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State Budgetary Assumptions in 2003 — States Cautiously Projecting Recovery

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Highlights

- ❖ The median state forecast for 2003 real gross domestic product growth is 2.7 percent, followed by 4.1 percent growth in 2004.
- ❖ Slow upward movement in the other key economic variables such as retail sales, employment, wage and salaries, personal income and corporate profits, is expected throughout this year and into the next.
- ❖ Revenue collections in 2002 were lower than originally estimated. Therefore, at least half of the states have been forced to reduce fiscal 2003 expenditures.
- ❖ States were too pessimistic in forecasting the national economy in 2002. However, they were too optimistic in forecasting many of the state level variables that most directly affect state budgets.
- ❖ Increased TANF, Medicaid and prison population caseloads over 2002 also hurt state budgets. If such caseloads decrease as expected, states could see some fiscal relief.
- ❖ Full economic recovery is expected in 2004, rather than 2003.
- ❖ Sizeable deficits for the current and upcoming fiscal year plague almost every state in the union.

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Introduction

This is the Rockefeller Institute of Government's eighth 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 2003-04 budgets that governors released in January 2003 or thereafter. Most states developed their forecasts between October 2002 and May 2003. (For more on forecasts and this survey, see the Technical Notes box.)

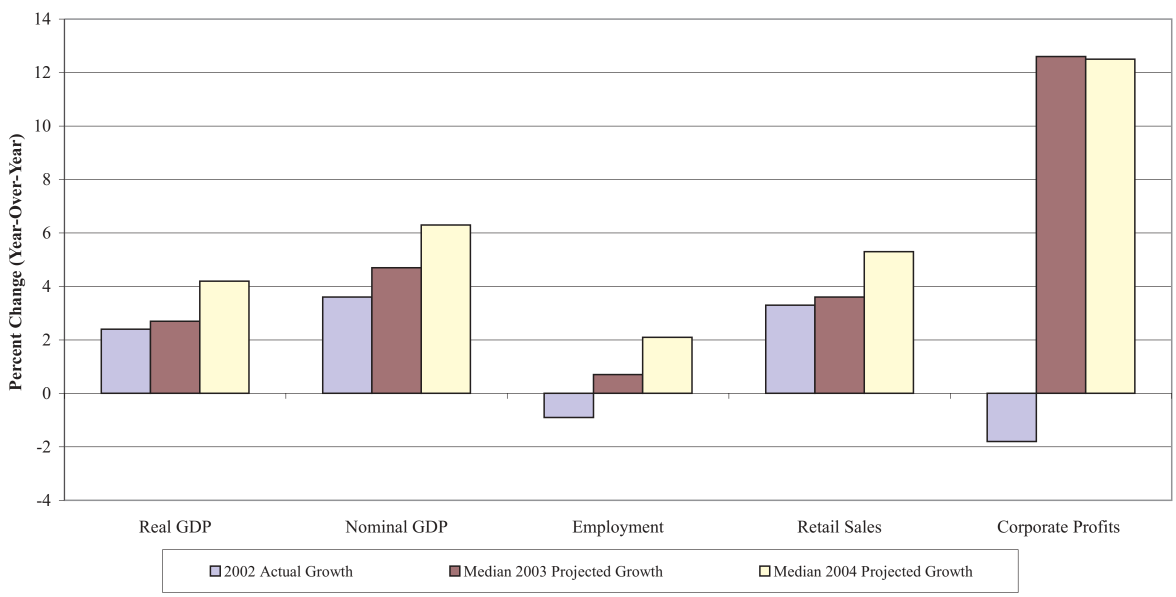
State budget officers use revenue and spending forecasts to project future financial outlooks. These forecasts, in turn, rely on economic assumptions and caseload projections. For example, a state may use projections of retail sales to help forecast sales tax revenues, or projections of the prison population to help forecast corrections expenditures. Such measures are critical because they help states determine whether or not to enact a tax cut or increase spending — as was the case in the late-1990s — or, increase taxes and decrease spending — as is the case currently and most likely for fiscal year 2004.

In the majority of our previous surveys, states underestimated the strength of economic growth. Most public and private forecasters also failed to accurately predict the conditions resulting from the soaring state market and dot.com boom in the late-'90s. This huge increase in national wealth and income had a very positive impact on state budgets. Many states would end their fiscal years with large surpluses as the economy outperformed their predictions. As a result, they were able to simultaneously increase spending, cut taxes and build up their financial reserves, or "rainy-day funds," to very high levels.

However, by 2001, the fiscal landscape had changed. As the economy began its downturn, state governments — many of which had already based their budgets on forecasts made during the height of the financial boom — experienced a reversal of fortune as the recession set in. While the recession did not have a dramatic effect on the 2001 fiscal year, it did pose challenges for forecasters and governors for subsequent budgets. Economic growth for 2001 was nearly non-existent, and some measures, like corporate profits, declined significantly. Economic growth returned in 2002, though the growth was rather sluggish and some lagging factors like employment were still declining. The 2002 fiscal year was little short of a disaster for most state governments, as revenues fell well short of projections.

Last year, states were very conservative in their forecasts, anticipating a slow recovery. When we prepared our report on last year's survey, it seemed that the pattern of the late-'90s might be returning and that states had been too conservative, since private forecasters were raising there projections for the national economy. However, in this case, the states ended up being

Figure 1
States Expect National Economy to Recover in 2003 and 2004



pretty close to correct: the initial recovery in 2002 was sluggish.

By late 2002 and early 2003, as states prepared and enacted their budgets, the expectation was that the economy trend up toward normal non-recessionary growth rates. This time, however, private forecasters have moderated their projections for the economy in 2003, postponing full recovery until 2004. States may end up having overshot the mark slightly for 2003, at least as far as their projections of the economy goes.

States' Forecasts of the National Economy

The median state forecast called for economic growth to be a bit stronger in 2003 than it was in 2002, followed by a return to strong growth in 2004. Using real gross domestic product (GDP), the broadest measure of the national economy to compare state projections, we can see this trend. The latest estimate of real GDP growth in 2002 was 2.4 percent.[1] The median state forecast for 2003 GDP growth is 2.7 percent, followed by 4.1 percent growth in 2004.

This same upward movement is predicted for other key national variables. Employment declined by 1.1 percent in 2002; the states median prediction for 2003 was 0.7 percent growth in 2002, and 2.1 percent growth in 2003. Retail sales grew by 3.1 percent in 2002; the median projection for 2003 was 3.6 percent and for 2004 is 5.3 percent. Corporate profits declined by 0.7 percent in 2002, and the median state projections are strong growth rates of 12.6 and 12.5 percent in 2003 and 2004 respectively.[2] (See Table 1 for state-by-state and median forecasts of key national economic variables, and Figure 1 for selected variables.)

States' Forecasts of Their Own Economies

The national and state economies generally operate in tandem, with the states usually mirroring national fiscal patterns. The median state estimate of employment declined by 0.5 percent in 2002, and the median state prediction was for a 0.8 percent increase in 2003, followed by an increase of 1.9 percent in 2004. Retail sales, personal income, and wages and salaries all follow the same pattern: slow growth in 2002, a projection of stronger growth in 2003, followed by even stronger growth in 2004. Relatively few states make capital gains forecasts, which showed a median estimated decline of 23.5 percent in 2002; yet, those states that did, expect another decline of 6.2 percent in 2003, and then an increase of 8.5 percent in 2004. (See Table 2 and Figure 2.)

Figure 3 shows the regional pattern in state employment growth forecasts for 2003. New England and the Mid-Atlantic states are predicting only weak employment growth, well under the national median projection of 0.8 percent, while the Great Lakes states are projecting a decline in employment. Meanwhile, the Far

Figure 2
State Economies Also Expected to Recover Through 2003 and 2004

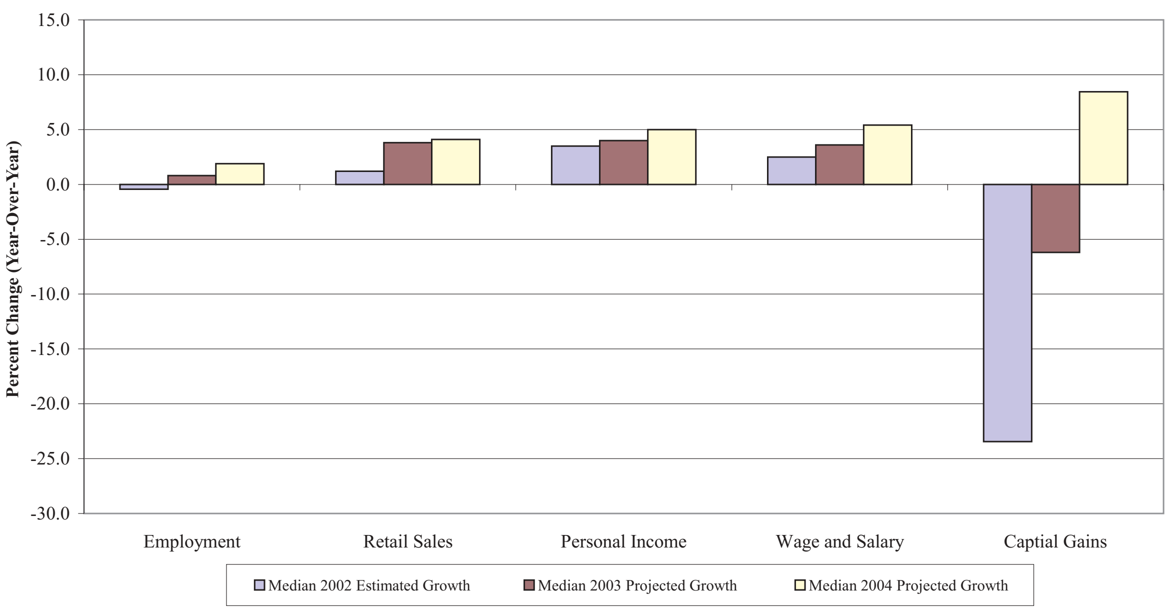


Table 1. Forecasts of National Economic Variables
year-over-year percentage change (except unemployment rate)

	Real GDP		*Nominal GDP*		*Employment*		*Retail Sales*		*Personal Income*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*
National Median	**2.7**	**4.1**	**4.7**	**6.3**	**0.7**	**2.1**	**3.6**	**5.3**	**4.2**	**5.8**
New England										
Connecticut	2.7	3.9	4.3	6.3	0.0	1.7	—	—	4.0	5.6
Maine	—	—	—	—	—	—	—	—	—	—
Massachusetts	2.6	3.5	—	—	0.7	2.0	—	—	—	—
Rhode Island	—	—	—	—	—	—	—	—	—	—
Vermont	—	—	4.0	3.2	1.0	2.9	5.3	4.5	1.7	2.6
Mid-Atlantic										
Delaware	2.7	4.3	4.4	6.3	0.2	1.9	—	—	4.1	5.4
Maryland	2.5	3.5	—	—	0.7	2.0	—	—	3.3	4.7
New York	2.4	3.3	4.0	5.3	0.6	1.7	2.4	3.1	4.7	5.3
Pennsylvania	3.1	4.7	5.1	7.1	0.8	3.1	3.6	6.4	5.0	6.5
Great Lakes										
Indiana	2.5	3.4	3.8	5.0	—	—	—	—	3.9	4.8
Michigan	2.4	3.7	4.3	5.9	—	—	—	—	—	—
Ohio	2.8	3.6	4.5	5.6	—	—	—	—	4.2	5.5
Wisconsin	3.1	4.7	5.2	7.2	0.7	2.6	3.6	6.4	5.0	6.5
Plains										
Iowa	2.8	—	—	—	—	—	—	—	2.7	—
Kansas	2.6	4.2	4.3	6.1	0.3	1.7	2.6	4.0	3.8	4.9
Nebraska	2.7	4.3	5.2[3]	6.0[3]	0.2	1.9	3.5[3]	5.3[3]	4.7[3]	5.6[3]
North Dakota	2.4	3.5	—	—	0.4	1.8	—	—	1.5	2.7
South Dakota	3.0	4.6	4.9	6.6	0.4	2.3	4.0	5.8	4.7	6.0
Southeast										
Alabama	3.0	4.6	4.9	6.6	0.4	2.3	4.0	5.8	4.7	6.0
Arkansas	2.7	3.7	4.8	6.5	—	—	—	—	—	—
Florida	2.9	4.6	4.9	6.7	0.3	2.3	4.0	5.9	4.7	6.1
Georgia	2.8	4.1	3.6	6.3	0.9	1.2	—	—	4.2	5.9
Kentucky	3.1	4.7	5.2	7.2	0.7	2.6	3.6	6.4	5.0	6.5
Mississippi	2.6	4.1	4.7	6.6	—	—	—	—	4.2	5.9
North Carolina	4.5	3.7	5.0	7.1	2.5	1.9	—	—	6.4	6.0
South Carolina	1.7	—	2.9	—	1.1	—	—	—	4.0	—
Tennessee	3.1	4.7	5.2	7.2	0.7	2.6	—	—	5.0	6.5
Virginia	3.2	3.9	5.7	6.0	1.1	2.0	—	—	4.7	5.2
West Virginia	2.6	4.1	4.7	6.6	0.9	2.5	4.6	6.1	4.2	5.9
Southwest										
Arizona	2.9	4.5	—	—	—	—	—	—	—	—
Oklahoma	2.6	4.2	4.7	6.6	0.9	2.5	0.6	1.0	4.2	5.9
Texas	2.7	4.3	4.4	6.3	0.2	1.9	2.9	4.8	4.1	5.4
Rocky Mountain										
Colorado	2.5	3.7	4.4	6.1	0.6	2.1	4.0	4.8	3.4	4.7
Idaho	2.9	4.5	5.0	7.1	0.8	2.5	—	—	4.7	6.4
Utah	3.0	4.6	—	—	0.4	2.3	3.2	4.8	4.7	6.0
Far West										
California	2.5	3.5	4.6	5.9	0.9	2.1	3.1	4.8	4.1	5.4
Hawaii	2.8	3.2	4.6	5.2	—	—	—	—	—	—
Washington	3.0	4.6	4.9	6.6	0.4	2.3	4.0	5.8	4.7	6.0

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

	Wage and Salary		*Corporate Profits*		*Inflation (CPI-U)*		*Unemployment Rate*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*
National Median	**4.2**	**6.3**	**12.6**	**12.5**	**2.3**	**2.4**	**6.0**	**5.4**
New England								
Connecticut	—	—	—	—	2.1	2.4	5.9	5.6
Maine	—	—	—	—	2.5	2.5	—	—
Massachusetts	—	—	8.6	12.4	2.0	2.1	6.2	5.7
Rhode Island	—	—	—	—	2.5	2.5	—	—
Vermont	—	—	—	—	2.3	2.3	5.6	5.4
Mid-Atlantic								
Delaware	3.5	5.3	13.3	20.2	2.3	1.6	5.9	5.4
Maryland	—	—	8.5[1]	12.6[1]	1.9	2.1	6.2	5.7
New York	4.5	6.0	8.5	14.7[2]	2.4	2.5	5.8	5.4
Pennsylvania	—	—	6.1	3.2	2.3	2.4	6.2	5.3
Great Lakes								
Indiana	—	—	—	—	1.3	1.5	—	—
Michigan	—	—	—	—	2.6	2.7	6.1	5.6
Ohio	—	—	10.2	9.6	2.0	2.3	5.8	5.4
Wisconsin	—	—	15.0	16.5	2.3	2.4	—	—
Plains								
Iowa	—	—	—	—	2.2	—	5.8	—
Kansas	3.2	4.8	—	—	2.5	2.7	5.8	6.0
Nebraska	4.4[3]	5.8[3]	8.3[3]	4.2[3]	0.5	0.5	5.8	5.9
North Dakota	—	—	2.3	9.7	2.1	2.0	6.2	5.7
South Dakota	4.2	6.4	15.8	14.0	2.1	1.9	6.1	5.3
Southeast								
Alabama	4.2	6.4	15.8	14.0	2.1	1.9	6.1	5.3
Arkansas	—	—	—	—	<u>2.5</u>	<u>2.8</u>	—	—
Florida	4.2	6.5	15.5	13.7	2.5	1.9	6.1	5.3
Georgia	2.5	6.0	8.6	11.4	2.6	3.0	—	—
Kentucky	4.6	7.3	15.0	16.5	2.3	2.4	6.2	5.3
Mississippi	—	—	—	—	2.3	2.4	6.0	5.3
North Carolina	4.6	7.1	12.6	17.8	2.3	2.5	5.3	5.0
South Carolina	—	—	—	—	1.2	—	5.2	—
Tennessee	—	—	—	0.0	2.4	2.5	6.2	5.3
Virginia	4.7	6.0	20.7	12.3	2.8	2.9	6.0	5.8
West Virginia	5.8	5.8	4.3	4.3	2.9	2.9	5.9	5.3
Southwest								
Arizona	—	—	—	—	2.5	2.5	0.0	—
Oklahoma	4.1	6.7	—	—	2.3	2.4	—	—
Texas	3.5	5.3	—	—	2.8	2.9	5.9	5.4
Rocky Mountain								
Colorado	—	—	9.0[1]	12.0[1]	2.0	2.1	6.2	5.7
Idaho	4.6	7.1	—	—	2.3	2.5	5.9	5.3
Utah	4.2	6.4	15.8	14.0	2.1	1.9	6.1	5.3
Far West								
California	4.1	6.2	15.2	9.3	2.5	2.6	6.0	5.5
Hawaii	—	—	—	—	—	—	—	—
Washington	4.2	6.4	15.8	14.0	2.1	1.9	6.1	5.3

— Data not available.
Note: Underlined number indicates forecast is for fiscal year rather than calendar year.
1 Nominal corporate profit after tax.
2 Reflect the expiration of the "bonus depreciation" provision of the Job Creation and Worker Assistance Act of 2002. The NYS Budget Division estimates that absent this expiration, pre-tax corporate profits would rise only 8.7 in 2004.
3 4th quarter to 4th quarter.

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

	Employment		*Retail Sales*		*Personal Income*		*Wage and Salary*		*Unemployment Rate*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*
National Median	**0.8**	**1.9**	**3.8**	**4.1**	**4.0**	**5.0**	**3.6**	**5.4**	**5.3**	**4.9**
New England										
Connecticut	(0.8)	0.4	—	—	2.8	4.8	—	—	4.4	4.4
Maine	0.0	0.8	6.6	5.6	3.2	4.0	3.0	3.6	4.2	4.1
Massachusetts	(0.2)	1.9	1.9	4.5	2.6	4.0	2.2	5.7	5.4	4.8
New Hampshire	0.1	0.8	—	—	5.2	5.3	4.8	4.6	—	—
Rhode Island	0.4	1.0	—	—	3.5	4.7	3.3	5.5	4.6	4.4
Vermont	1.6	2.3	—	—	3.4	5.5	6.1	6.7	4.5	4.3
Mid-Atlantic										
Delaware	0.1	2.0	—	—	3.4	5.0	3.0	5.2	—	—
Maryland	1.0	1.6	—	—	4.4	5.3	4.1	5.9	4.4	4.0
New York	0.7	1.0	—	—	3.1	4.2	2.3	4.7	5.9	5.7
Pennsylvania	(1.0)	0.2	3.1	3.3	4.2	4.1	—	—	5.6	5.6
Great Lakes										
Indiana	—	—	—	—	3.7	4.8	—	—	—	—
Michigan	(0.3)	1.7	—	—	3.6	5.2	3.3	4.7	6.2	5.7
Ohio	—	—	—	—	3.8	5.0	—	—	5.6	5.3
Wisconsin	1.4	2.6	—	—	3.9	5.4	—	—	—	—
Plains										
Iowa	1.3	2.6	—	—	5.1	5.0	4.6	4.9	—	—
Kansas	—	—	8.8	2.5	4.3	5.3	2.7	—	4.4	4.2
Nebraska	—	—	3.6	5.9	—	—	5.1	5.5	—	—
North Dakota	0.1	1.5	—	—	1.9	3.5	—	—	3.5	3.3
South Dakota	0.5	2.1	—	—	4.8	6.0	4.3	5.4	3.3	3.1
Southeast										
Alabama	0.9	1.2	—	—	4.5	5.3	3.3	4.3	5.4	5.1
Arkansas	(0.2)	1.7	5.2	2.9	3.8	4.5	3.2	5.8	—	—
Florida	1.1	3.0	—	—	4.8	6.1	4.9	6.5	5.5	4.9
Georgia	1.9	3.4	3.9	4.9	5.1	6.2	2.9	6.3	—	—
Kentucky	0.9	2.3	—	—	4.6	5.5	4.7	5.5	—	—
Louisiana	0.0	1.0	—	—	1.4	2.4	—	—	—	—
Mississippi	0.9	1.5	—	—	4.0	4.5	3.5	4.3	6.5	6.0
North Carolina	2.1	1.9	4.5	4.4	5.8	5.5	6.1	5.9	6.1	5.3
South Carolina	1.0	2.0	4.0	3.0	4.5	4.5	—	—	4.7	4.5
Tennessee	0.7	1.7	2.6	3.1	4.8	5.5	4.1	5.4	4.6	4.5
Virginia	0.3	2.1	—	—	5.7	5.5	4.4	6.6	5.0	4.9
West Virginia	0.4	0.7	2.7	3.0	2.9	4.0	3.3	3.9	6.1	5.9
Southwest										
Arizona	2.6	3.7	5.0	5.8	3.7	4.0	—	—	4.9	4.6
Oklahoma	1.0	2.1	0.8	1.8	3.4	4.6	3.9	5.2	—	—
Texas	1.2	2.1	5.5	6.2	5.2	6.0	4.9	6.4	5.8	5.6
Rocky Mountain										
Colorado	0.8	2.2	3.1	3.8	4.0	5.3	3.6	5.4	5.2	4.6
Idaho	0.9	1.9	—	—	4.4	5.8	4.2	5.7	—	—
Utah	0.8	2.5	3.8	4.8	3.8	5.0	2.8	4.7	5.3	5.3
Wyoming	0.5	0.7	4.3	4.1	3.1	3.7	3.3	5.4	4.4	4.2
Far West										
Alaska	1.5	1.5	—	—	—	—	—	—	—	—
California	0.7	2.1	3.4[2]	5.6[2]	3.3	5.3	3.6	6.0	6.5	6.2
Hawaii	1.4	1.2	—	—	4.6	4.9	3.8	4.5	—	—
Nevada	2.6	3.3	—	—	5.7	6.1	—	—	5.5	5.5
Washington	0.6	2.2	2.5[2]	3.8[2]	4.1	5.1	3.3	5.5	7.0	6.6

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

	Capital Gains		*Medicaid Caseload*		*TANF Caseload*		*Prison Population*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*
National Median	**(6.2)**	**8.5**	**7.6**	**4.0**	**1.4**	**0.0**	**4.0**	**3.6**
New England								
Connecticut	—	—	—	—	(8.9)	(5.1)	4.3	3.2
Maine	—	—	—	—	—	—	—	—
Massachusetts	—	—	—	—	—	—	—	—
New Hampshire	—	—	14.3	—	2.3	9.3	4.0	4.0
Rhode Island	—	—	—	—	(6.8)	(6.3)	9.6	1.7
Vermont	—	—	—	—	—	—	—	—
Mid-Atlantic								
Delaware	(40.1)	21.0	—	0.0	1.8	4.0	3.8	3.7
Maryland	(10.0)	10.0	4.5	3.0	1.0	(4.0)	2.5	2.0
New York	(12.9)	10.5	—	—	—	—	—	—
Pennsylvania	—	—	2.9	2.8	0.6	0.0	5.5	3.4
Great Lakes								
Indiana	—	—	7.7	10.0	1.5	—	5.4	3.6
Michigan	7.2	7.2	4.4	(2.0)	(3.6)	(1.8)	7.1	3.5
Ohio	—	—	17.5	—	—	—	—	—
Wisconsin	—	—	—	—	—	—	—	—
Plains								
Iowa	—	—	9.6	11.1	1.2	4.6	0.0	5.7
Kansas	—	—	9.3	10.1	11.5	7.8	3.3	(0.4)
Nebraska	6.5	11.0	(3.8)	3.8	12.0	12.0	4.7	5.2
North Dakota	—	—	2.6[1]	0.0[1]	0.6	0.2	1.2	4.8
South Dakota	—	—	8.8	5.8	5.7	0.0	7.0	7.3
Southeast								
Alabama	—	—	—	—	—	—	—	—
Arkansas	—	—	—	—	—	—	3.7	3.6
Florida	—	—	8.4	4.0	(0.3)	0.6	4.0	2.7
Georgia	—	—	—	—	—	—	—	—
Kentucky	—	—	3.9	1.5	10.0	3.0	4.8	3.8
Louisiana	—	—	11.2	10.0	14.2	0.0	2.9	3.9
Mississippi	—	—	7.6	5.0	12.0	5.0	2.6	3.1
North Carolina	(12.7)	8.3	—	—	—	—	6.4	3.7
South Carolina	—	—	6.5	7.8	7.0	(2.0)	2.6	4.6
Tennessee	—	—	23.4	4.7	0.3	(0.5)	7.0	0.0
Virginia	—	—	4.8	3.6	1.5	(0.6)	1.1	(0.6)
West Virginia	(10.0)	5.0	—	—	—	—	—	—
Southwest								
Arizona	—	—	23.4	12.2	20.1	0.0	5.2	5.2
Oklahoma	(0.1)	3.0	(3.5)	(2.7)	1.8	(0.7)	2.9	(2.8)
Texas	—	—	6.0	—	1.2	(0.5)	1.4	1.2
Rocky Mountain								
Colorado	—	—	9.5	6.1	6.0	8.0	5.0	5.0
Idaho	—	—	7.1	3.9	4.5	4.2	2.7	8.2
Utah	(2.4)	8.6	10.1	8.8	5.0	5.0	0.0	0.0
Wyoming	—	—	7.1	7.0	(6.1)	(6.0)	8.5	3.9
Far West								
Alaska	—	—	—	—	—	—	—	—
California	7.0	7.0	9.5	(3.2)	1.1	0.5	0.0	0.6
Hawaii	—	—	4.6	0.0	(14.0)	(13.0)	1.2	5.3
Nevada	—	—	15.2	12.2	—	—	8.8	(5.1)
Washington	—	—	1.7	3.1	(1.4)	(0.4)	4.4	2.3

— Data not available.
Note: Underlined number indicates forecast is for fiscal year rather than calendar year.
1 Eligibles
2 Taxable Sales

West and Southwest states are projecting employment growth well in excess of the national median. This pattern is consistent with employment growth patterns since the early-'90s, except somewhat weaker overall. Arizona and Nevada had the strongest projected growth at 2.6 percent, while Pennsylvania is projecting a decline of 1.0 percent.

Caseload Predictions

Medicaid and Temporary Assistance for Needy Families (TANF) caseloads, as well as state prison populations, are variables that significantly affect state spending and are very important when states are planning their budgets. Median state Medicaid caseloads grew by 8.6 percent in 2002. States projected that this growth would slow to 7.6 percent in 2003, and to 4.0 percent in 2004. There was a large range in these projections. For example, Arizona and Tennessee projected a 23.4 percent increase in Medicaid caseloads in 2003, while Nebraska projected a 3.8 percent decline.

State TANF caseloads increased by a median 4.0 percent in 2002, reversing several years of decline. States project that TANF caseloads will increase by 1.4 percent in 2003, and the median projection was for no growth in 2004. Median state prison population growth in 2002 was 2.8 percent. It is projected to grow by 4.0 percent in 2003 and by 3.8 percent in 2004.

Last Year's State Forecasts — A Mixed Bag

By most measures, states were on the conservative side when they made their projections of the national economy last year. (See Figure 4.) Last year's median forecast for real GDP growth in 2002 was 0.6 percent, while the January 2002 Blue Chip consensus forecast was 1.0 percent.[3] (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.) The GDP actually ended up growing by 2.4 percent, still low by historical standards, but considerably stronger than anyone was projecting at the beginning of the year. State and private forecasters were also on the conservative side on inflation and unemployment, but were a bit optimistic about corporate profits.

It might be expected that this stronger-than-anticipated national economic growth would have translated into a windfall for the states, as happened when the states underestimated the strong economy for many years in the late-1990s. However, Figure 5 suggests why this was not so. The measures of the

Figure 3
Forecasts of 2003 State Employment Growth by Region

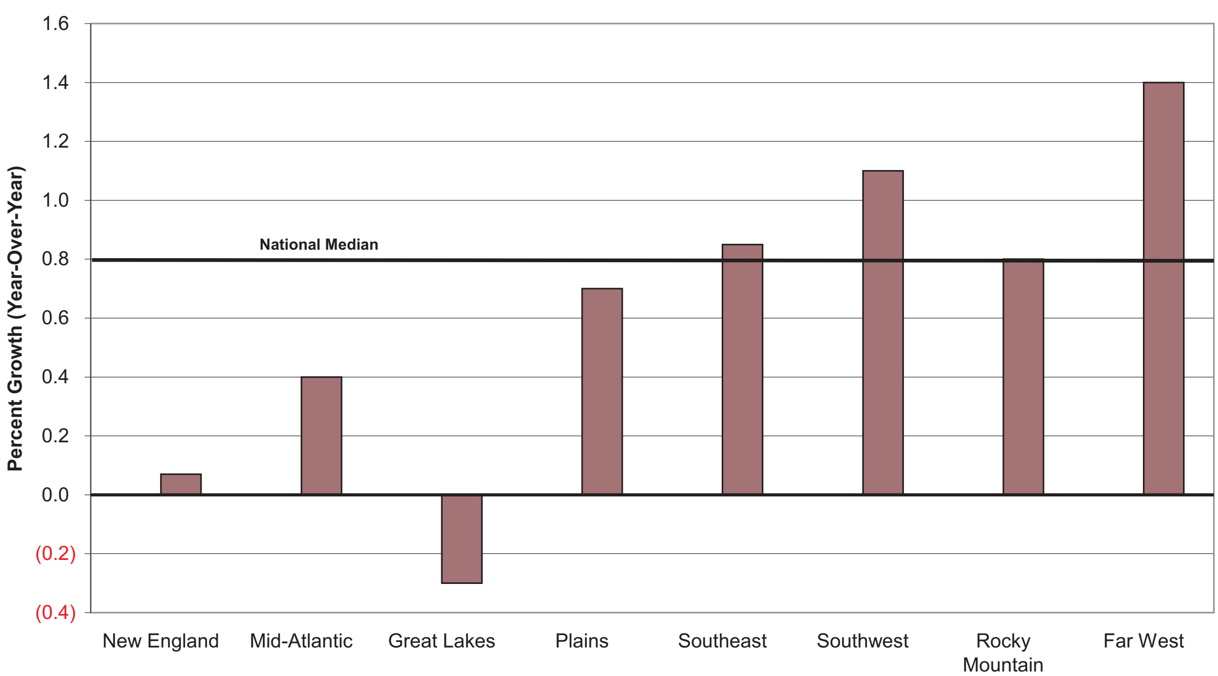


Figure 4
The Economy Was Stronger in 2002 Than Predicted By Either Private or State Forecasters

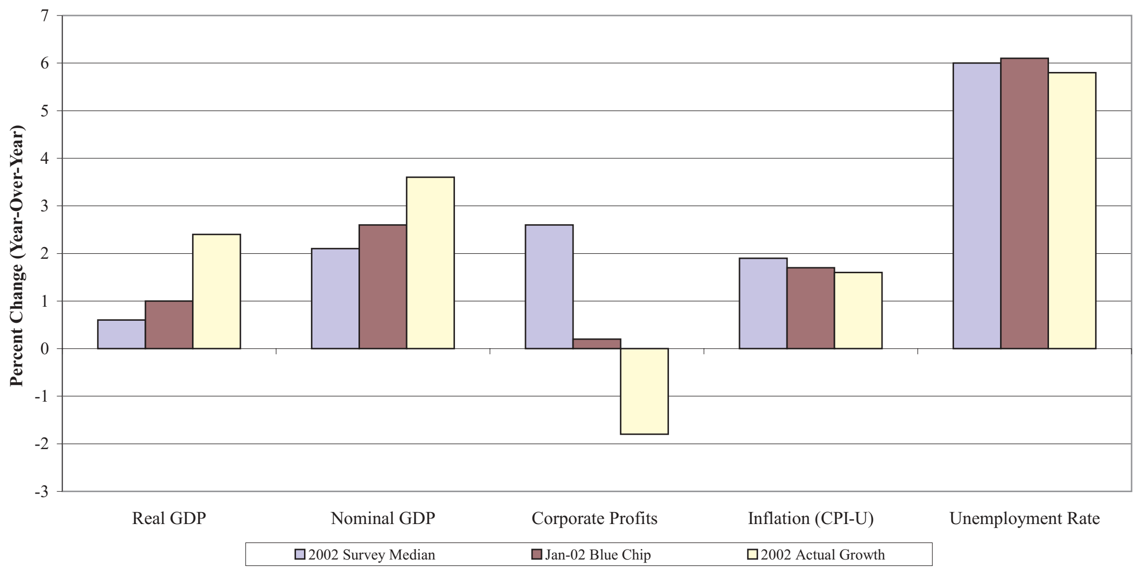
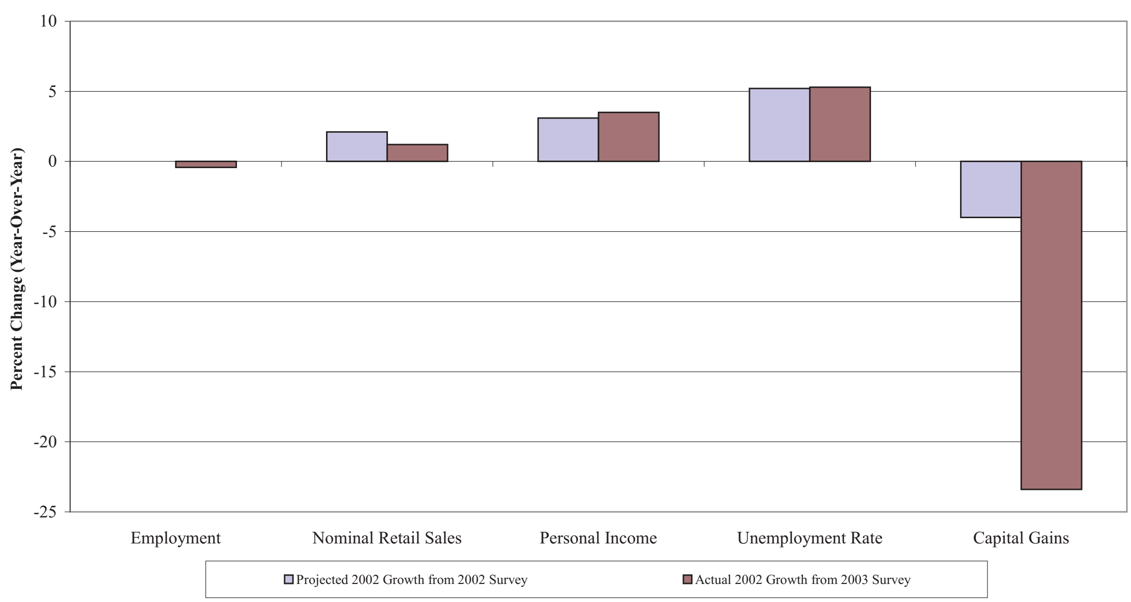


Figure 5
State Economic Growth in 2002 Was Generally Worse Than Projected



* Projected 2002 Employment Growth was 0.0 percent.

state economies that translate most directly into state revenues did not perform as strongly as the more general measures of the national economy. States had projected that employment would be flat, while in fact it declined by 0.4 percent, negatively affecting personal income tax withholding. Retail sales had been expected to increase by 2.1 percent, but only managed a 1.2 percent increase, depressing sales tax growth. Capital gains, a major input into personal income tax collections in many states, declined by 23.4 percent, instead of the 4.0 percent that had been projected. The states underestimated personal income somewhat, projecting 3.1 growth, when actual growth was 3.5 percent.

When we turn to caseload measures, we see that states were feeling more pressure on the expenditure side of the budget equation as well. (See Figure 6.) Medicaid grew by 8.6 percent, instead projection of 5.2 percent. TANF caseloads grew by 4.0 percent, instead of the projected 1.4 percent. Prison populations grew by 3.0 percent instead of the projected 1.9 percent. All of these increases force states to spend more on these programs than they had budgeted.

Even as states were making their projections last year, they were confronting huge gaps in their projected 2003 budgets resulting from the recession that hit in 2001 and left big deficits by the end of fiscal 2002. States managed to close these gaps in their enacted fiscal 2003 budgets through a combination of spending cuts, tax increases, and the use of budget reserves and other one-time measures. However, weak revenue performance and upward pressure on expenditures from caseload expansion and other causes opened new gaps of about $29.9 billion according to a survey by the National Conference of State Legislatures.[4] According to the National Governors Association and the National Association of State Budget Officers, 41 states reported that total revenue collections for fiscal 2002 were lower than their original estimates, and at least 24 states were reducing their fiscal 2003 expenditures.[5]

Why Being Wrong Can Be Good

States were too pessimistic in forecasting the national economy in 2002. However, they were too optimistic in forecasting many of the state level variables that most directly affect state budgets. If states had predicted the stronger national economy more precisely, this probably would have caused them to estimate stronger performance in such things as employment, retail sales, and capital gains — which in fact, did not happen. That, in turn, would have caused even greater problems with state budgets in fiscal 2002, as revenue and expenditure estimates would have been further off and there would have been even larger budget gaps than there were.

In any case, states were in good company in underestimating the strength of the national economy in early 2002. As Figure 7 shows, the Blue Chip consensus moved steadily upwards during early 2002, only reaching the near-correct level in April — long after state

Figure 6
Medicaid and TANF Caseloads and Prison Populations Were Higher Than Predicted

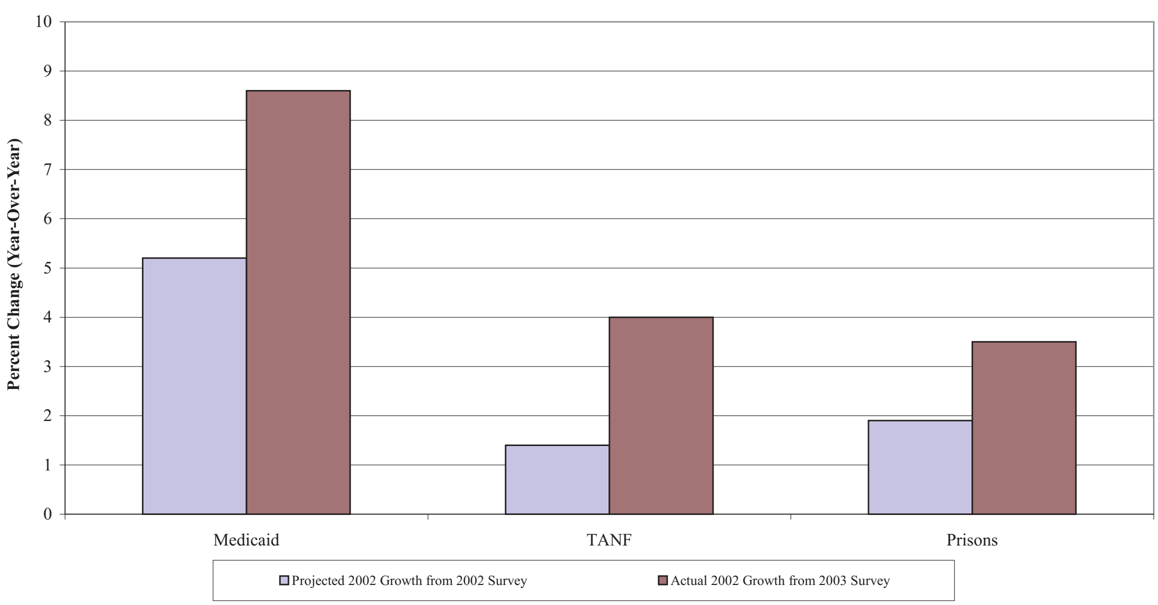


Figure 7
Blue Chip Consensus Increased Sharply in Early 2002

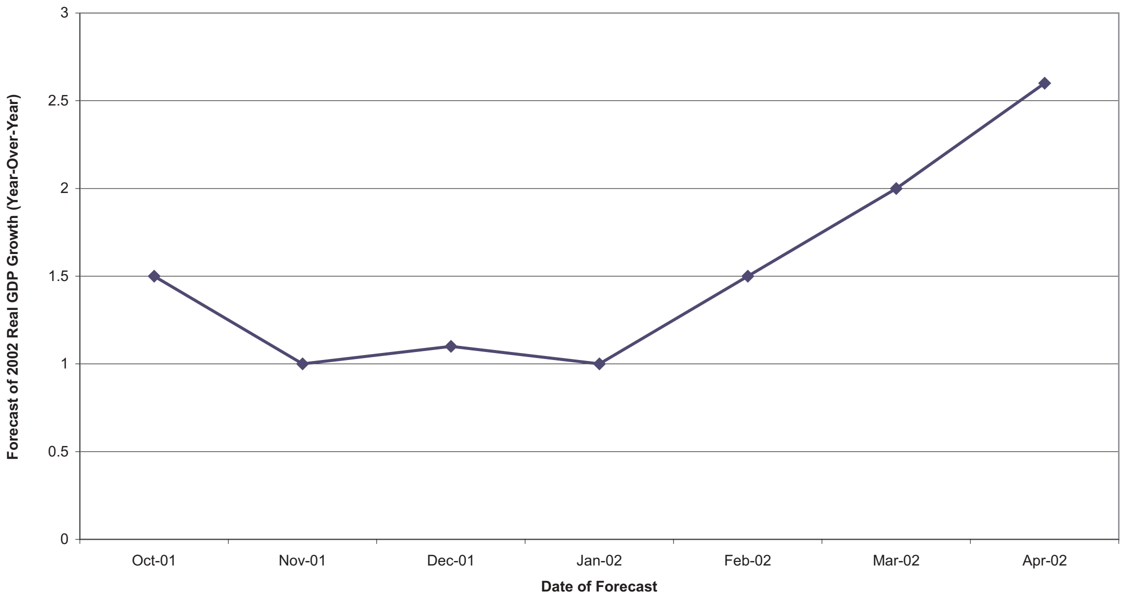


Figure 8
Predictions for 2003

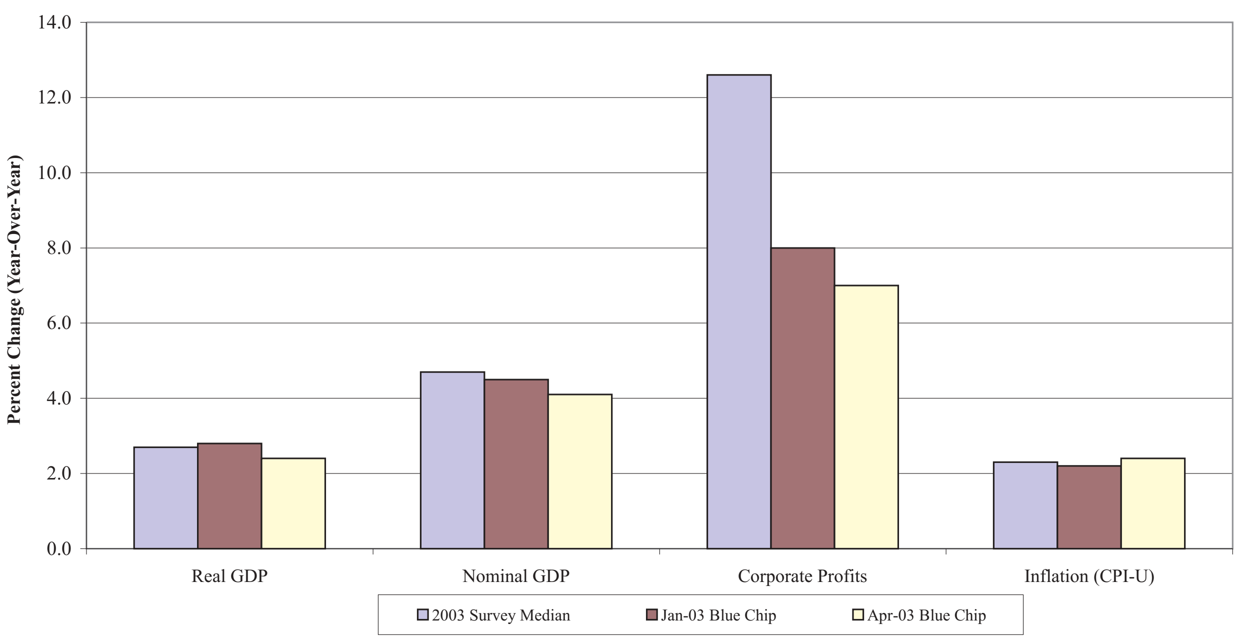
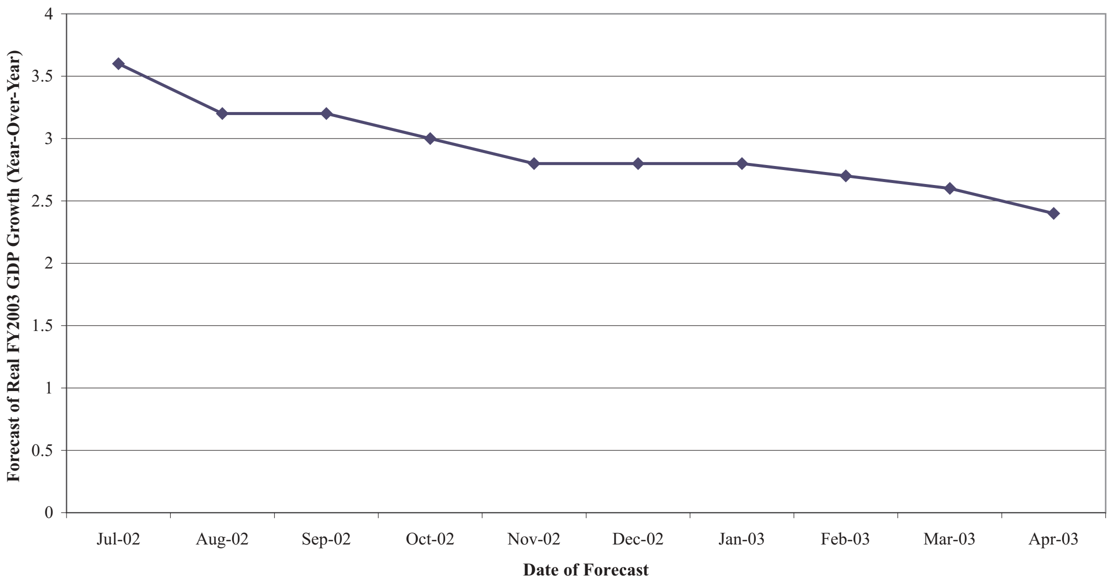


Figure 9
Blue Chip Consensus Heading Slightly Down in 2003



executive budgets were drafted and even after many state budgets were enacted.

The pattern this year is not nearly as strong as it was last year. As can be seen in Figure 8, states were fairly close to the January 2003 Blue Chip forecast in their median forecasts of the national economy, except with regard to corporate profits, where they may have been a little optimistic.

Figure 9 shows a downward moving Blue Chip consensus that appears to counter what states had predicted. However, when many states prepared their forecasts — September, October and November — the Blue Chip consensus was higher. Furthermore, the Blue Chip consensus was moving down because the preliminary real GDP growth for the first quarter of 2002 was only 1.9 percent, lower than had been projected.[6] However, the Blue Chip consensus still expects the economy to strengthen later in the year.

Figure 10 arrays each state's 2003 real GDP growth forecasts in comparison to Blue Chip consensus forecasts for July 2002 — the high point for the Blue Chip forecast of 2003 growth — and January and April 2003. The majority of states fell between the 3.1 and 2.4 ranges, both of which included the state median and 2003 Blue Chip consensus forecasts. Outliers included North Carolina, who projected 4.5 percent growth, and South Carolina, who forecasted 1.7 growth.

Conclusion

While the national economy appears to be making some incremental progress, state budgets will likely feel continuing strain. Many of the sectors of the economy that are the most important to state revenue collections, like retail sales and capital gains, continue to languish. To the extent that these strengthen as states are projecting, it will help the revenue side of the equation significantly. If, however, the economy falters, or these measures continue to lag the general economy, states will fall further behind than they already are.

The increase in caseloads over 2002 also hurt state budgets. However, should Medicaid, TANF and prison populations decrease as predicted, this could prove to be good news. Fewer caseloads should offer states some financial respite. Nevertheless, this needs to be balanced by strong state and local economies, inclusive of high retail sales, low unemployment and significant gains in personal and corporate income tax collections, for fiscal relief to be realized.

Almost every state in the union is facing sizeable deficits in the current and coming fiscal years. Since states are generally required to balance their budgets, the strategies for closing these gaps will become fewer and tougher. If tax revenues continue to trickle amidst relatively high unemployment and upward caseload pressure, states will be forced to continue to cut services, and/or increase taxes.

Figure 10
State Forecasts of Real GDP Growth for 2003

Growth Rate:						
4.5	NC					
4.4						
4.3						
4.2						
4.1						
4.0						
3.9						
3.8						
3.7						
3.6						June 2002 Blue Chip Forecast
3.5						
3.4						
3.3						
3.2	VA					
3.1	KY	PA	TN	WI		
3.0	AL	SD	UT	WA		
2.9	AZ	FL	ID			
2.8	GA	HI*	IA	OH		January 2003 Blue Chip Forecast
2.7	AR*	CT	DE	NE	TX	Median
2.6	KS	MA	MS	WV	OK	
2.5	CA	CO	IN	MD	NM	
2.4	MI	ND	NY			April 2003 Blue Chip Forecast
2.3						
2.2						
2.1						
2.0						
1.9						
1.8						
1.7	SC					

* - Fiscal Year

Endnotes

1 United States Department of Commerce, Bureau of Economic Analysis News Release, May 29, 2003. It should be noted that late in 2002 the estimate for 2001 growth declined from 1.2 percent to only 0.3 percent, so there may still be revisions to 2002 GDP growth.

2 2002 employment data from Bureau of Labor Statistics, United State Department of Labor, *Current Labor Statistics, http://www.bls.gov/;* 2002 retail sales data from United State Census Bureau, *Service Sector Statistics*, *http://www.census.gov/mrts/www/mrts.html*; 2002 corporate profits data from Bureau of Economic Analysis, May 29, 2003.

3 *Blue Chip Economic Indicators*, Vol. 27, No. 4, April 10, 2002.

4 National Conference of State Legislatures, *State Budget Update: April 2003*.

5 National Governors Association and National Association of State Budget Officers, *Fiscal Survey of the States, November 2002*, (Washington, DC).

6 U.S. Bureau of Economic Analysis (5/29/03), "Gross Domestic Product: First Quarter 2003 (Preliminary), Corporate Profits: First Quarter 2003 (Preliminary)," *www.bea.gov*

Technical Notes

The survey was sent out to budget offices in all 50 states, and was supplemented by a review of budget documents for many states. In all, we were able to get some economic assumptions data for 43 states. Of the 38 states that reported their forecast date, all but seven were prepared in February or earlier, generally for use in preparing official executive budget projections for fiscal year 2003-2004. 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. Fourteen of the 35 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 2004-2005 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 Global Insight 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. 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.

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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

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