The State Fiscal Crisis:  
A New Fiscal Reality Emerges

A DISCUSSION FEATURING:

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Texas State Senate

Friday,  
October 17, 2003

8:30 am — Continental Breakfast  
9:00–11:00 am — Discussion

Reserve Officers Association of the United States  
One Constitution Avenue, NE  
Congressional Hall of Honor — Fifth Floor  
(Across from the Dirksen Senate Office Building)

To register:  
Please call Marcia Howard at 202/872-1392 as soon as possible. Space is limited.

For additional information on this topic:  
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In the third year of a fiscal crisis, states have been trying to control their budgetary shortfalls by turning to the three critical components determining their balance sheets. First, states have been cutting spending in a variety of programs and in the agencies that administer them. Second, they have been borrowing from several state funds—including rainy day funds—to help tide them over to the next fiscal years. And they have been boosting revenues by increasing their tobacco, sales, corporate, and income taxes.

Similar actions by states in response to the fiscal crises of the early 1980s and 1990s resulted in a return to fiscal stability during the third year of the crises. States’ efforts this time around are not having the same effect.

While states are again experiencing growing revenues, the growth is at the lowest rate since 1991 and is not sufficient to overcome budgetary shortfalls. For fiscal year (FY) 2003, overall revenues increased by just 0.7 percent over FY 2002; a quarter of the states collected less revenue in FY 2003 than in FY 2002.

The revenue side is not the only concern. Spending could exceed projections. Medicaid, states’ second largest source of expenditures after education, is of particular concern to states. Like other payers of health care services, Medicaid is being threatened with double-digit growth as a result of the recent surge in medical inflation. Yet states have allocated a mere 4.6 percent increase in Medicaid for FY 2004.

Despite these revenue and spending risks, states have left little margin for error in their FY 2004 budgets. Although states hold a percentage of
their budget as reserves to cover unforeseen shortfalls, these reserves have been declining steadily since their peak level of 10 percent in FY 2000. For FY 2004, 20 states project their reserves to be lower than last year’s average of 3.1 percent; 12 expect reserves of 1 percent or less.

THE NEW STATE FISCAL REALITY

Observers note that some of the states’ actions, far from resolving their budgetary woes, may be contributing to them. In fact, Don Boyd of the Rockefeller Institute notes that the frequent reliance on temporary solutions, such as borrowing and the use accounting gimmicks, have pushed fiscal problems from FY 2003 into FY 2004, and a likely repeat of the behavior will push FY 2004 problems into FY 2005 and beyond, “effectively converting the crisis into several years of lesser but sustained fiscal difficulty.”

Nor can states rely on the growth in the overall U.S. economy to get them out of trouble. As Boyd argues, “The state fiscal boom of the late 1990s was driven by exceptional forces unlikely to be repeated in the years ahead. Even after the economy recovers, states finances are likely to be tight for the next several years.”

CONTAINING MEDICAID AND RESTRUCTURING GOVERNMENT

What is a state to do? Medicaid has become too big to be ignored. As a share of total state spending, Medicaid has grown from 14.5 percent in 1991 to 19.3 percent in 2001, the largest change in state spending allocations since the initiation of massive aid to kindergarten through grade 12 education in the 1950s and 1960s.

But states argue that their ability to implement the innovative solutions necessary for controlling Medicaid costs is hampered by the Medicaid statute. They maintain that current waiver options are insufficient tools for addressing the problems and that fundamental reform at the national level is required. Absent national reform, some states fear, they will be forced to continue the constant whittling away of Medicaid through reductions in provider payments, optional benefits, drug coverage, and eligibility levels.

Another option for dealing with the budgetary crisis is also being explored: fundamentally realigning state government. Decimated by the accumulation of hiring freezes, layoffs, early retirements, and across-the-board agency cuts, some states have administrative structures so weak that leaders believe government must streamline the way it does business.
THE FORUM SESSION

While states are slowly mending, the new fiscal reality they face clearly precludes a return to their halcyon days of the late 1990s, when they cut taxes, increased spending, and set aside large reserves. During this Forum session, a national expert on state fiscal issues will provide an update on state financial conditions, discuss the actions taken to fill the budget gaps, and provide observations about what lies ahead. Speakers from two states who had long, contentious legislative sessions will provide insights on those and other issues, such as the future shape of Medicaid and the State Children’s Health Insurance Program (SCHIP) and the role those programs will play in addressing the needs of the uninsured, vulnerable families, and children.

Speakers

Corina Eckl is director of the Fiscal Affairs Program at the National Conference of State Legislatures (NCSL). She will describe NCSL’s updated findings on the status of the state fiscal crisis, discuss how states have used the assistance from the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, and provide observations on future trends in state spending. Eckl has written extensively on state budget and tax issues and has served as a consultant on evaluations of state legislative organization and staff operations.

Jennifer Chambers is legislative assistant on health and human services issues for Texas Sen. Robert Duncan (R). She will provide an overview of the state’s recent decisions to balance the budget and the effect on the Medicaid, SCHIP, and other health programs. She will also describe the enacted legislative decision to consolidate 12 health and human service agencies. Chambers, who has assisted Duncan in his assignments to medical cost, long-term care, and Medicaid committees and workgroups, previously worked as deputy director for a Texas land commissioner.

Gary Weeks is director of Oregon’s Department of Administrative Services. He will describe the state’s recent legislative session (the longest in Oregon’s history), the tax increases (both those recently passed by the legislature and another rejected in a voter referendum), and the options enacted to control the costs of the Medicaid program. He will also describe his assignment by the governor to restructure state government. Weeks was a senior fellow with the Casey Foundation and has held several positions in the Oregon government, including director of the Department of Human Services.

Key Questions

- Is the state fiscal crisis nearing an end, with a recovery to old times around the corner? Or is the crisis simply revealing the
emergence of the long-predicted state structural deficit that will force states to reduce their future financial obligations for Medicaid, SCHIP, and other programs?

- With the significant funding restrictions made to many other priority programs in order to accommodate Medicaid, has policymakers’ support for Medicaid changed? What changes in Medicaid and SCHIP are being considered to control their long-term growth?

- How have other health and social service programs fared during the fiscal crisis? Which programs are most vulnerable to current and future cuts?

- What is the cumulative impact of the state budget decisions on the capacity of local government to deliver health services? After years of reduced state revenue sharing, are local governments suffering crisis similar to those being faced by the states?

- How have states used the funds under the federal Jobs and Growth Tax Relief Reconciliation Act of 2003? Are more states “securitizing” their tobacco settlement monies?

- Do states recognize the impending structural imbalance of a gap between state revenues and spending projections over the next decade?

- Are states undertaking systemic tax reform to improve their future flow of revenue?

ENDNOTES


4. NCSL, “State Budget,” figure 1, 11.


