

2/18/03

NCSL

**PRESENTA-
TION**

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FILE

State Fiscal Conditions



**Presentation to the
Alaska House Finance Committee
February 18, 2003**

**Corina Eckl
Fiscal Program Director**

National Conference of State Legislatures

Background on NCSL



- **National Conference of State Legislatures**
 - ◆ **Bi-partisan organization founded in 1975**
 - ◆ **Serves all 50 states, territories and commonwealths**
 - ◆ **Offices in Denver and Washington, D.C.**

NCSL Is a Valuable Resource



- **Information from NCSL:**
 - ◆ **Non-biased research, publications, 50-state data, special projects**
 - ◆ **Technical assistance on a wide range of topics**
 - ◆ **Meetings and seminars**
- **Bob Boerner is the NCSL liaison to Alaska**

Summary of FY 2003 Budget Gaps



- **The initial estimated gap for FY 2003 (prior to budget enactment) was \$49.1 billion (10.1%)**
- **At least 42 states reported initial budget gaps going into FY 2003**

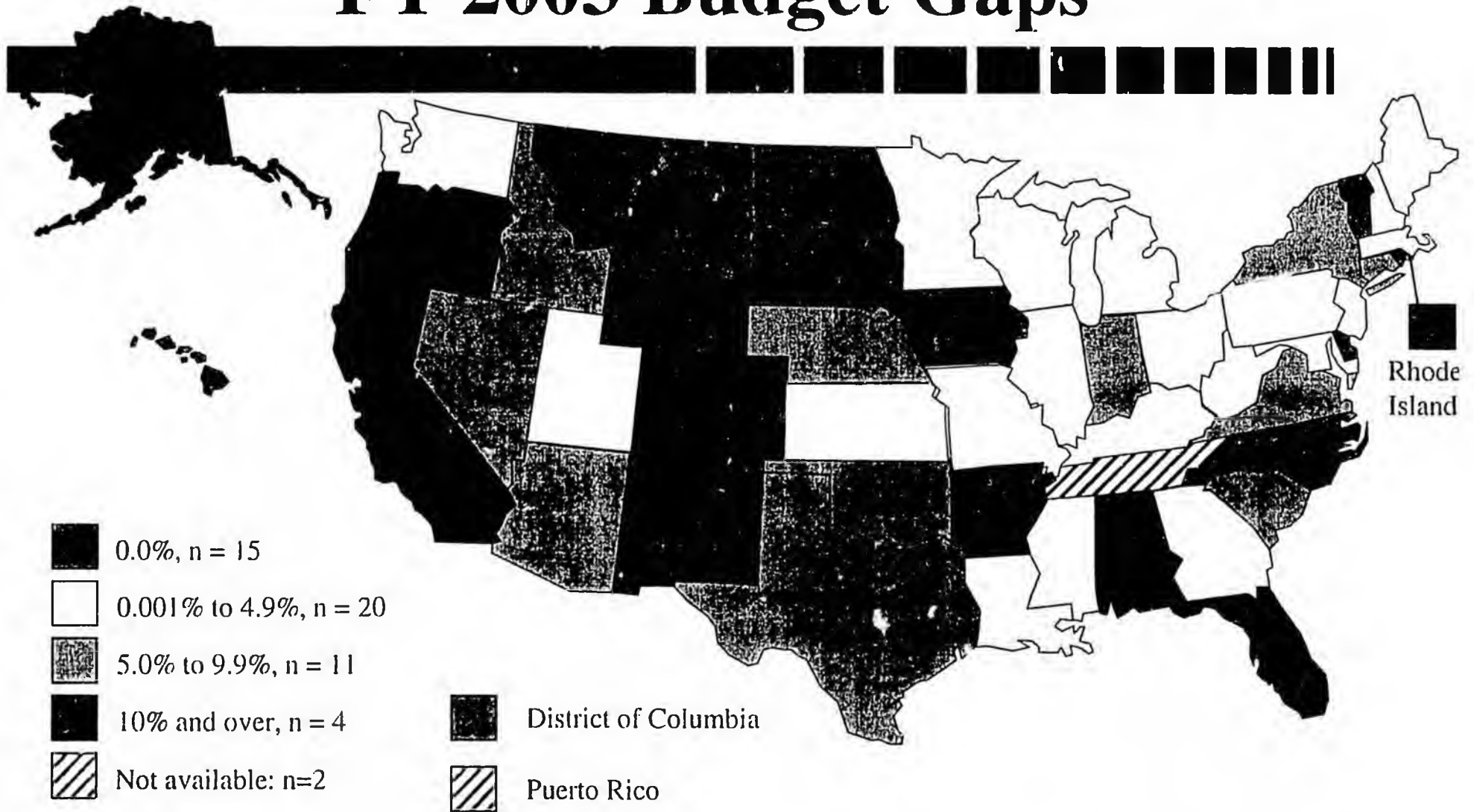
State Fiscal Update

(February 2003)



- **State budget gaps have grown nearly 50% since November**
- **States now face at least a \$25.7 billion (5.2%) gap in FY 2003**
- **Thirty-six states reported gaps**

FY 2003 Budget Gaps



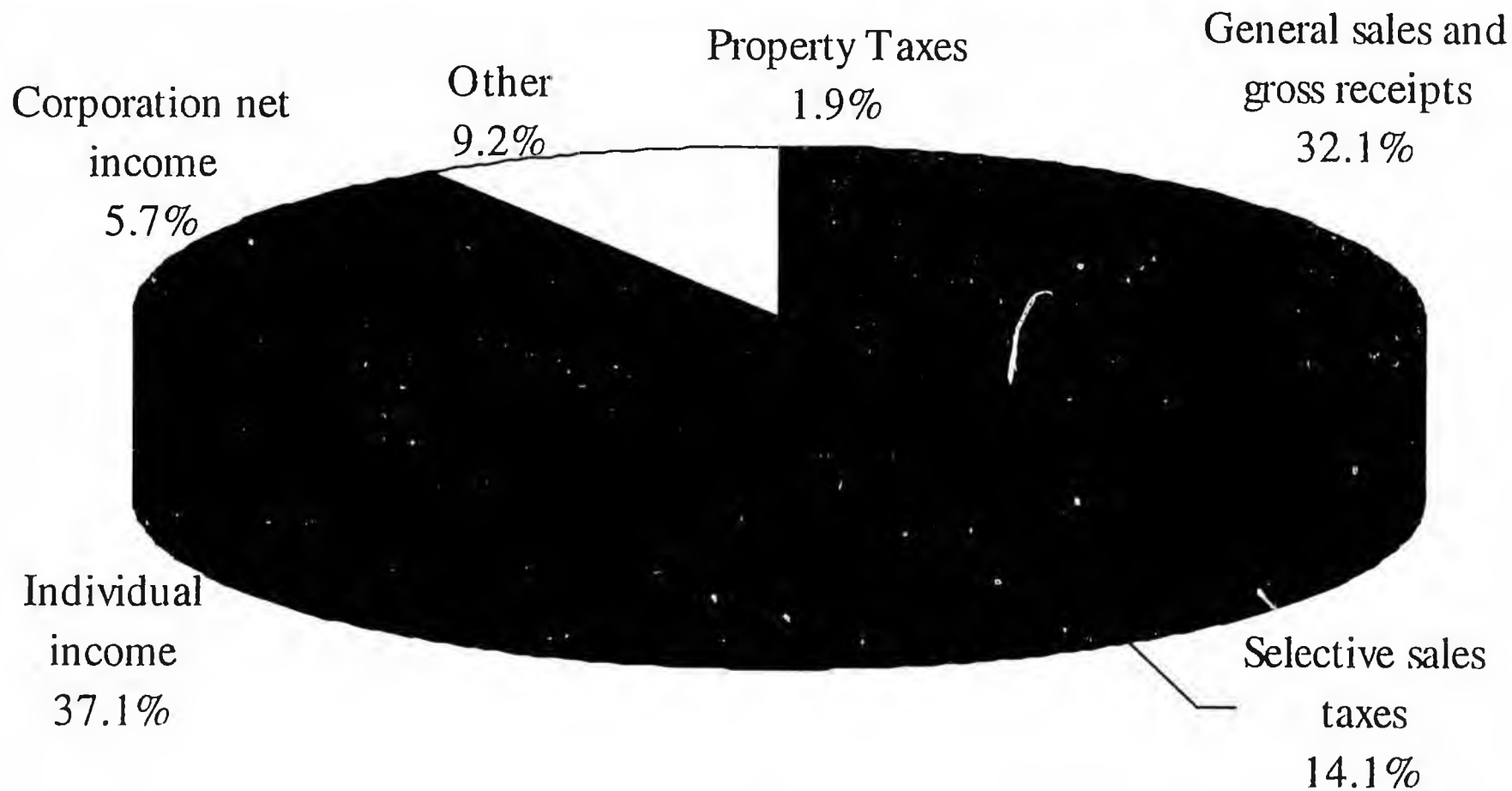
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Revenue Growth Has Not Rebounded




- 30 states reported that revenues are below projections in FY 2003
- In 12 states, collections are failing to meet revised levels
- Aggregate state revenue growth was projected to be 2%

FY 2001 State Own-Source Revenue



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Revenue Outlook for the Rest of FY 2003

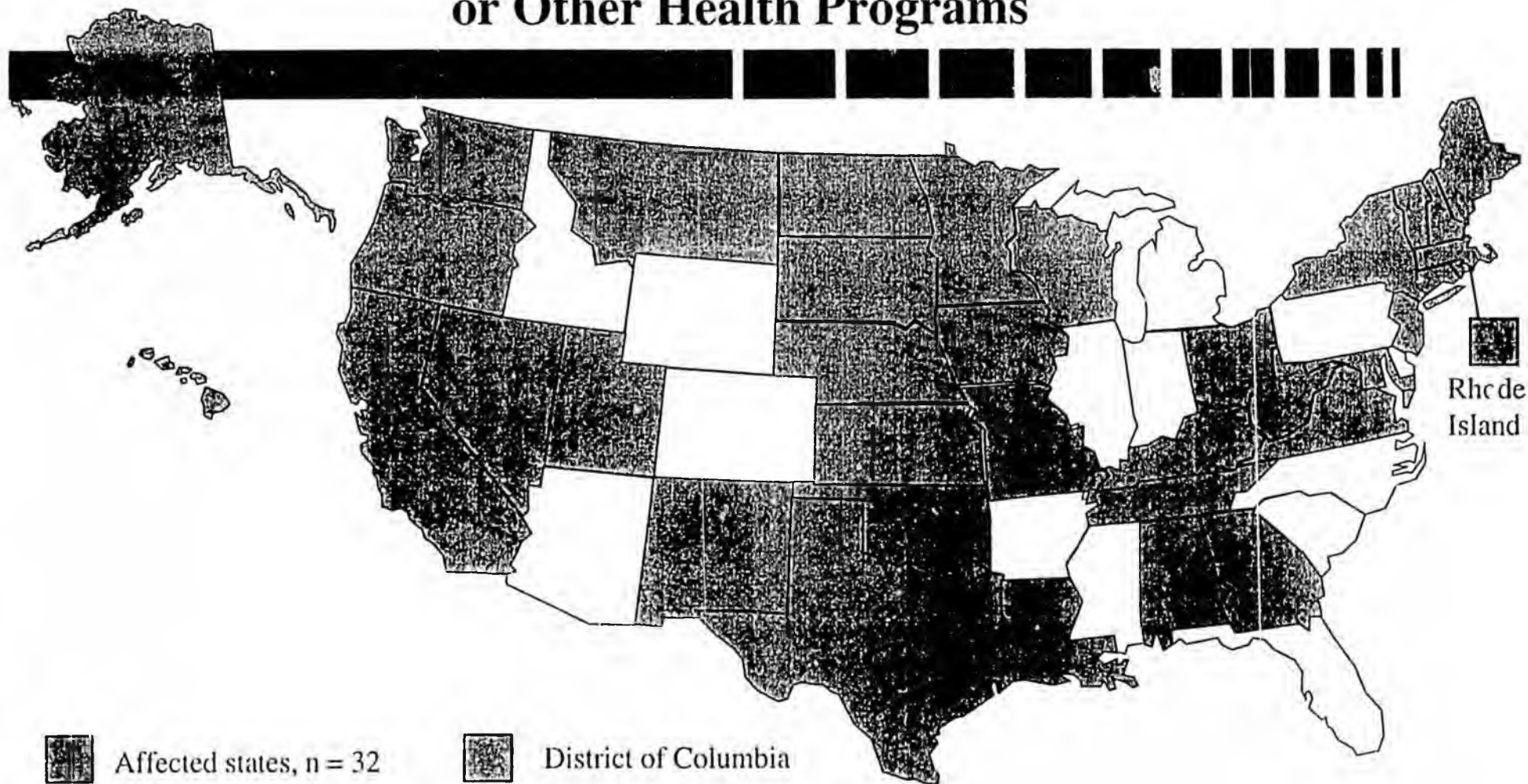
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- **Optimistic: 2 states**
 - **Stable: 11 states**
 - **Concerned: 30 states + DC**
 - **Pessimistic: 7 states**

Expenditure Update



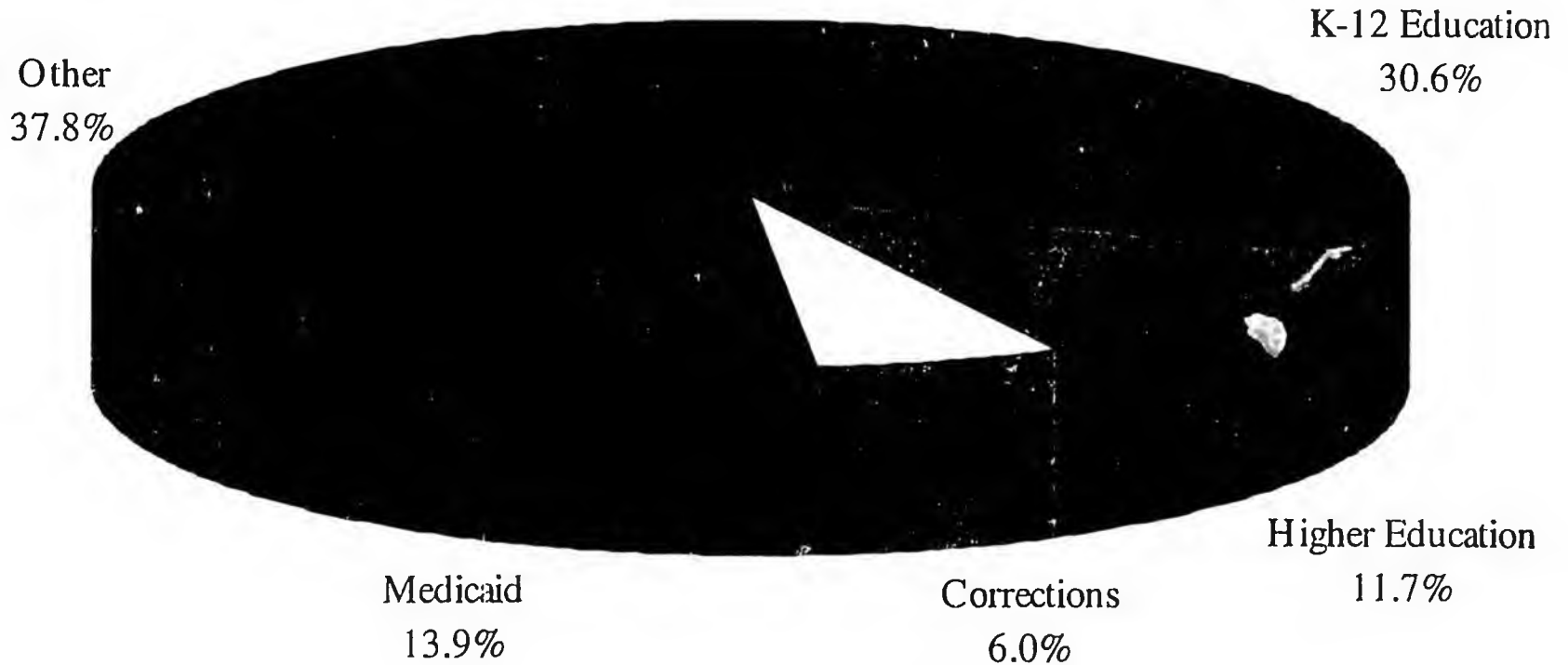
- **37 states report that spending is exceeding budgeted levels**
- **32 states report that Medicaid or other health care programs are over budget**

States with Overruns in Medicaid or Other Health Programs




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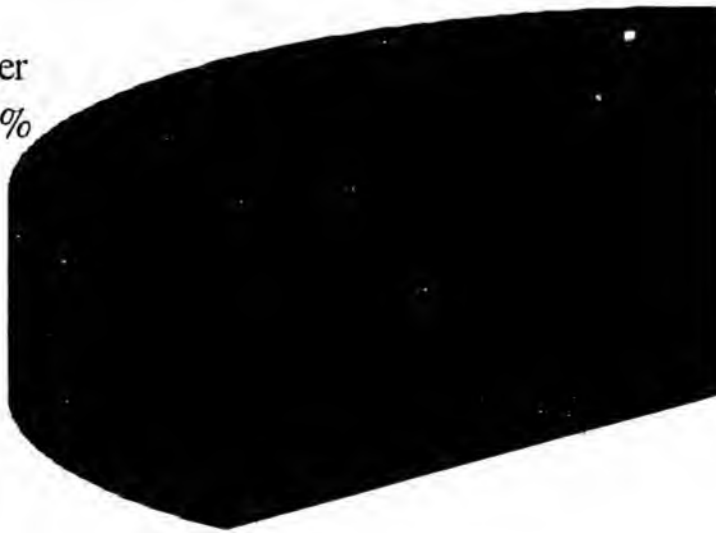
FY 2002 General Fund Spending by Category



All Other



Other
37.8%



■ What's in "other"?

- ◆ Public assistance
- ◆ Parks and recreation
- ◆ State police
- ◆ Employer contributions to pensions and benefits
- ◆ Information technology
- ◆ Environment
- ◆ Economic development
- ◆ Arts programs

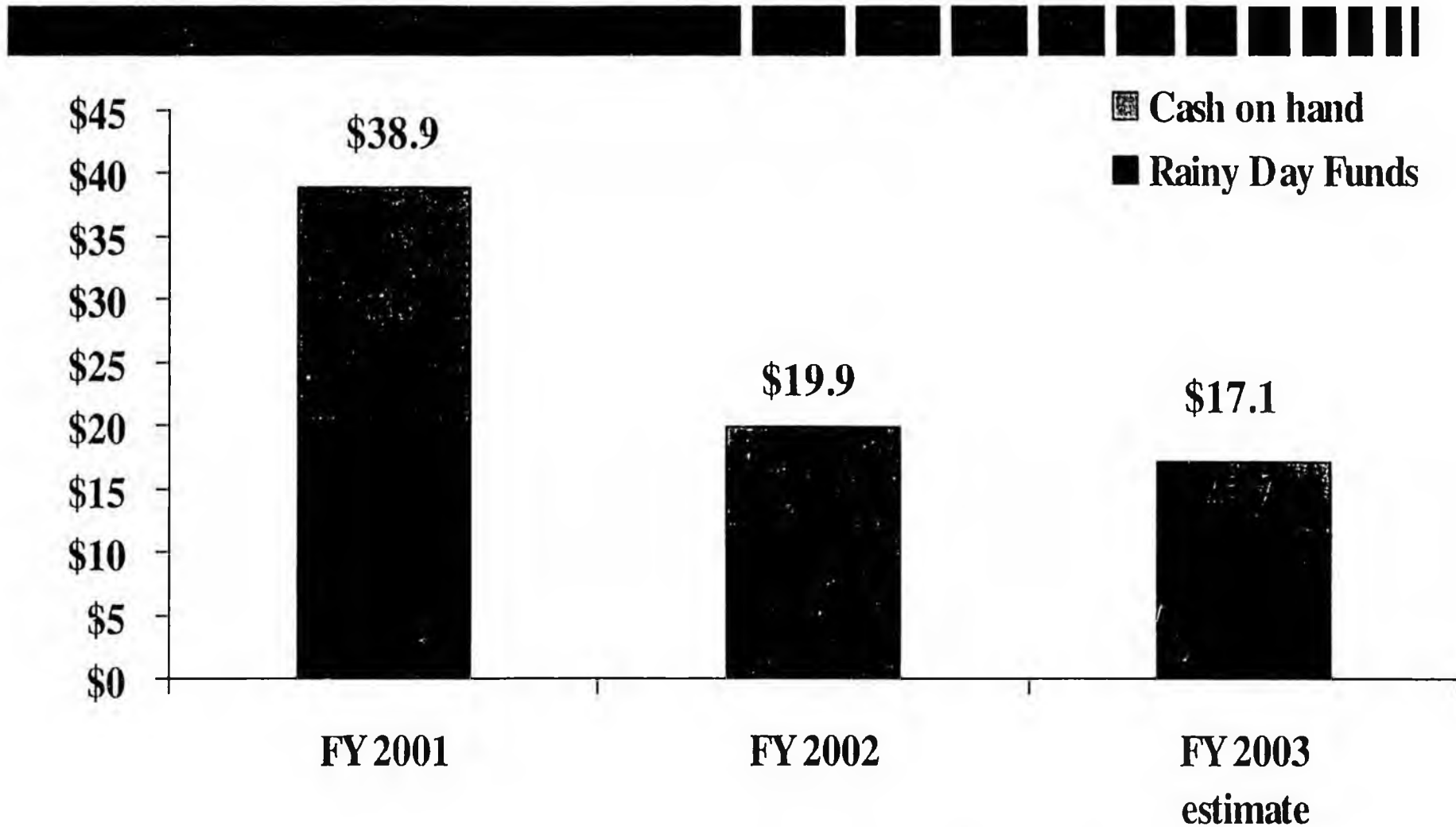
Dealing with Shortfalls in FY 2002 & FY 2003



- **Imposing budget cuts: 36 & 31 states**
- **Using tobacco settlement funds: 16 & 21 states**
- **Tapping various state funds: 23 & 28 states**
- **Tapping rainy day funds: 23 & 14 states**

State Balances Fall

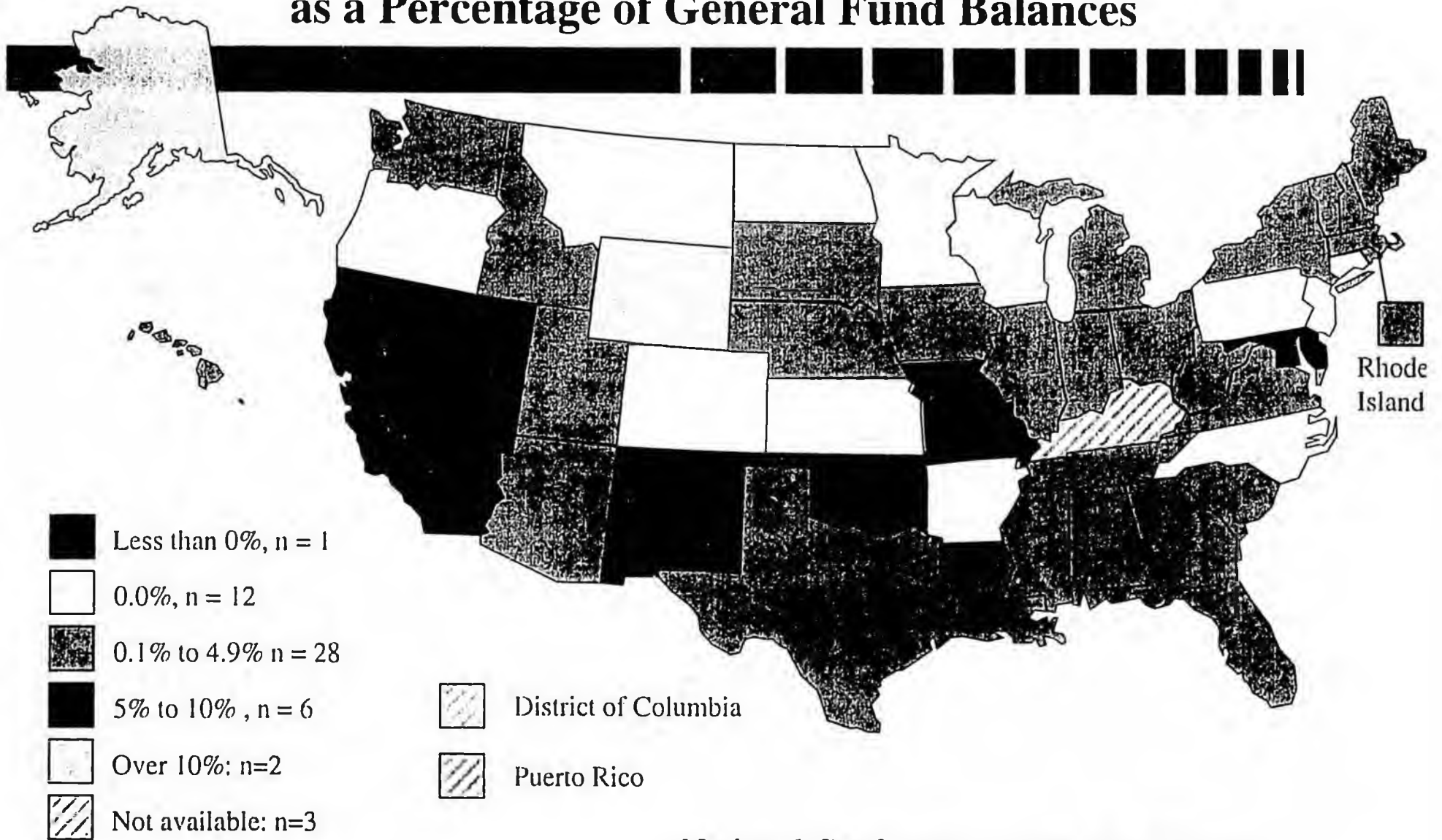
(billions of dollars)



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Rainy Day Fund Balances for FY 2002

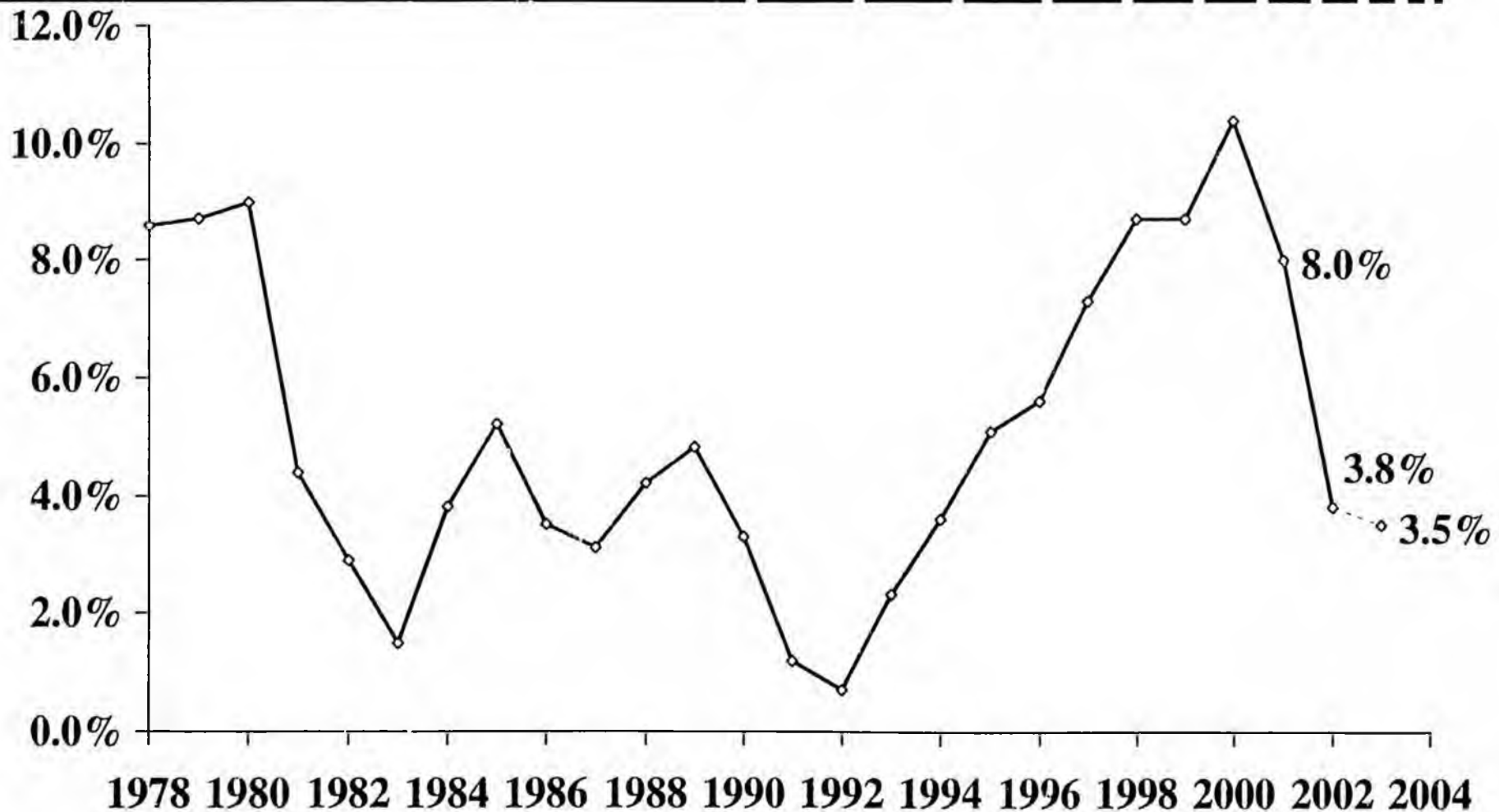
as a Percentage of General Fund Balances



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State Year-End Balances

FY 1978-FY 2003



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Dealing with Shortfalls in FY 2002 & FY 2003

- 
- **K-12 spending cuts: 17 & 14 states**
 - **Higher education spending cuts: 26 & 20 states**
 - **Corrections spending cuts: 24 & 17 states**
 - **Medicaid spending cuts: 16 & 16 states**
 - **TANF spending cuts: 6 & 8 states**
 - **Cuts in local revenue sharing: 8 & 12 states**

Dealing with Shortfalls in FY 2002 & FY 2003



- **State employee layoffs: 11 & 9 states**
- **Employee travel bans/restrictions: 19 & 14 states**
- **Employee hiring freeze: 19 & 13 states**
- **Delayed capital projects: 9 & 10 states**

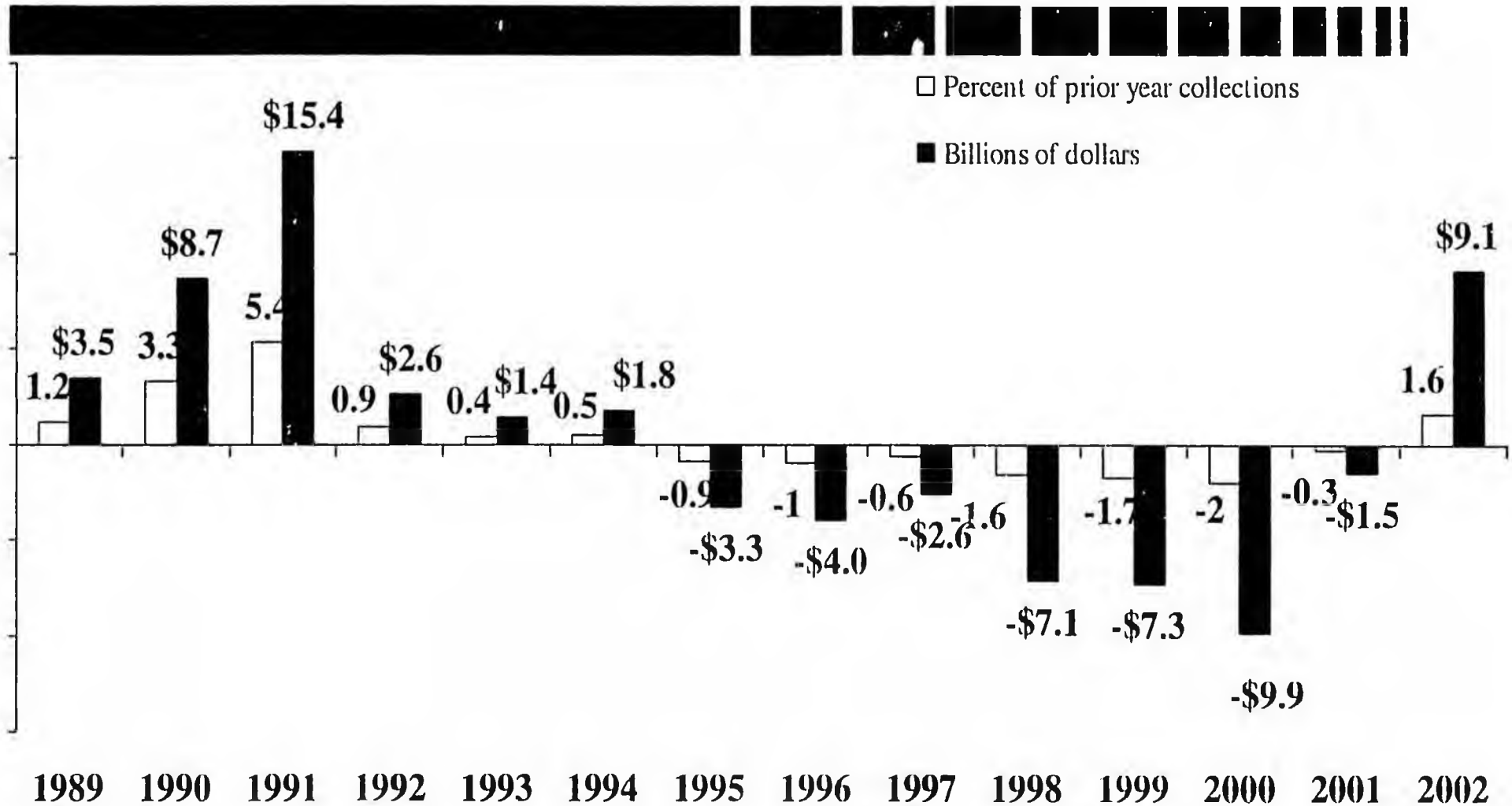
Dealing with Shortfalls in FY 2003



- **Raising taxes by more than 1% (18 states)**
- **Raising taxes by more than 5% (Indiana, Kansas, Massachusetts, New Jersey and Tennessee)**
- **Hawaii was the only state to cut taxes by more than 1%**

Net State Tax Changes


By Year of Enactment, 1990-2002



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2002 Net State Tax Changes

(in millions)



Personal income	\$1,605.3
Corporation income	2,315.6
Sales and use	976.5
Health care	338.7
Motor vehicle	136.6
Miscellaneous	724.5
Alcoholic beverage	7.0
Cigarette and tobacco	3,018.1
Net Change	\$9,122.3

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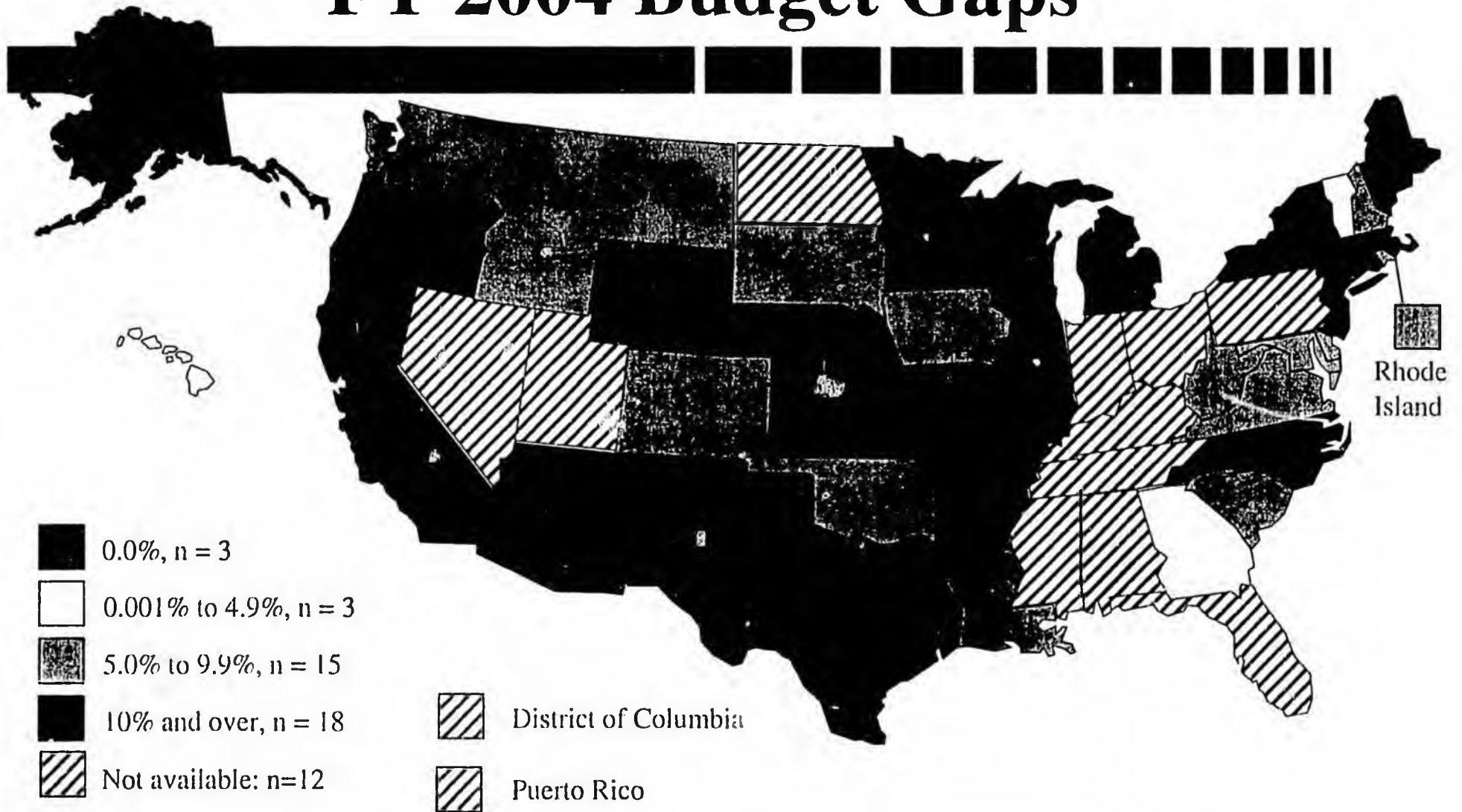
FY 2004 Budget Projections



- **The FY 2004 projected budget gap is \$68.5 billion**

- **36 states are facing gaps:**
 - ◆ **33 with gaps >5%**
 - ◆ **18 of these with gaps >10%**

FY 2004 Budget Gaps



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Possible Tax Increases?



- **25 states have tax proposals under consideration**

- **Sin taxes are the focus of early proposals**
 - ◆ **14 states with cigarette tax proposals**
 - ◆ **6 states with alcohol tax proposals**

For More Information



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Examples of Budget Balancing: Arizona



- **Shifted K-12 school construction funding from the general fund to lease-purchase financing**
- **Delayed a K-12 education payment by one month (from the FY 2003 budget to the FY 2004 budget) temporarily saving \$191 million**

Examples of Budget Balancing: Connecticut



- The Legislature gave the governor an extra \$35 million of extraordinary budget cutting authority to help balance the budget
- Transferred resources from quasi-public agencies (\$100 million)
- Implemented a tax amnesty program (\$100 million)

Examples of Budget Balancing: Iowa



- **Reduced Medicaid reimbursement rates by approximately 3%**
- **Tapped \$97.1 million in revenues from non-general fund sources**
- **Shifted \$304.3 million in expenditures traditionally funded from the general fund to non-general fund sources, including \$93.5 million in tobacco receipts to fund programs (Medicaid)**

Examples of Budget Balancing: Iowa



- **Realized \$33.5 million in savings from employee furloughs (departments were allowed discretion on how to implement)**
- **Saved \$6.5 million from implementing a 5-month delay in the state employee cost of living increase negotiated by the unions; Governor requested and unions acceded to avoid layoffs**
- **Implemented administrative rules to control pharmaceutical costs**

Examples of Budget Balancing: Louisiana



- **Implemented tax amnesty program that earmarked revenues for capital outlay**
- **Appropriated current year excess revenue into dedicated funds and will appropriate out of the special funds in the next fiscal year (averts a requirement that surplus revenues be limited to debt service, capital outlay and extra retirement payments)**

Examples of Budget Balancing: Michigan



- **Shifted collection date of the 6-mill state education tax (all of which goes to the School Aid Fund) resulting in one-time \$460 million gain for FY 2003**

Examples of Budget Balancing: New Jersey

- **Adopted business tax reform that: closed loopholes, created new alternative minimum assessment, suspended NOL carryforward for two years, accelerated quarterly payments, increased taxable income of investment companies, subjected savings institutions to corporate income tax, raised minimum tax under corporate income tax and reduced the tax rate on small businesses. (\$836 million)**

Examples of Budget Balancing: New Jersey



- **Raised fees, including \$2/day on vehicle rentals**
- **Offered a two-month tax amnesty program**
- **Flat-funded formula school program in FY 2003**
- **Postponed a scheduled increase in the property tax rebate program**
- **Cancelled some inflation adjustments in formula aid distributions**
- **Offered early retirement program for 5,000 employees**

Examples of Budget Balancing: Pennsylvania



- **Transferred \$100 million to the general fund from Underground Storage Tank Indemnification Fund to be repaid over 10 years beginning in FY 2005**
- **Reduced the dormancy period for most unclaimed property from seven to five years (\$197.6 million)**
- **Decreased the reserve for tax refunds (\$32.4 million)**

Examples of Budget Balancing: Rhode Island



- Gave each department a single line item in the budget (rather than budgeting by division or major programs) after reducing requested amounts for personnel expenditures, and granted flexibility to departments to operate within appropriated levels. Intent is to eliminate the need for supplemental funding.

Examples of Budget Balancing: Utah



- **Changed disbursements to higher education institutions to six month period resulting in net interest earnings gain of \$500,000**
- **Changed statute that requires a level of funding for capital improvements equal to 1.1% of the insured value of state buildings; was modified to 0.9% in cases of financial need**
- **Sold Utah Technology Finance Corporation to the private sector for \$4 million**

ALASKA

Adequacy of revenue ★
 Fairness to taxpayers ★ ★ ★
 Management of system ★ ★

When Prudhoe Bay, Alaska's most lucrative oil field, was tapped in 1977, it did more than reduce the United States' reliance on foreign oil and stimulate the growth of corporate giants such as BP and Exxon Mobil. Historically a cash-poor state, Alaska suddenly found that the seemingly endless supply of black gold could generate enough revenue to make most other forms of taxation unnecessary. Without any statewide sales or personal income tax at all, Alaska could afford to pave its dirt roads, build new schools and provide many other services that had previously been difficult to support.

That was just the beginning, however. The state established a Permanent Fund—a constitutionally protected investment account that now holds about \$21 billion—as a form of protection against the dire day when the oil would run out. The principal from that fund has never been touched. Its income has been used to write an annual dividend check to every man, woman and child in the state. Even with this level of generosity, there was enough revenue left to create a so-called Constitutional Budget Reserve Fund, intended to tide the state over on a short-term basis when oil prices drop.

But the oil harvest hit its peak in 1988, when more than 2 million barrels of oil flowed through the pipeline each day. Since then, production has slowed (to about 1.1 million barrels per day in 2001). Volatile oil and gas prices haven't helped either. So, over the past seven years, the state has had to use some \$4.6 billion from the Constitutional Budget Reserve to balance its books. Some years, the Reserve has accounted for nearly half the state's spending. For fiscal year 2002, forecasters estimated a year-end gap of about \$1 billion. Rising oil prices closed roughly

a quarter of that, but a \$750 million deficit is still a massive problem in a state with a budget of only \$2.4 billion.

Right now, \$2.5 billion is about what's left in the Budget Reserve. This will be enough to avert disaster in the near term, and probably enough to leave Alaska in somewhat better fiscal shape than most other states for the coming biennium. But ultimately, even if oil prices rise beyond their currently high levels of about \$30 per barrel, the cash will run out. If prices hold stable, the reserve fund will be drained by about 2006. So the state's leaders have about three years to make some very difficult decisions—or suffer the consequences. "We're on the edge of the train wreck," says Dan Dickinson, director of the tax division.

ment Fund has been dropping steadily. It was \$1,800 per person in 2001, then slipped to \$1,500 in 2002, and there are worries that, because of the stock market's effect on the fund's principal, earnings this year could drop significantly lower.

But the public doesn't seem ready to change the system just yet. Last year, the Alaska House voted in favor of an income tax, only to have the plan shot down in the Senate. Drained by the contentiousness of the argument, the House speaker and the two co-chairs of the Finance Committee opted not to run for reelection.

Unlike many of its counterparts in other states, Alaska's tax division hasn't made the jump to an integrated information system. Director Dickinson argues

FAST FACTS

Gross state tax revenues (rank)	\$1.4 billion (47)
State tax revenues per capita (rank)	\$2,250 (11)
State tax revenues as % of personal income (rank)	7.6% (19)
State and local tax revenues as % of personal income (rank)	13.2% (3)

Standout characteristics: No statewide sales or income tax; majority of revenue comes from oil- and gas-related taxes on corporations; residents receive annual dividend check from earnings of the state's Permanent Fund.

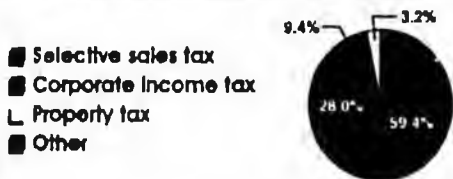
If that's true, then most residents have yet to hear the warning whistle. Politicians here sometimes talk about the "Alaska disconnect," the gap that seems to exist between citizens' perceptions and the reality of the state's fiscal situation. "We're talking about terrible budget shortfalls, and the public sees no taxes," explains former state Representative Lisa Murkowski, now a U.S. senator. "And they're getting a \$1,500 check." A full generation has grown up in Alaska since the state revoked its personal income tax more than 20 years ago, in anticipation of the oil bonanza. They're accustomed to paying only limited local property and sales taxes.

Although some officials still believe the state will be able to muddle through with spending cuts and increased economic development, most agree that a statewide income or sales tax will be necessary eventually. The annual dividend from the Perma-

that it's unnecessary—with no sales or income tax, there isn't that much to integrate. But Dickinson admits that tax technology is "fairly antiquated and stumbles along with Band Aids." Electronic filing (by compact disc or e-mail, not the Internet) began last year for oil and gas companies, but other returns still have to be sent in manually.

Where the division seems to be succeeding is in auditing and compliance. Fewer disputes over oil prices during the past decade have meant fewer debates about the amounts corporations owe the state, and the backlog of disputed oil tax cases has disappeared. Each of the 18 active oil and gas taxpayers is audited annually. Auditors also have stepped up their pursuit of retail businesses that evade the cigarette and alcohol tax. When the state catches up with them, Dickinson says, these scofflaw businesses are surprised. "They went for a generation without paying taxes," he says. "The idea that they're taxpayers upsets them." □

State tax collection by source (2001)



Portion of total state and local revenues collected by state (2000): 80.3%