	4.9	(4.0)	12.8	2.4	1.8	4.9	5.3
South Carolina	5.4	6.7	7.0	4.7	3.2	2.6	4.2	4.4
Tennessee	—	—	—	—	2.1[5]	1.4[5]	4.4	4.5
Virginia	5.1	4.6	5.7	5.0	2.5	2.4	4.3	4.4
West Virginia	5.8	5.8	(2.0)	9.4	2.4	1.8	4.5	4.8
Southwest								
Arizona	—	—	—	—	2.7	2.5	—	—
New Mexico	5.3	4.0	—	—	2.2	2.2	—	—
Oklahoma	5.1	5.5	—	—	2.6	1.8	—	—
Texas	—	—	—	—	2.7	2.5	—	—
Rocky Mountain								
Colorado	5.3	4.9	(0.9)[4]	13.0[4]	2.4	1.8	4.9	5.3
Idaho	6.0	6.0	—	—	2.2	1.7	—	—
Utah	3.9	3.6	1.6	5.6	2.7	2.6	4.7	5.1
Wyoming	6.5	5.9	—	—	2.5	2.5	4.3	4.8
Far West								
Alaska	—	—	—	—	—	—	—	—
California	5.5	5.5	0.1	13.3	21.4	2.1	4.5	4.7
Hawaii	—	—	—	—	—	—	—	—
Oregon	5.1	5.5	(1.4)	11.2	2.6	1.8	4.0	4.7
Washington	5.5	5.1	(3.9)	11.3	2.5	2.4	4.8	5.1

Note: Underlined numbers indicate forecast is for fiscal year rather than calendar year.
— Data not available.
1 Personal Consumption Expenditures.
2 Taxable Retail Sales.
3 Disposable Personal Income.
4 After Tax.
5 GDP Implicit Price Deflator.

Table 2. State Economic and Caseload Forecasts
year-over-year percent changes

	Employment		*Retail Sales*		*Personal Income*		*Wage and Salary*		*Unemployment Rate*	
	2001	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*
Median of All States	**1.2**	**1.4**	**4.4**	**5.2**	**5.2**	**5.5**	**5.3**	**5.5**	**4.4**	**4.4**
New England										
Connecticut	1.2	1.1	—	—	5.3	5.2	—	—	2.3	2.5
Maine	1.1	1.3	—	—	4.5	5.0	5.3	5.8	—	—
Massachusetts	1.4	1.6	—	—	6.1	5.7	6.4	6.1	2.6	2.7
Rhode Island	1.1	0.8	3.4	4.5	5.5	5.5	5.7	4.8	4.7	5.1
Mid-Atlantic										
Delaware	1.1	1.1	—	—	5.8	4.5	6.1	4.3	—	—
Maryland	1.6	1.9	—	—	6.2	5.9	6.6	6.0	3.6	4.0
New Jersey	1.0	1.0	—	—	5.0	5.0	—	—	—	—
New York	1.2	1.0	—	—	4.5	3.9	4.9	4.1	5.0	5.5
Pennsylvania	0.4	1.1	—	—	6.1	6.7	6.5	7.2	4.0	4.1
Great Lakes										
Illinois	0.7	0.8	4.5	4.3	5.0	4.4	4.5	4.5	4.4	4.4
Michigan	(0.3)	1.0	—	—	3.4	5.3	3.1	5.6	4.7	4.5
Ohio	0.3	0.8	2.2	4.0	5.1	4.5	—	—	4.3	4.5
Wisconsin	0.0	0.9	—	—	4.3	5.0	4.4	5.3	4.4	4.7
Plains										
Iowa	0.6	0.5	—	—	6.0	5.9	5.9	6.1	—	—
Kansas	—	—	2.8	3.7	4.8	4.8	5.2	—	3.2	—
Minnesota	0.7	0.9	—	—	4.6	5.4	5.1	5.7	—	—
Missouri	0.9	0.7	4.2	4.5	4.7	4.5	—	—	3.6	4.0
Nebraska	—	—	4.5	5.2	9.5	6.6	—	—	—	—
North Dakota	0.6	1.7	—	—	6.1	5.2	5.6	5.9	2.9	3.2
South Dakota	(0.5)	1.3	5.0	5.3	3.8	5.7	5.3	4.6	2.4	2.5
Southeast										
Arkansas	2.4	1.7	3.8	5.2	5.0	5.4	4.0	4.9	4.8	4.4
Florida	3.5	2.2	—	—	6.2	6.2	6.8	6.6	3.8	4.4
Kentucky	1.3	1.7	—	—	3.9	4.8	6.6	4.6	—	—
Louisiana	1.3	1.9	—	—	4.8	5.0	—	—	5.8	—
Mississippi	1.3	1.3	—	—	4.8	4.8	4.7	4.8	5.9	5.8
North Carolina	1.4	2.0	4.4[1]	5.6[1]	5.0	5.5	5.2	5.6	4.6	4.3
South Carolina	2.0	2.0	5.0	5.0	6.1	6.1	5.5	5.5	4.1	4.1
Tennessee	1.2	1.6	4.5[1]	5.3[1]	5.4	5.8	5.1	4.8	4.3	4.5
Virginia	2.5	2.1	—	—	6.1	6.2	7.0	6.7	2.6	2.8
West Virginia	0.5	0.7	2.9	3.7	3.2	3.7	3.7	3.9	5.7	5.7
Southwest										
Arizona	3.7	3.5	7.3	7.3	6.6	6.5	—	—	4.5	4.5
New Mexico	2.0	2.2	—	—	5.1	4.9	4.8	5.1	—	—
Oklahoma	0.6	1.2	3.7	3.9	3.4	4.0	3.6	4.1	—	—
Texas	2.3	2.3	—	—	6.8	6.4	—	—	4.5	4.6
Rocky Mountain										
Colorado	3.4	3.0	6.8	6.1	7.6	7.0	8.3	7.2	2.9	3.4
Idaho	2.3	2.4	—	—	6.3	6.1	5.8	6.6	—	—
Utah	2.4	1.8	4.6	5.4	5.6	5.6	3.0	3.6	3.5	3.9
Wyoming	1.4	1.4	—	—	6.2	6.6	6.5	6.3	4.4	4.8
Far West										
Alaska	—	—	—	—	—	—	—	—	—	—
California	2.8	2.7	4.9[1]	6.4[1]	5.7	6.9	5.5	7.8	4.8	4.7
Hawaii	—	—	4.1[2]	7.8[2]	5.7	5.6	4.7	4.9	—	—
Oregon	0.7	1.8	—	—	4.8	6.0	5.2	6.6	—	—
Washington	1.7	1.4	4.0[1]	4.3[1]	3.2	5.4	2.4	5.1	5.2	5.5

Table 2. State Economic and Caseload Forecasts
year-over-year percent changes **(Continued)**

	Capital Gains		*Medicaid Caseload*		*TANF Caseload*		*Prison Population*	
	2001	*2002*	*2001*	*2002*	*2001*	*2002*	*2001*	*2002*
Median of All States	**(5.0)**	**2.8**	**4.0**	**3.1**	**(3.0)**	**0.0**	**3.2**	**3.3**
New England								
Connecticut	—	—	1.4	2.0	(10.4)	(11.2)	3.4	3.7
Maine	—	—	—	—	—	—	—	—
Massachusetts	—	—	4.0	3.6	(8.5)	(6.2)	(3.0)	1.4
Rhode Island	—	—	11.9	9.8	(6.5)	(6.5)	8.5	0.0
Mid-Atlantic								
Delaware	(10.1)	(4.5)	5.3	5.2	(9.7)	(8.6)	0.4	7.6
Maryland	10.0	7.5	—	—	—	—	—	—
New Jersey	—	—	—	—	—	—	—	—
New York	(9.5)	9.7	—	—	—	—	—	—
Pennsylvania	—	—	0.9	1.0	(3.3)	0.0	0.5	0.1
Great Lakes								
Illinois	—	—	4.5	3.8	(23.3)	(16.3)	4.2	4.3
Michigan	—	—	1.8	1.0	(5.9)	(4.1)	3.2	3.5
Ohio	—	—	12.9	6.1	(7.5)	0.2	(1.8)	(0.2)
Wisconsin	—	—	4.0	2.4	0.0	0.0	1.4	(0.2)
Plains								
Iowa	—	—	3.1	0.7	(2.1)	(6.3)	—	—
Kansas	—	—	7.2	11.7	2.8	0.0	(8.6)	(5.8)
Minnesota	0.0	5.6	4.4	3.0	(0.9)	(6.8)	5.2	3.3
Missouri	—	—	14.3	5.0	0.5	6.5	2.9	—
Nebraska	—	—	5.8	5.8	0.0	0.0	2.9	5.1
North Dakota	—	—	0.0	0.0	(2.5)	1.7	7.6	6.4
South Dakota	—	—	1.2	1.6	3.7	4.3	6.0	4.2
Southeast								
Arkansas	—	—	—	—	6.1	5.7	—	—
Florida	—	—	13.0	6.3	(14.1)	(6.6)	1.8	2.2
Kentucky	—	—	4.0	2.4	1.9	3.7	—	—
Louisiana	—	—	2.0	2.0	(6.8)	6.5	0.5	0.1
Mississippi	—	—	3.0	—	(12.5)	16.4	—	—
North Carolina	0.0	(5.0)	—	—	—	—	—	—
South Carolina	—	—	9.0	9.0	0.5	1.5	2.0	2.0
Tennessee	—	—	0.0	0.0	0.0	(0.9)	10.2	0.0
Virginia	—	—	0.3	1.5	(14.5)	(12.3)	1.7	1.6
West Virginia	(12.0)	0.0	—	—	—	—	—	—
Southwest								
Arizona	—	—	4.2	4.0	(1.2)	0.0	3.3	3.3
New Mexico	—	—	—	—	—	—	—	—
Oklahoma	—	—	5.4	1.9	3.7	0.0	3.0	—
Texas	—	—	—	—	—	—	—	—
Rocky Mountain								
Colorado	—	—	5.4	3.8	0.0	0.0	7.6	6.5
Idaho	—	—	16.5	11.7	4.5	(0.1)	6.6	7.4
Utah	0.0	(14.0)	1.5	3.1	(7.1)	2.0	6.8	5.4
Wyoming	—	—	—	—	0.0	0.0	(1.2)	3.4
Far West								
Alaska	—	—	—	—	—	—	—	—
California	(10.0)	6.0	2.0	12.3	(8.1)	(4.4)	2.2	2.2
Hawaii	—	—	2.7	2.0	(9.5)	(5.3)	7.0	5.3
Oregon	—	—	2.7	3.9	(8.5)	1.7	7.6	6.6
Washington	—	—	6.2	2.7	2.7	1.2	1.2	0.2

Note: Underlined numbers indicate forecast is for fiscal year rather than calendar year.
— Data not available.
1 Taxable Retail Sales.
2 General Excise and Use Tax.

Southwest and Rocky Mountain states are forecasting growth well above the national median for 2001 of 1.3 percent, while the Great Lakes states are predicting zero growth and the Plains states are predicting only 0.7 percent growth. Arizona is forecasting the highest employment growth, a very robust 3.7 percent, while South Dakota is forecasting a 0.5 percent drop in employment in 2001.

Caseload Predictions

Also part of the survey were three variables that might affect state spending: Medicaid and TANF (Temporary Assistance for Needy Families) caseloads, and state prison populations. Medicaid caseloads grew 3.2 percent in 2000, faster than expected in last year's survey, as discussed below. States predict this growth will accelerate to 4 percent in 2001 and then slow again to 3.1 percent in 2002. States have been predicting declining TANF caseloads for several years now and indeed caseloads dropped by 6.7 percent in 2000 in the median states. States now expect this decline to moderate – the median prediction was a 3 percent drop in 2001 and no change in 2002.

States expect prison populations to continue to grow at a moderate pace in the next two years – a median forecast of 3.2 percent in 2001 and 3.3 percent in 2002. However there is a considerable range in these predictions. The highest estimated increase for 2001 was 16.4 percent in Mississippi. Kansas is projecting the largest drop in prison population in 2001, at 8.6 percent.

States Underestimated Economic Growth in Last Year's Survey

Figure 4 shows that at the start of last year both public and private sector economic forecasters underforecasted economic growth for 2000. Last year's median state government forecast for real GDP growth in 2000 was 3.4 percent, which was only a little lower than the January 2000 Blue Chip consensus forecast of 3.6 percent. (The Blue Chip consensus is a widely followed monthly survey of the forecasts of approximately 50 economists. The "consensus" is the average of these forecasts.) These forecasts were well shy of 2000's actual real GDP growth of 5 percent. State and private forecasts of corporate profits were way too low: the median state prediction was 3.5 percent, the Blue Chip consensus was 4.8 percent, and actual growth was 10.5 percent – three times higher than the median state estimate.

States also generally underforecast growth in their own economies in 2000. (See Figure 5.) Misestimates of state economic growth have a direct effect on state revenues and spending. The median state estimate was that retail sales would grow by 5 percent in 2000, but they actually grew by 6.5 percent. This should translate into higher than expected sales tax growth. Likewise, the median state estimate for personal income growth was only 5 percent, while actual growth was 5.7 percent. Again, this should translate into higher than expected income tax growth.

Figure 6 compares the median estimates for Medicaid and TANF caseload growth and prison population growth in 2000 with actual reported growth from the states. The median state estimate for Medicaid caseload growth was 2.4 percent, but the actual was slightly higher at 3.2 percent. There are some early indications that Medicaid caseload growth is accelerating even beyond the 4 percent growth predicted by the states for 2001; Medicaid, which is the second-largest spending category in the average state budget, probably will continue to be a trouble spot for states..

States expected TANF caseloads to drop by 11 percent in 2000, continuing the trend of the last several years; the actual drop was somewhat smaller than expected, at 6.5 percent – meaning states may have spent more on welfare programs in 2000 than they had budgeted for, even if less than the year before. In contrast, prison populations grew slightly more slowly than predicted. The median projection for 2000 was 4.4 percent growth, while actual growth was only 3 percent – so states may have saved some money here.

Underestimating the strength of the economy can lead to unanticipated revenue and large surpluses. In fiscal year 2000 states underestimated revenues by $17.7 billion (see Table 3.) According to the National Association of State Budget Officers, 29 states underestimated personal income tax revenues, for $9.9 billion in unexpected additional revenues. Most states with a sales tax (82% or 36 states) underestimated sales tax revenues. A majority of states with corporate income taxes, 24, underestimated corporate income tax revenues, a notoriously unstable revenue source.

This has been the pattern for several years now. The end-of-year surpluses have allowed states to make large annual net tax cuts and increase spending. After several years of these surpluses states have made significant reductions in taxes and added significant new spending commitments that affect subsequent years – commitments that may be hard to maintain when the economy slows. Successive years of surpluses also can create pressure to budget more aggressively – to use less conservative economic and revenue assumptions — especially in the face of these commitments.

Table 3
Fiscal 2000 Tax Collections Compared with Projections Used in Adopting Fiscal 2000 Budgets

	States Underestimating Revenue		
	Amount (billions)	*Number*	*Percent*
Total	$17.7	42	84%
Personal Income Tax (42 States)	9.9	29	69
Sales Tax (44 States)	4.8	36	82
Corporate Income Tax (44 States)	0.6	24	55

Source: National Association of State Budget Officers, *Fiscal Survey of the States*, December 1999, 2000.

State Economic Forecasts in the Context of a Weakening Economy

While states' economic forecasts for 2000 were low, they were not much lower than those private forecasters made at the same time. As 2000 went on the Blue Chip consensus forecast moved upward considerably. (See Figure 7 for the revisions to real GDP forecasts – other measures followed a similar upward pattern.) This had been the pattern for several years.

This year is different. The economy has been weakening and private forecasts have been moving downward. States prepared the economic forecasts covered in this survey between October 2000 and March 2001. The median forecast was quite close to the December Blue Chip consensus, but by January the Blue Chip had fallen sharply and state forecasts were looking optimistic as shown in Figure 8.[1] The Blue Chip consensus has continued moving downward, as can be seen by the trajectory of real GDP forecasts shown in Figure 9. The right hand bar in Figure 8 shows the prediction for each measure in the April Blue Chip consensus forecast, and in each case the April forecast is gloomier than the January forecast and the median state forecast. This is the opposite of last year's pattern, as can be seen by comparing Figures 7 and 9.

Figure 10 shows that states tried to consider the changing economic situation as they made their economic predictions for 2001. However, the Blue Chip consensus forecast has continued to move downward, while forecasters in the states had to freeze their predictions at some point in order to finalize the executive budget. All states that predicted early (October or November 2000) predicted high (higher than the January or later Blue Chip consensus). Arizona, Arkansas, Ohio, South Carolina, and Virginia were in this group – states that have reduced revenue estimates or cut spending for fiscal year 2001 and/or 2002.

Figure 11 arrays the states by their forecasts of real GDP growth in 2001 and shows the Blue Chip consensus at several points in time. Unlike past years when we have seen states very tightly clustered near the Blue Chip consensus, this year states are clustered in several groups largely based on when they prepared their forecast. Most states would have been more conservative (i.e., lower) than the October Blue Chip consensus, but by December the consensus had dropped considerably. By January, the consensus was lower than all of the early-forecasting states but later-forecasting states managed to have forecasts that, at the time, seemed conservative relative to the consensus. As the economy continued to weaken, the consensus continued to fall, and all states on the table are above the April Blue Chip consensus. The only state that is more conservative than the current consensus is North Dakota (excluded as an outlier), which is actually predicting a 0.6 percent decline in real GDP in 2001.

The figure suggests that while states may forecast conservatively, this conservativism is modest compared to the speed at which the economic environment can change. States that looked slightly conservative in October or December now look wildly optimistic.

Economic Weakness and Budgets

The downturn may mean that states will have even less money for their fiscal year 2001 budgets than projected. Indeed, in the last four months many states have announced revenue shortfalls for the current fiscal year, or have revised their estimates for the next fiscal year downward. Table 4 lists states that have experienced some distress because of falling revenues. The situation in these states demonstrates one of the reasons why states tend to use conservative economic estimates when preparing their budgets – if they overestimate the strength of the economy it can lead to overestimated revenues and can cause severe problems in bringing budgets into balance.

Table 4
States With Recently Announced Revenue Problems

Alabama*	Gov. Sigelman (D) cut FY 2001 budget by $266M
Arizona	Enacted FY 2002-03 biennial budget with $850M less spending than original proposal
Arkansas	State forecasters reduced revenue estimates for FY 2002 by $58M, and Gov. Huckabee (R) cut FY 2001 by $8M
California	Legislative Analyst reduced FY 2002 revenue estimate by $4.8B
Colorado	State forecasters reduced revenue estimates for FY 2002 by $478M
Delaware	State forecasters reduced revenue estimates for FY 2001 by $70M, for FY 2002 by $86M. Gov. Minner (D) cut FY 2001 budget by $32M
Illinois	Legislative forecasters project $460M gap in FY 2002 budget as originally proposed
Iowa	Gov. Vilsack (D) cut $144M from original FY 2002 budget proposal
Indiana	State forecasters reduced revenue estimates through FY 2003 by $950M
Kentucky	State forecasters project $300M gap in FY 2001 budget
Louisiana	Legislative Auditor projects $200M gap in FY 2002 budget
Maine	Revenue Forecasting Committee projects $295M gap in FY 2002 budget
Michigan*	Gov. Engler (R) cut $125M from original FY 2002 budget porposal
Mississippi	Gov. Musgrove (D) cut FY 2001 budget by $134M
Missouri	State forecasters project $307M gap in FY 2001 budget and $299M gap in FY 2002 budget
North Carolina	Gov. Easley (D) cut FY 2001 budget by $470M
Nevada	State forecasters reduced revenue estimates for FY 2001 by $45M, for FY 2002 by $96M
Ohio	State forecasters reduced revenue estimates for FY 2001 by $288M, for FY 2002 by $562M
Oregon	State forecasters reduced revenue estimates for FY 2002-03 by $102M
South Carolina	Budget and Control Board cut FY 2001 budget by $50M
Tennessee	Finance commissioner projects revenue shortfall for FY 2001 of $200M, for FY 2002 bu $600M
Utah	State forecasters reduced revenue estimates for FY 2001 by $48M
Virginia	Gov. Gilmore (R) cut $189M from original FY 2002 budget proposal
West Virginia	Gov. Wise (D) cut FY 2001 budget by $24M
Wisconsin	State forecasters reduced revenue estimates through FY 2003 by $651M
All actions taken since beginning of 2001. Fiscal year ends June 30, except for states marked * where it ends September 30.	

Some states, such as Alabama, Delaware, Mississippi, North Carolina, South Carolina and West Virginia, have cut spending in fiscal year 2001, when revenues failed to meet expectation, or spending exceeded projections, or both. Many other states have revised fiscal year 2002 budgets to reflect the drop in economic and revenue prediction since they were first prepared a few months before.

States that have had to confront revenue shortfalls so far are concentrated in the Southeast and Midwest, but the large drop in the Blue Chip consensus forecast from January through April could indicate that may more states will have to tighten their belts in the coming year.

Conclusion

Many state legislatures are still working on their budgets for fiscal year 2002, even as predictions for the economy in the coming year are heading down. Budget officials must decide how much to adjust revenue forecasts to account for the new economic realities. If they adjust expected revenues downward, then lawmakers may have to sacrifice the tax cuts and spending increases that they have been able to give their constituents in recent years. If the economy gets worse, or is worse in particular states, then significant spending cuts or even tax increases may become necessary, something lawmakers would very much like to avoid.

Endnotes

1 All Blue Chip consensus forecasts are from: *Blue Chip Economic Indicators*, Vol. 26, No. 4, April 10, 2001.

Figure 1: States Expect National Economy to Slow

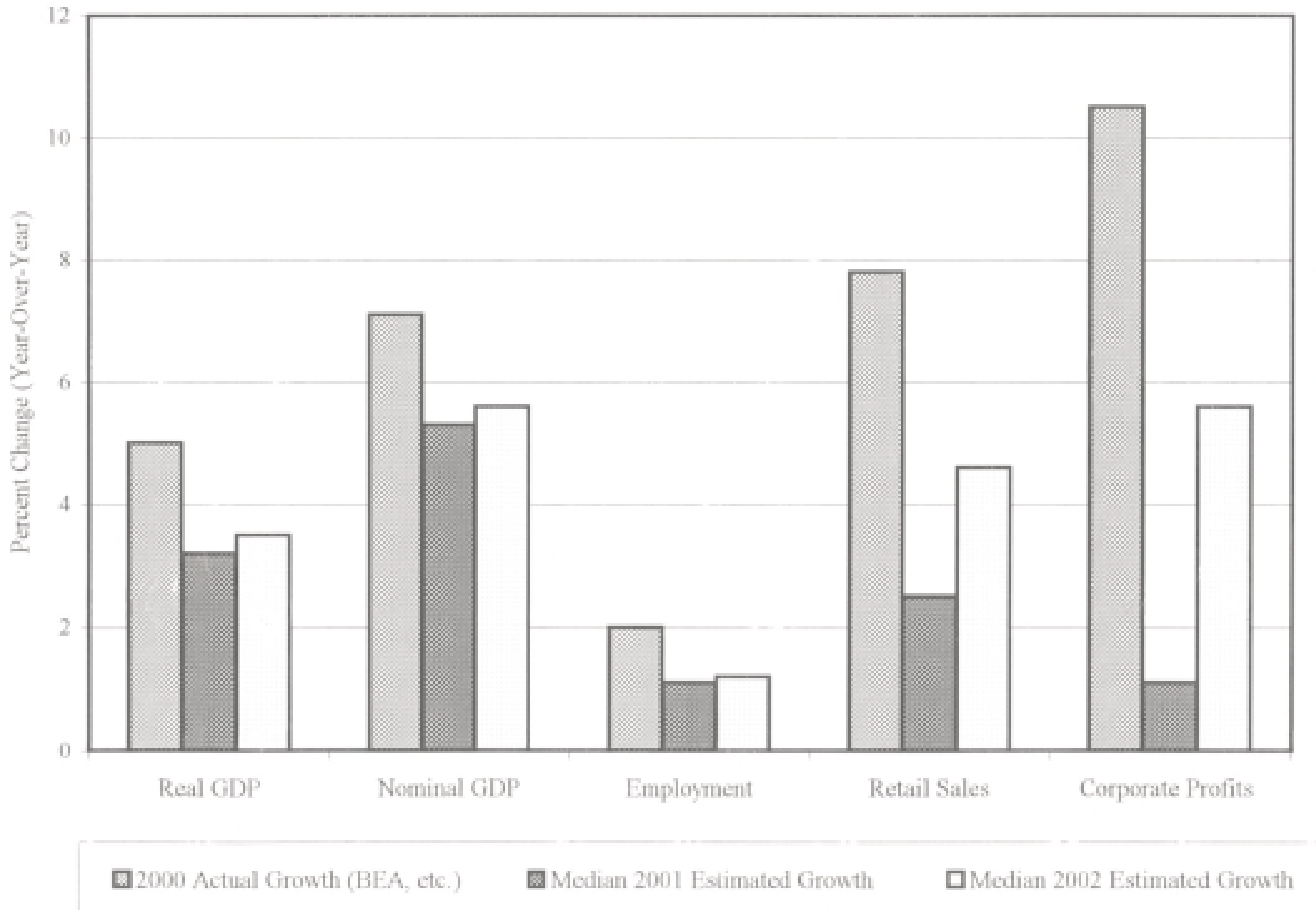

Figure 2: States Also Expect State Economies to Slow

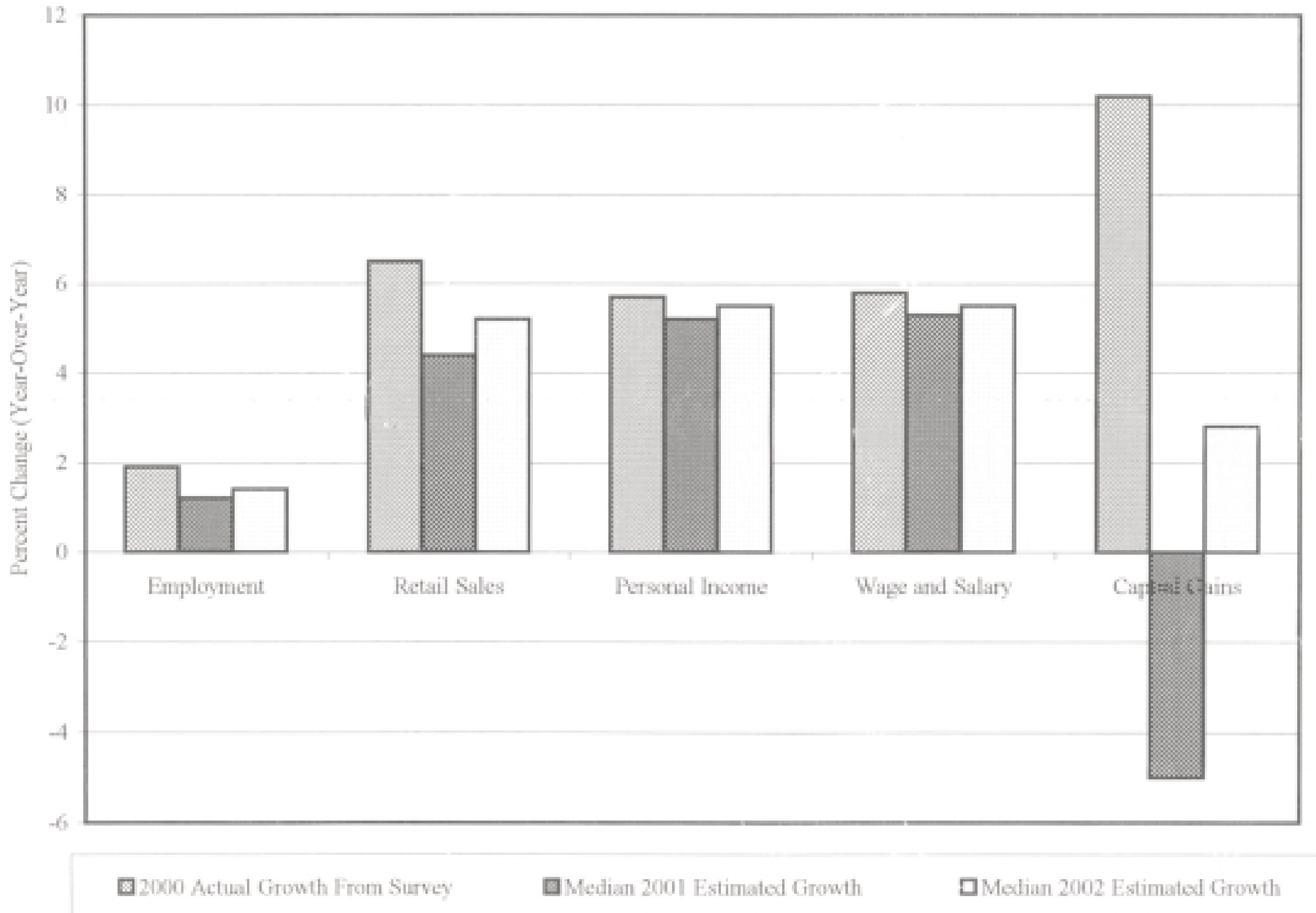

Figure 3: Forecasts of 2001 State Employment Growth by Region

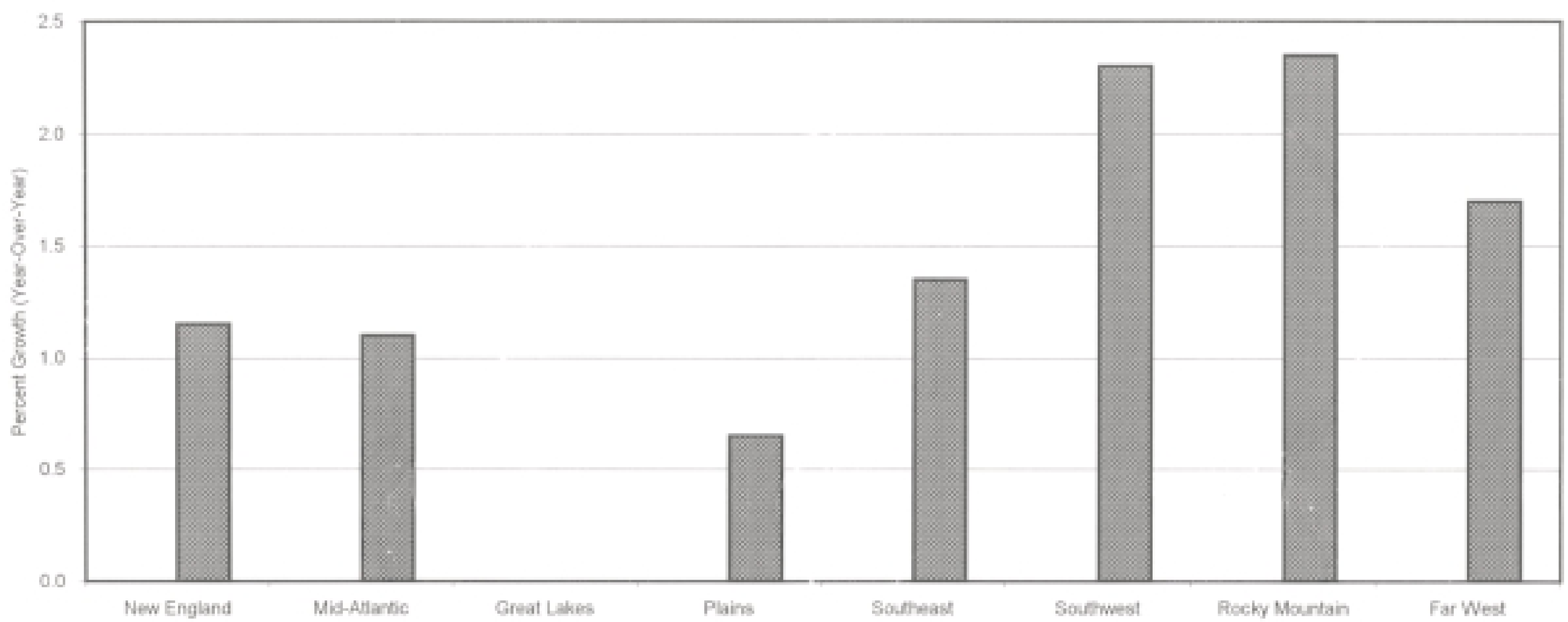

Figure 4: Both State and Early Blue Chip Forecasts Underestimated 2000 National Economic Growth

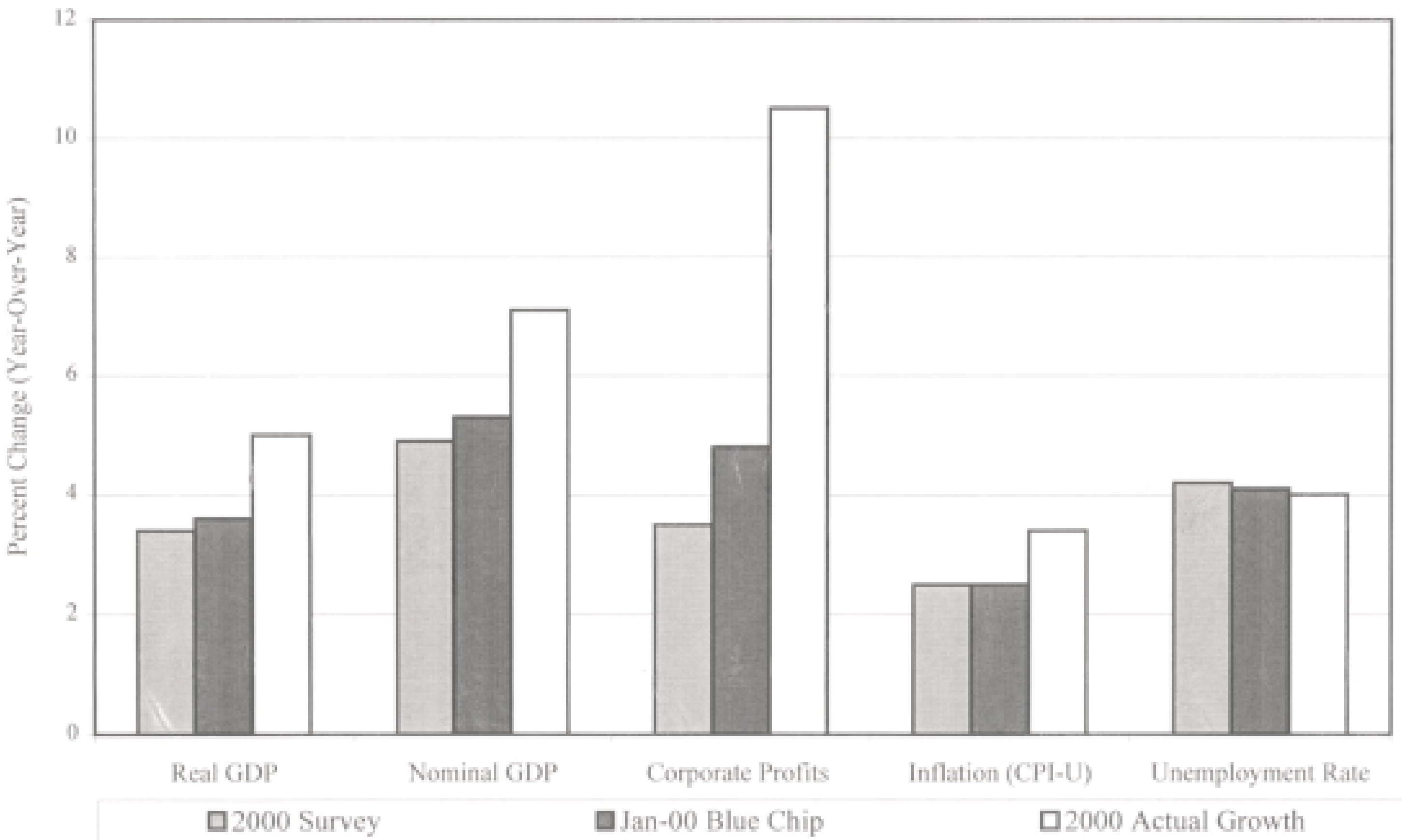

Figure 5: States Also Underestimated State Economic Growth

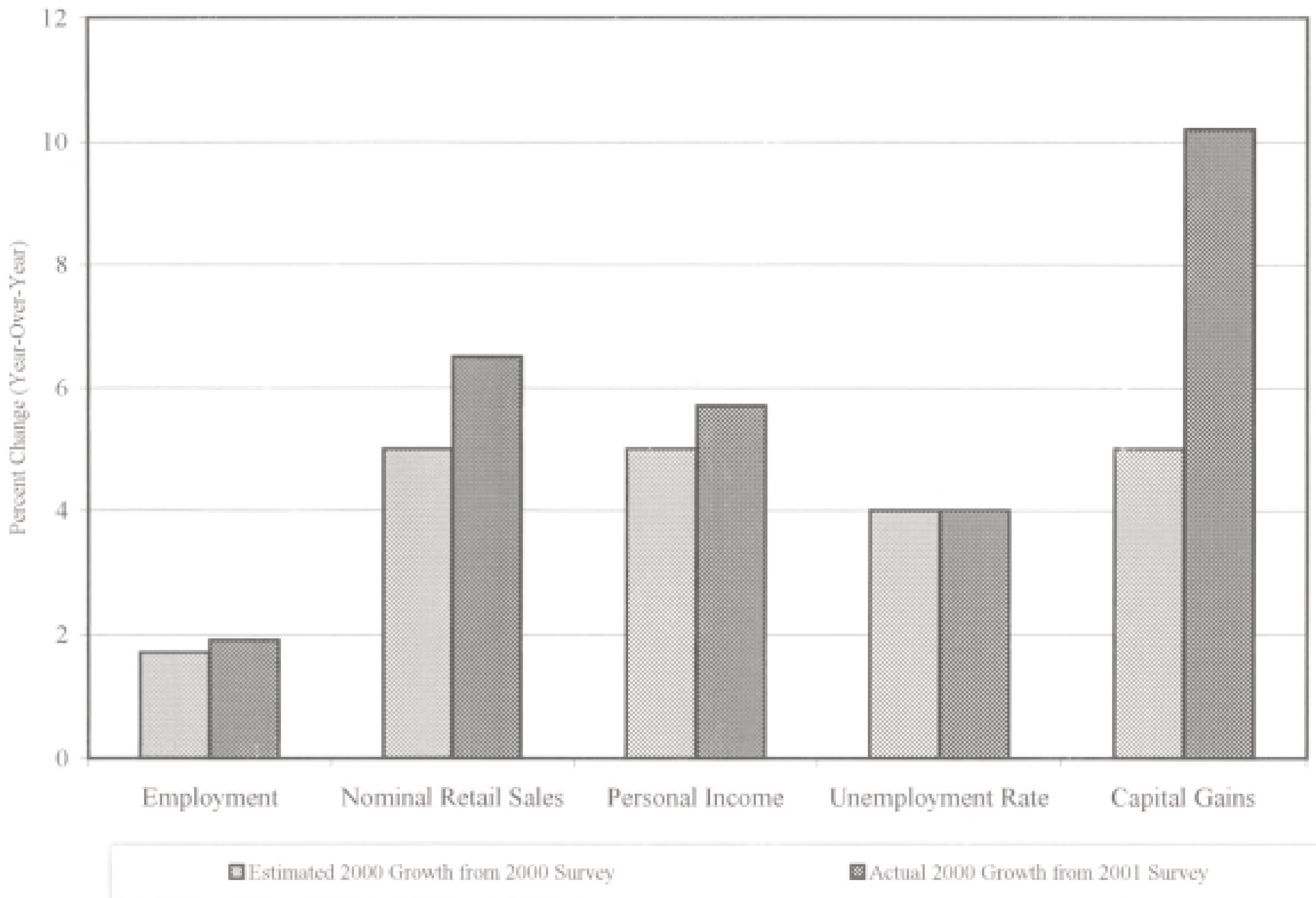

Figure 6: Caseload Predictions Were Low, Prison Population Predictions High

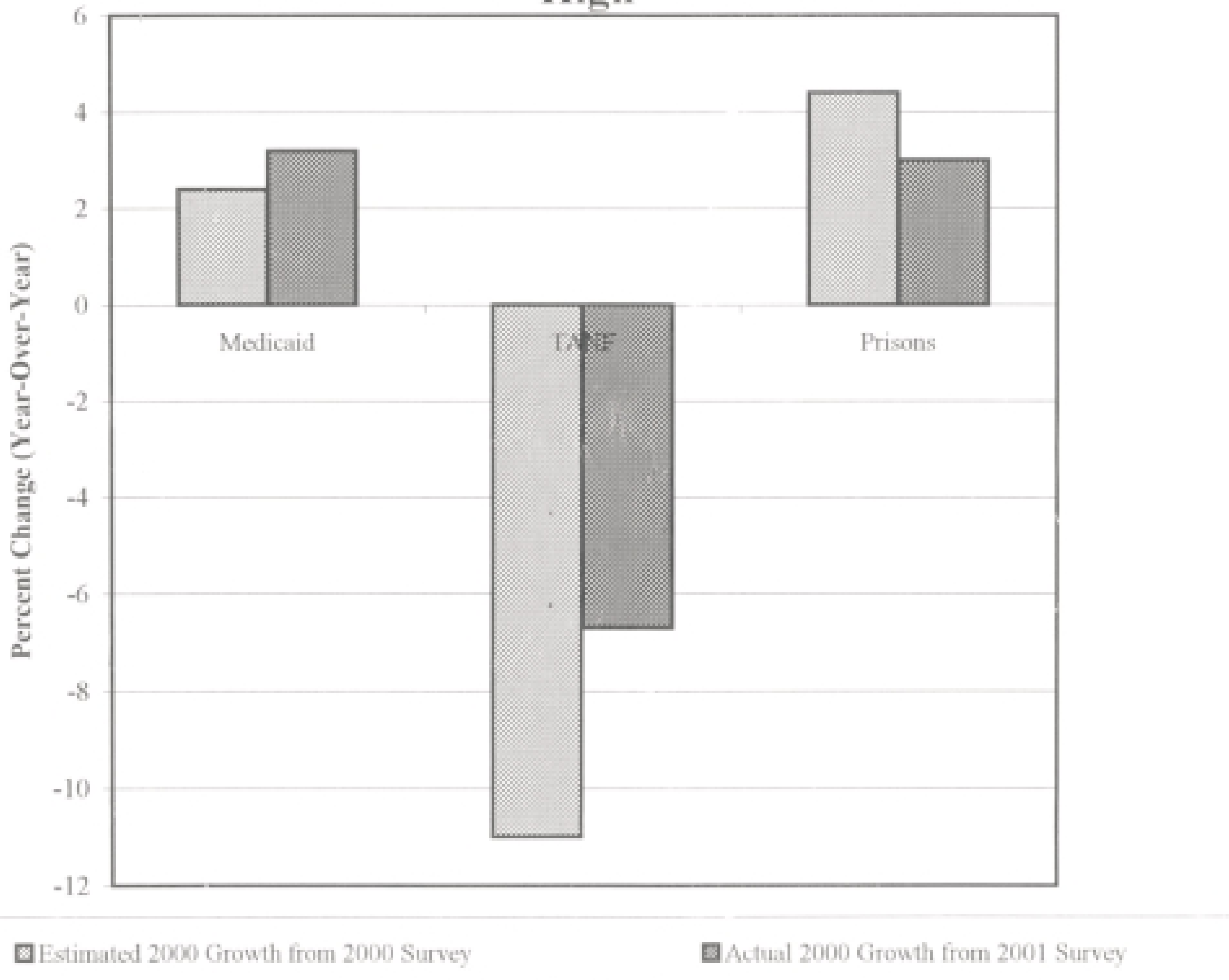

Figure 7: Blue Chip Consensus Went Up in 2000

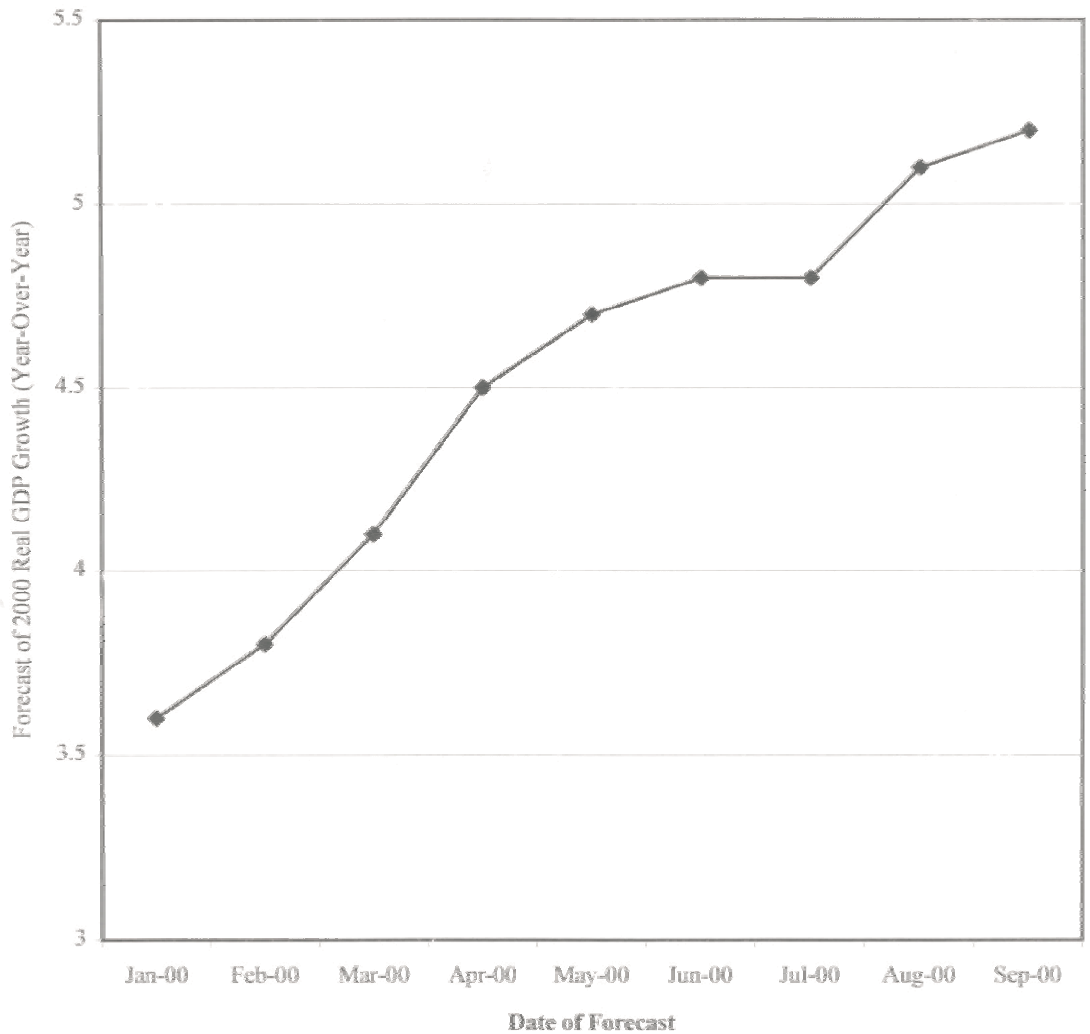

Figure 8: Picture for 2001 Getting Worse

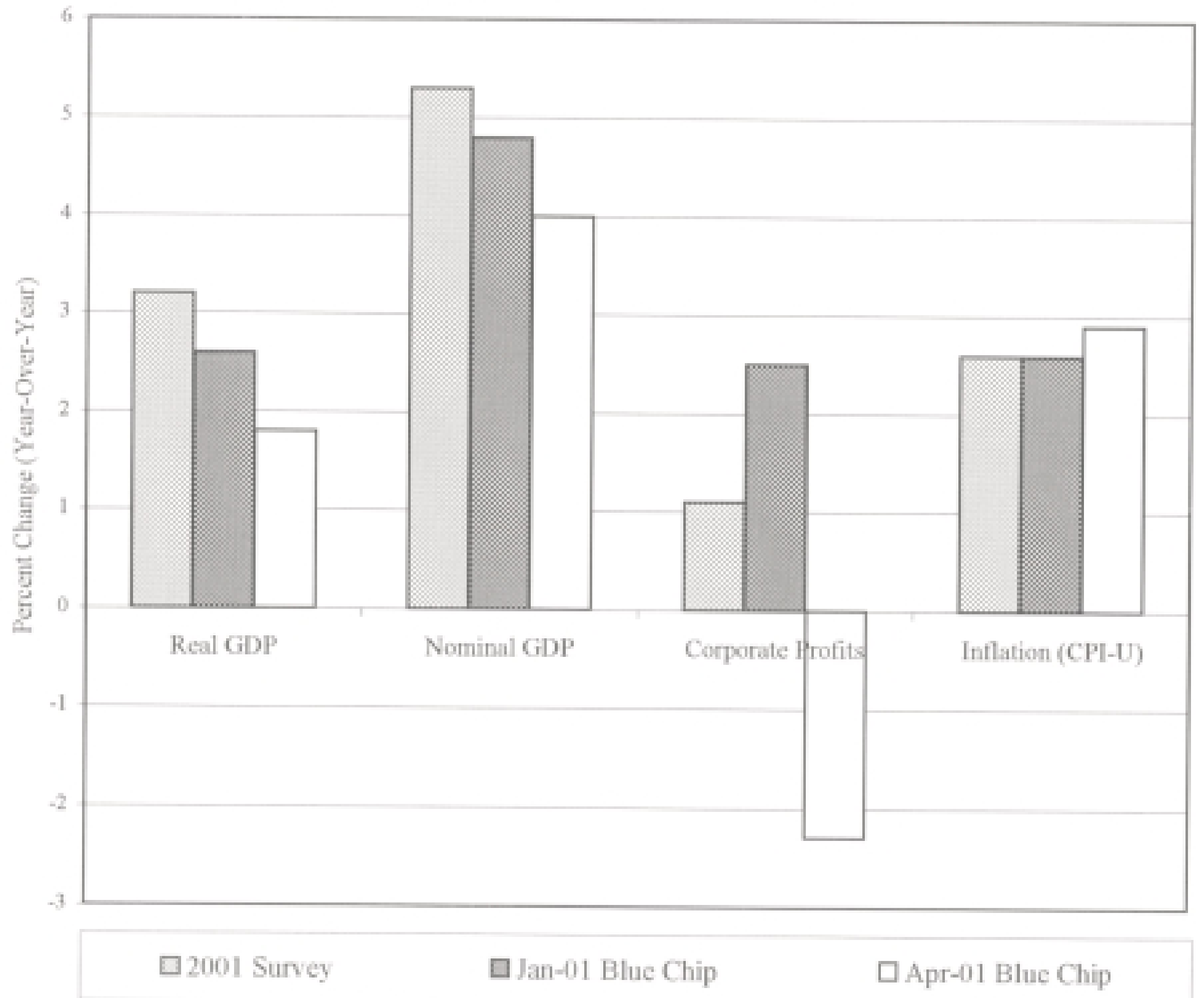

Figure 9: Blue Chip Consensus Has Been Going Down in 2001

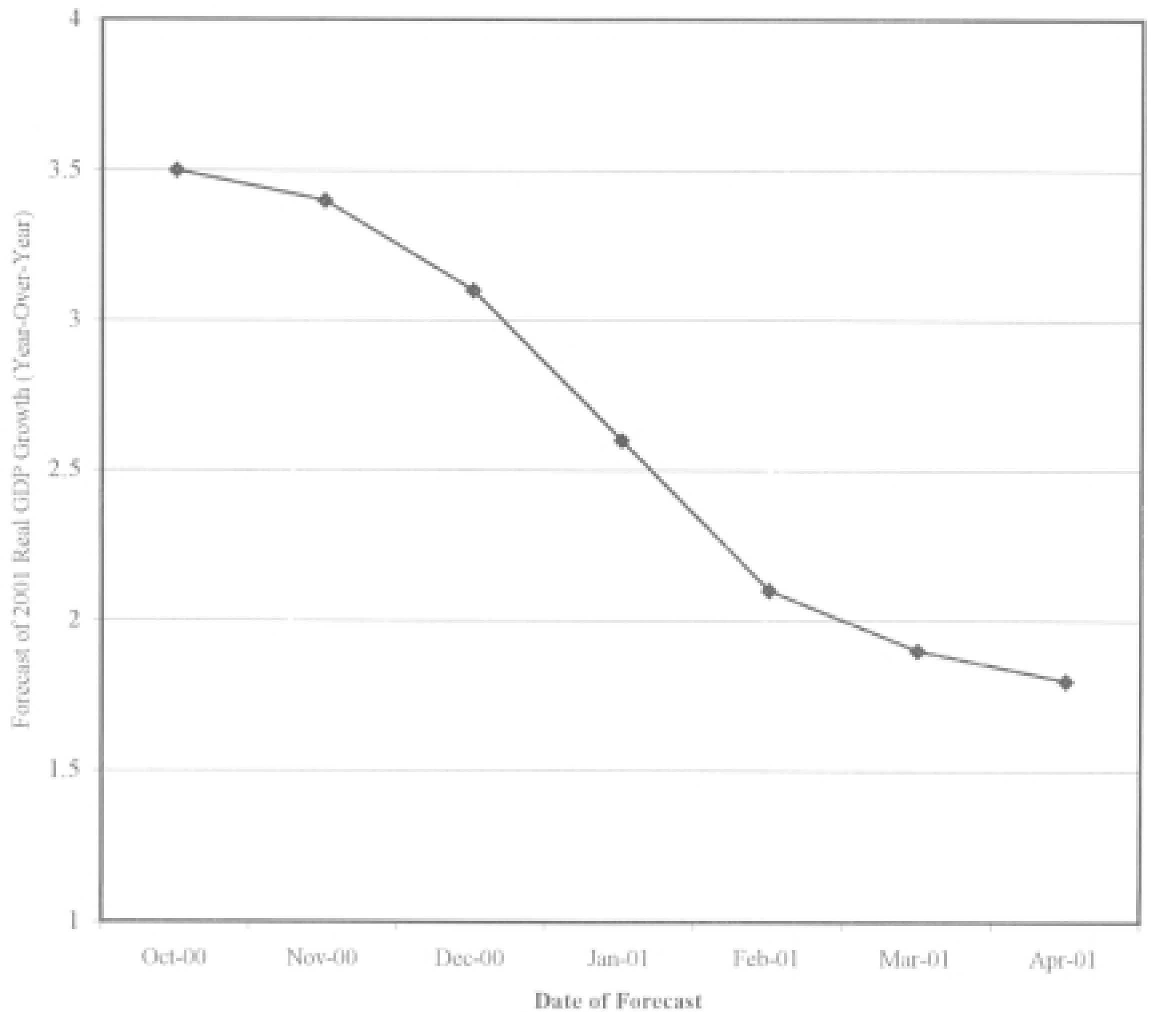

Figure 10: State Estimates for Real GDP in 2001

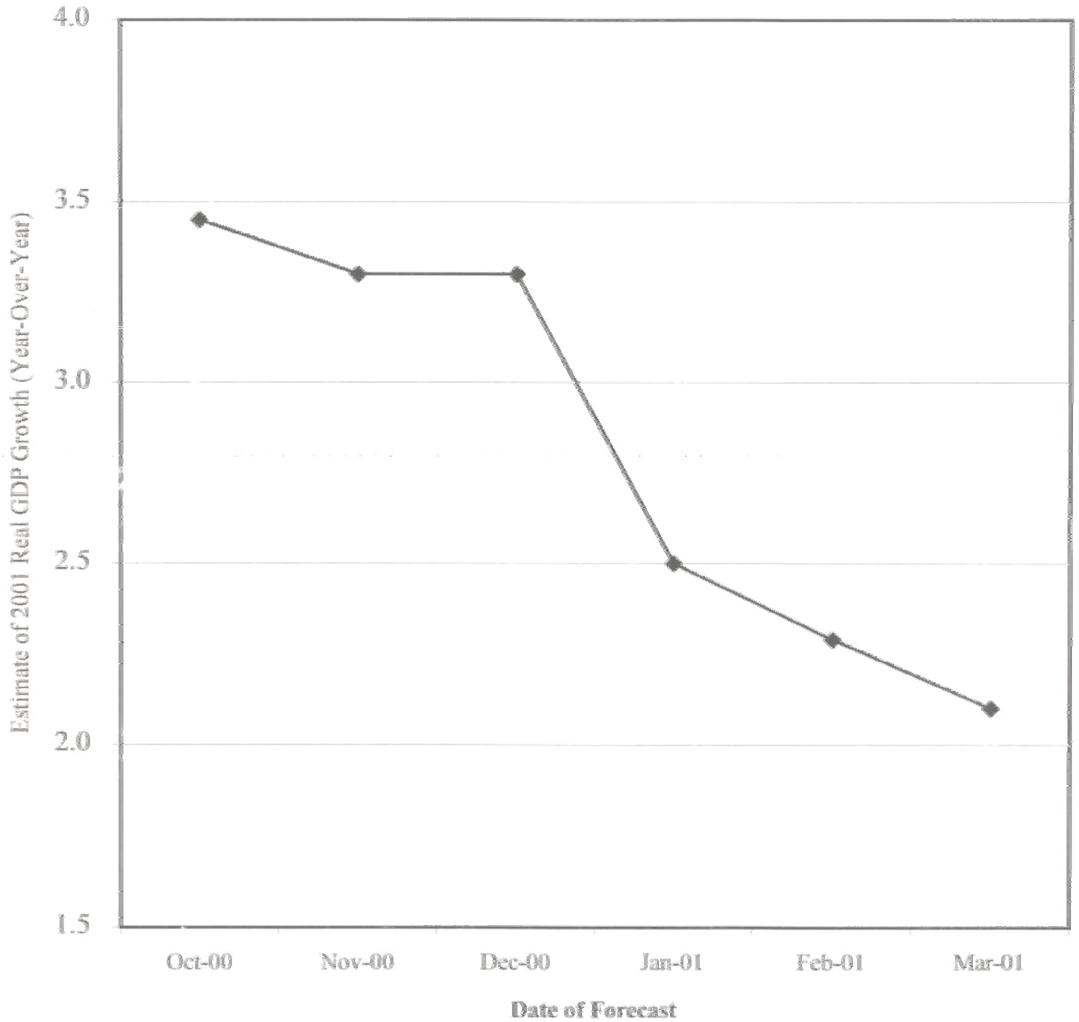

Figure 11

State Forecasts of Real GDP Growth For 2001

Growth Rate:							
4.2	AR	SC					
4.1							
4.0	CT						
3.9	TX						
3.8							
3.7	MO						
3.6	ID	VA					
3.5	IL						October Consensus
3.4							
3.3	KS	MD	NE	OH	RI	WY	
3.2	AZ	FL	MS	PA	TN		
3.1	NM	WV					December Consensus
3.0	CA						
2.9							
2.8							
2.7							
2.6							January Consensus
2.5	MI	OK	OR	SD	WI		
2.4							
2.3							
2.2	LA	NC	NY	WA			
2.1	CO	KY	MN	UT			
2.0	DE						
1.9	IA						
1.8							April Consensus
1.7							
1.6							
1.5							

Economic Forecasts and the Survey

We received 43 responses to our survey this year. Of the 39 that reported the date of their forecast, all but seven were prepared in February or earlier, generally for use in preparing official executive budget projections for fiscal year 2001-2002. None of the forecasts are from before October 2000. State's 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 36 state reporting their next forecast date, however, reported that the next forecast will be at the end of the year – in time for the fiscal year 2002-2003 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 forecast by private firms, such as the WEFA Group, Standard and Poor's DRI, or Regional Financial Associates. 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 state's forecast state prison population, Medicaid and welfare caseloads, personal income and employment. Most forecast wages and the unemployment rate as well.

The Nelson A. Rockefeller Institute of Government

The Nelson A. Rockefeller Institute of Government, the public policy research arm of the State University of New York, was established in 1982 to bring the resources of the 64-campus SUNY system to bear on public policy issues. The Institute is active nationally in research and special projects on the role of state governments in American federalism and the management and finances of both state and local governments in major areas of domestic public affairs.

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The Institute's Fiscal Studies Program, originally called the Center for the Study of the States, was established in May 1990 in response to the growing importance of state governments in the American federal system. Despite the ever-growing role of the states, there is a dearth of high-quality, practical, independent research about state and local programs and finances.

The mission of the Fiscal Studies Program is to help fill this important gap. The Program conducts research on trends affecting all 50 states and serves as a national resource for public officials, the media, public affairs experts, researchers, and others. The Program is directed by Donald J. Boyd, who has spent two decades analyzing state and local fiscal issues.

This Report

This report was written by Nicholas W. Jenny, Policy Analyst, and Donald J. Boyd, Deputy Director of the Rockefeller Institute. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design, with assistance from Michele Charbonneau.

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