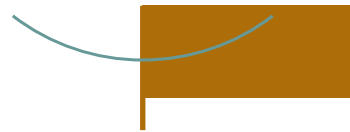




# Budgeting Amid Fiscal Uncertainty

*Ensuring Budget Stability by Focusing on the Long Term*



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National  
Association of  
State Budget  
Officers

2004

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## **PREFACE**

The fiscal dilemma states currently face is strikingly similar to their experiences in the early 1980s and 1990s. After a prosperous period of booming budgets, the ebbing economic cycle has taken its toll on revenues. At the same time, spending pressures have mounted, particularly from Medicaid. In response, states cut spending severely and are examining intensely both short term cyclical remedies to stop the fiscal hemorrhage and long term structural changes that will help their budgets better weather the next fiscal storm. This report explores the dynamics surrounding fiscal uncertainty in the states and how states work to avoid it. As the current fiscal crisis continues to subside, state officials will have the opportunity and challenge to pursue long-term strategies that will improve fiscal stability. Budget officers will be at the forefront of the challenge to pursue policies that reach the goal of sound financial management.

### 1. THE STATE FISCAL CRISIS

#### The Fiscal Crisis Impacts Nearly Every State

Nearly every state was in fiscal crisis during 2003. Amid a stagnant national economy, state revenues shrunk at the same time that spending pressures mounted—particularly for Medicaid and other healthcare—creating massive budget shortfalls. In fiscal 2003, states faced budget shortfalls that neared \$80 billion; in fiscal 2004 they continue to face difficult budgetary challenges. As states fight to balance their budgets, the choices available to them are increasingly difficult, and some of the most difficult fiscal decisions have yet to be made.

While the problems confronting states are dire, they are nothing new. Economic cycles of growth and contraction are normal and states act accordingly. While revenue growth declined significantly during the last two years, the fiscal stress states faced and continue to grapple with is similar to the budget crunches that coincided with the weak economies of both the early 1980s and the early 1990s. States' present fiscal troubles are particularly difficult since revenues fell farther than would have been expected. The late 1990s boom was so strong that the bust following it has been similarly dramatic.

#### State Revenue Actions

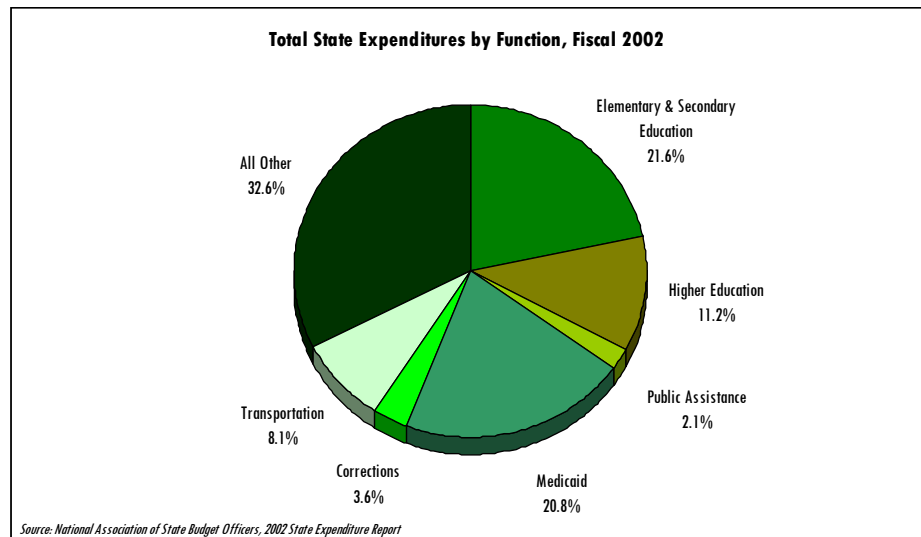
The pattern of dwindling tax collections continued throughout fiscal 2003. According to NASBO's *Fiscal Survey of States*, thirty-one states collected less revenue in fiscal 2003 than they had planned for in their budgets. Nine states report that revenue was higher, while ten states met their revenue targets. Based on fiscal 2003 enacted budgets, total revenue was 6 percent lower than budgeted projections. Specifically, sales taxes were 2.9 percent lower, personal

income taxes were 9 percent lower, and corporate income taxes were 3.7 percent lower.

States enacted substantial tax and fee increases for fiscal 2004. Those tax and fee increases covered every category of broad-based taxation including sales, personal and corporate income, cigarette and tobacco, motor fuels, and alcohol taxes, and fees, and totaled \$9.6 billion.

#### State Spending: Dramatic Decline

The dramatic decline in state revenue growth resulted in a sharp drop in state spending in fiscal 2003. After growing 8.3 percent in fiscal 2001 and 1.3 percent in fiscal 2002, as a result of weakness in state tax collections and the stalled national economy, the increase in states' fiscal 2003 general fund spending was only 0.6 percent. Based on enacted fiscal 2004 budgets, spending will grow only by 0.2 percent compared to the



previous year, before being adjusted for inflation. These figures include one-time spending from surplus funds, transfers into budget stabilization funds and other reserve funds, and payments to local governments to reduce property taxes.

The cuts have been extensive. Forty states reduced fiscal 2003 enacted budgets by \$11.8 billion after they were passed—two states more than the previous year. While in the early months of fiscal 2003 23 states were taking action to reduce their enacted budgets by a net \$8.3 billion,

the number of states with budget gaps later grew to at least 39 states and a budget gap that during the year ranged from \$29 billion to as high as \$80 billion.

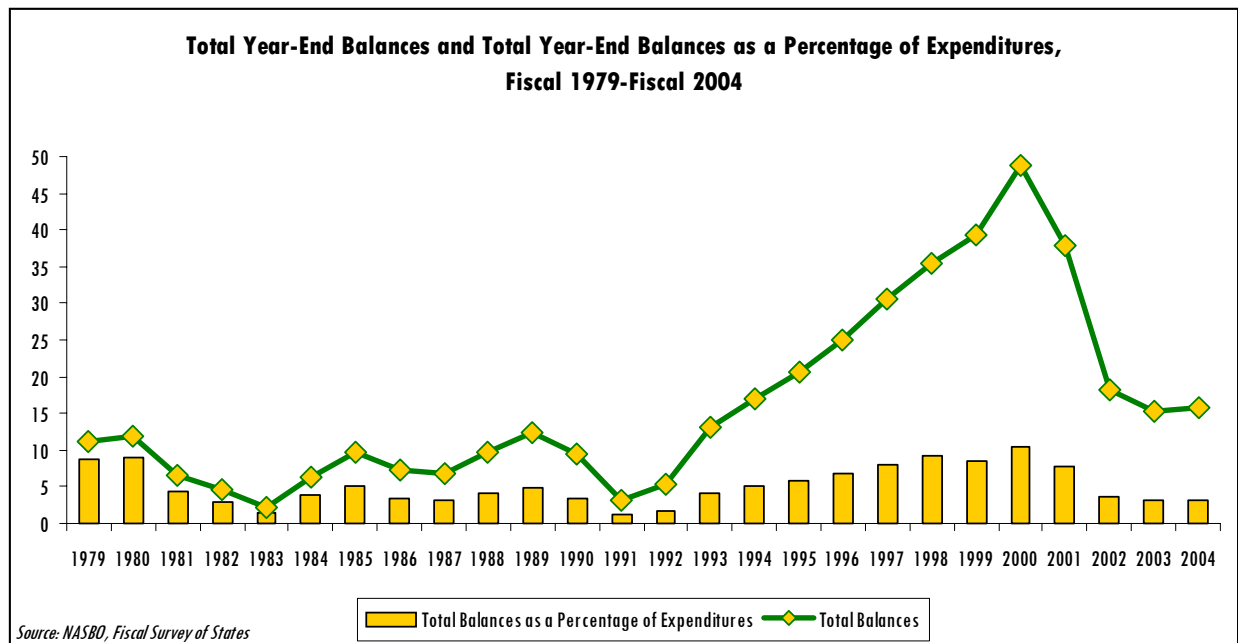
To address the severe imbalance between revenues and expenditures, states used a variety of specific strategies to reduce or eliminate budget gaps. In fiscal 2003, 32 states reduced that budget gap by enacting across-the-board cuts, 25 used rainy day funds, 16 states laid off employees, 13 states used early retirement, 13 states reorganized programs, and 29 states used a variety of other methods. This trend will continue in fiscal 2004. Many of these budget balancing actions are one-time only and cannot be used again. Further cuts could be even more painful.

Spending growth has slowed everywhere and, in fact, had been negative in many states. Two-thirds of the states reported expenditure growth of less than 5 percent in both fiscal 2002 and 2003. In comparison, 35 states had expenditure growth of more than 5 percent in fiscal 2001. Remarkably, 21 states experienced negative growth during fiscal 2003. Thirteen states enacted budgets for fiscal 2004 with lower levels of spending than the previous year..

Additionally, Medicaid spending has increased rapidly, requiring cuts in other parts of the budget. Medicaid spending grew 13.2 percent in fiscal 2002, the steepest rate of growth since 1992, and estimates show growth of 6.7 percent for fiscal 2003. That figure that is certain to increase since—as of early January, 2004—at least 15 states indicate that Medicaid expenditures are exceeding budgeted amounts.

**Year-End Balances Fall Spectacularly**

States were able to build up substantial balances during the 1990s boom, but like revenues, have decreased precipitously. The fiscal situation in the states can be most clearly seen in their year-end balances. Total balances in fiscal 2002, fiscal 2003, and enacted fiscal 2004, are \$18.3 billion, \$15.2 billion, and \$15.8 billion, respectively. Fiscal 2003 total state balances plummeted by a spectacular 70 percent since they peaked in fiscal 2000.



## 2. BOOM TIMES TO STATE FISCAL CRISIS

### Following the Cycle of Prior Decades

No state official likes to make promises and not keep them. No one wants to take an action one year only to reverse it the next. Yet many state officials did exactly that during the early 1980s, and again during the early 1990s, repeating a pattern that is decades old.

In 1980 and 1981, many state legislatures reduced taxes, expecting the lower rates to be permanent. In 1982 and 1983, many of the same legislatures voted to increase taxes because of changed fiscal conditions. A variety of taxes were raised again in most states in 1991 and 1992 as the economy's cyclical nature caught up to state budgets. This is occurring again now: after lowering taxes by \$33.4 billion over eight years, states enacted an \$8.3 billion net tax increase in fiscal 2003 and \$9.6 billion for fiscal 2004.

### Reacting to the Boom

During the economic boom of the late 1990s, state officials expanded programs, created new ones, and cut taxes. The period was a unique fiscal situation for states, as everything from a budget standpoint ran smoothly. Revenues grew at a remarkable rate—particularly personal income tax collections—and states had healthy ending balances and reserve funds. Health care and Medicaid expenditures were under control, and required payments to state pension funds had decreased significantly or were nonexistent.

With the economy stalled and revenues collapsed, however, states have been unable to meet those obligations. Most recently, states have been cutting or freezing spending, closing facilities, increasing tuition, canceling travel, and laying off employees. Simultaneously, spiking Medicaid and health care costs have created additional spending pressure, as have increases in payments to pension systems resulting from the lackluster stock market.

### State Budgets, The Business Cycle, and The Impact on State Finances

Business cycles and resulting cyclical revenues persistently cause instability in state finances.

The national economy does not grow smoothly; periods of expansion are followed by slowdowns or recessions, and the cycle repeats itself. Although many people criticize these cycles and policymakers search for strategies to make growth more stable, actions still tend to be reactive. While the media in the late 1990s trumpeted the end of the business cycle, the recent downturn indicates that the cyclical nature of the economy continues.

When the business cycle swings upward indicators of employment, personal income, consumer confidence, retail sales, power usage, and home building rise as well. The financial markets perform strongly as personal and business investment increases. State revenues benefit as a result. Indeed, according to the Federation of Tax Administrators (FTA) realized capital gains increased by more than 300 percent between 1994 and 2000 and state treasuries reaped a windfall: between the third quarter of 1999 and the third quarter of 2000, total state tax collections increased by 41.7 percent, and personal income tax collections increased by 60.1 percent.

When the business cycle veers downward, the uncertainty in state budgets grows markedly. As the economy slowed—both as part of the natural business cycle but compounded by the aftereffects of September 11—total state revenues fell by 24 percent between the third quarter of 2001 and the second quarter of 2002, and personal income tax collections plunged by 42.7 percent, says FTA. States have struggled with their budgets since the downturn began, and amid tumbling revenues have been forced to take austerity measures unthinkable just two years ago.

### Unpredictable Factors Impact State Finances

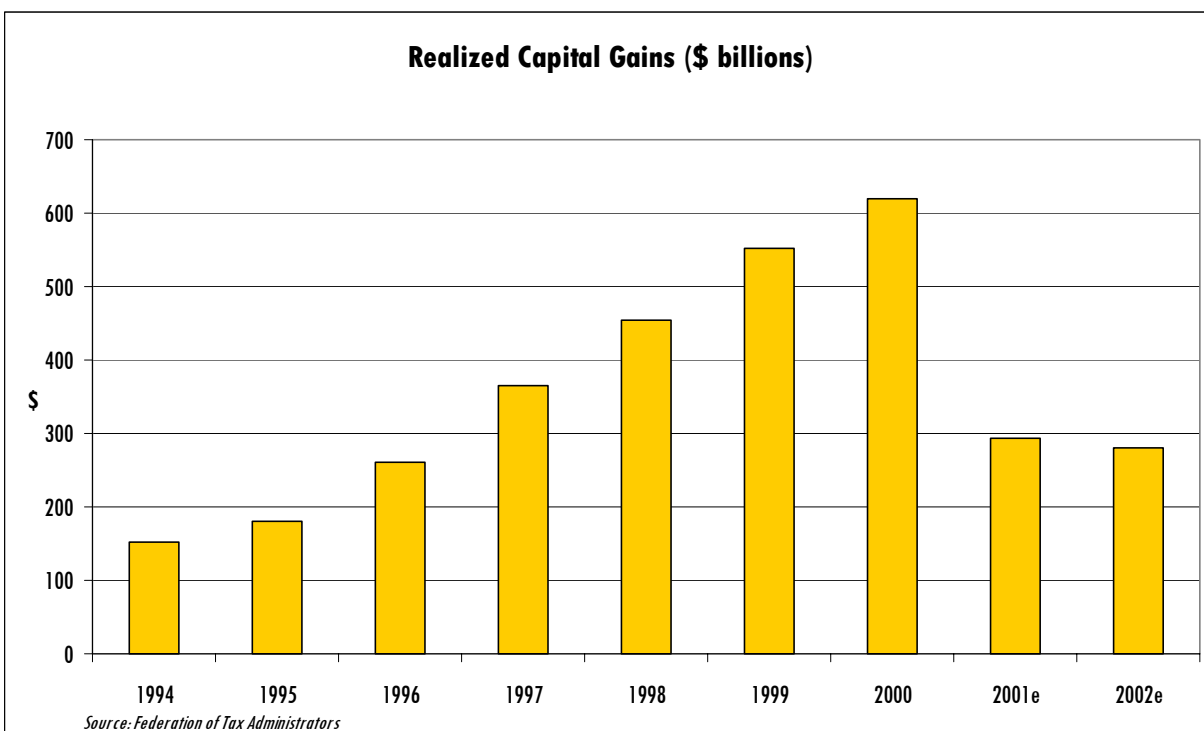
Although the business cycle causes the most uncertainty in state finances, other factors contribute to the uncertainty and unpredictability as well. These include:

**Revenue estimation uncertainty.** Predicting state revenue growth would be difficult even without business cycles. Even the most sophisticated

methods of economic forecasting inconsistently predict details about economic growth and decline. Too many uncertainties exist at the national level to account for them all in an economic forecast and projecting *state* economic changes may be even more difficult. Many state estimators use national economic forecasts and may incorporate errors in predictions of national trends into their own, and a skewed or inaccurate state forecast may result. This is true particularly in states more dependent on a particular sector or industry such as oil and gas or automobiles.

forecasters failed to estimate the double-digit inflation of the mid-1970s, failed to predict the high inflation associated with the “stagflation” of the early 1980s, and were largely surprised by the low inflation of the past few years.

Improving revenue estimates should be a top priority. Comparing revenue estimates with other states is one way to determine their relative accuracy. Reviewing and considering changes to the revenue estimation process may lead to improved and more accurately informative figures.



Additionally, states rely heavily on sales taxes (they constitute roughly one-third of state general fund revenue), a revenue source especially susceptible to inflation and the business cycle’s undulations. Additionally, because the sales tax generally is allied only to goods and not services, an increasingly large portion of economic activity is missed by sales taxes. According to Economy.com and the Federal Reserve, in 2001 services comprised 58.8 percent of personal consumption, while goods were only 41.2 percent. Compounding the vulnerability of the sales tax to inflation is how hard it is to predict:

**Expenditure estimation uncertainty.** Expenditure estimates are substantially more accurate than revenue projections, but have problems of their own. Although expenditures theoretically are limited by the appropriations made when the budget is passed, major components of the state budget—such as Medicaid—are based on formulas that are not directly controlled by the state budget director. For example, costs within Medicaid, such as for prescription drugs, have rocketed above estimates and driven the overall costs of the program up. Indeed, in fiscal 2001

the state share of Medicaid grew by 10.6 percent, exceeding the amounts states had budgeted by \$4.4 billion; in fiscal 2002 Medicaid by another 13.6 percent and exceeded budgeted amounts by \$2.8 billion. Improving state expenditure forecasts is another important action that should be considered.

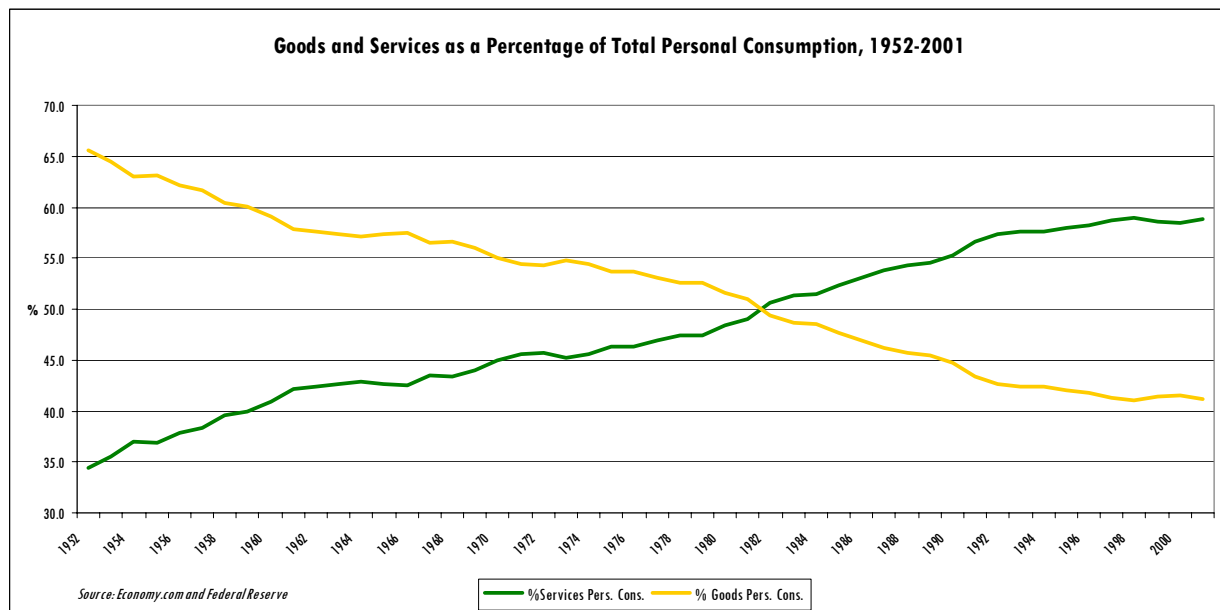
**Unpredictable Federal Tax Policy.** Most state tax systems are tied closely to the federal income tax. Some states calculate their personal income taxes based on the federal adjusted gross income or compute their tax as a percentage of federal tax liability. Thus, changes in the federal tax law can automatically alter state taxes, usually without any state legislative action needed.

Dealing with this issue recently, several states chose to decouple from the federal estate tax and from certain corporate income tax depreciation provisions that would have automatically lowered state taxes, at a time when state revenues already were suffering. The revenue impact will still be significant: eliminating the federal estate tax will cost the states \$4 billion annually by the time it is fully phased-out in 2005, according to the Federation of Tax Administrators. States may wish to consider ways to become less vulnerable to federal tax law changes.

**Unpredictable Federal Spending.** Because states rely

on federal grants for many programs—25.8 percent of all state spending came from federal funds in fiscal 2001—the timing of federal spending decisions can cause uncertainty in state budgets. The federal fiscal year begins in October, while most states begin theirs in July, and federal revenue or spending changes may affect decisions already enacted by the states. With federal spending policy increasingly focused on defense and security, funds available for grants to the states may become more limited. Indeed, in the president’s 2004 proposed budget, discretionary spending actually declined in real dollars.

**Unpredictable Federal Mandates.** Federal law may mandate state action in a number of ways, often with substantial impact on states’ bottom lines. The Congressional Budget Office (CBO) is required to screen legislation to determine whether it mandates unfunded spending by states by more than a certain threshold (currently, the aggregate threshold is \$58 billion). Certain programs are exempt from such screening, such as Medicaid, but others are not, and through the first nine months of 2002, 11 percent of the bills with mandates were over the threshold, according to CBO. Recently passed federal mandates in the areas of education and election reform may not be fully funded over the next few years. States need to determine ways to react to federal mandates.



**Unpredictable Court Decisions.** Federal and state court decisions can affect state revenues and spending. Court decisions on issues including the treatment of corporate income, taxation of out-of-state firms, education financing, and care for the mentally disabled in state facilities all have influenced state finances. Recent court decisions have involved orders to states to pay hundreds of millions of dollars to settle various claims. For example, in 1998 the North Carolina Supreme Court ordered the state to reimburse federal retirees for certain taxes collected on their pensions, an unplanned expense costing nearly \$800 million. Being prepared for these types of unpredictable actions is difficult.

**Unpredictable Voter Decisions.** Some states allow voter initiatives and referenda that may affect state budgets. These might include tax increases that require voter approval or voter-initiated changes in how a program is financed. For example, in Florida voters approved a class size initiative that will add significantly to state costs. States may wish to consider improvements to processes that cause voters to consider the relative choices of these decisions.

**Other Unpredictable Contingencies.** State budgets also are adversely affected by events that require unplanned spending ranging from hurricanes, floods, and other natural disasters. Responses to major events such as the September 11 attacks also involve major unplanned costs.

#### Improving Responses to Uncertainty

While significant uncertainty—and even error—is inherent in economic forecasting, officials must rely on forecasts to craft a budget. For example, multi-year forecasts help to determine whether long-term commitments such as a phased tax reduction is realistic considering other policy objectives and fiscal realities. Although states aim to reduce the uncertainty in their economic forecasts, the nature of the budget process tends to magnify the favorable effects of unanticipated revenue growth (such as during the late 1990s) and the unfavorable effects of unexpected revenue decline (as states are experiencing currently).

**Reacting to Boom and Bust.** During times of rapid economic growth, states often adopt spending and taxing behavior that they cannot maintain during recessions and slowdowns. During a recession or other economic downturn, it is common for states to react by spending and taxing in a manner that—when the economy recovers—generates large surpluses. The result of both examples is boom and bust in state finances.

When fiscal times become tight, the boom and bust cycle is amplified. For example, a 3 percent budget shortfall may trigger cuts of more than 3 percent. Four factors contribute to such a result, including:

- Required spending on some areas that cannot be cut, such as Medicaid, other entitlement benefits, or functions such as elementary education that are politically difficult to cut;
- The procedural and administrative difficulties of changing fiscal patterns mid-year;
- The impact of various carryovers from previous years;
- The affect of one-time measures in future years. These include increased future costs resulting from delayed maintenance, using reserve funds to address structural imbalances, and issuing debt that will incur interest costs over time.

**Budgetary “untouchables.”** When states cut their budgets to respond to fiscal crisis some programs are exempt, for various reasons. One obvious untouchable budget item is debt service, or payments to bond holders. Few states want to jeopardize its credit rating by not honoring the agreements it made when it sold bonds, and even if they did, most bond issues have provisions by which courts will order payment. Certain other financial commitments, such as lease payments and installment payments on construction contracts, are obligations similar to debt service.

Other expenditures are equally difficult to cut. Entitlement programs such as Medicaid and public assistance, and items such as school aid, are set by formulae enacted in law. State contributions to employee retirement and health plans largely are contractual obligations. And while some cost-cutting actions have short-term savings they may be exceeded by the short-term costs, such as immediate costs for severance benefits and cash payments as part of accrued vacation and sick leave.

However, large budgetary “untouchables” are usually those items that are politically sacrosanct, such as elementary and secondary education.

**Balancing the Budget on Less Than 100 Percent.** The affect of untouchable expenditures on the rest of the budget may be severe, as “untouchable” programs mean it must be balanced on less than 100 percent of the total. For example, if the budget needs to be balanced, but state officials deem untouchable Medicaid (20.8 percent of total state spending in fiscal 2002), elementary and secondary education (21.6 percent), public assistance (2.1 percent), corrections (3.6 percent), and transportation (8.1 percent), then the remaining 32.6 percent all other expenditures will bear the burden of budget cuts. This can make many budget cuts severe.

**The Problem of the Mid-Course Correction Multiplier.** As the fiscal year progresses, attempts to raise additional revenue or reduce expenditures become more difficult because an increasing percentage of the budget has been spent and tax revenue lost. For example, if a state needs to raise revenues or cut spending by 3 percent to balance its budget at the beginning of the year, it will need to make those corrections by *6 percent* if the need for such action is not discovered until halfway through the fiscal year. A similar amplification occurs when economic conditions improve.

**Annualization.** Spending and tax changes tend to have a larger impact the year after they are made rather than the year they are implemented, meaning that actions to fix fiscal problems that are in the right amount in the year they are made

tend to be an over correction for the next. For example, if layoffs and hiring freezes are necessary to save 3 percent of state spending starting halfway through the fiscal year, those same measures will save about 6 percent if continued in the second year. Similarly, a tax increase in effect for half a year that increases revenue by 3 percent will increase revenues by 6 percent the next year.

**Starting from a New Economic Base.** Revenue and expenditure estimates are applied to a base, generally the previous year’s revenue and spending amounts and considering the previous year’s economic performance. Changes that affect the current year also change the base for the next year: a downward revision in one year will lower base amounts used for the next year’s budget.

**Psychological Effects: Overreaction.** Erroneous budget estimates can impact state government decisionmakers whether they result in windfalls or budget shortfalls. Inaccurate revenue estimates leave estimators concerned about where the forecast model’s shortcoming is, and looking for ways to correct it. Because estimators may think that the assumptions used in the model were too optimistic, the correcting process is inherently pessimistic. When memories of a budget crunch are fresh, legislators behave likewise. Too often decisionmakers “overreact” and assume that the future will be like the immediate past.

Similar sentiments also operate when budgets are booming. During favorable fiscal times, decisionmakers take different positions on how bright they expect the future to be. These disputes become particularly crucial during the consensus revenue estimating process, as varying opinions of economic outlook have to agree on one a common forecast of a state’s economy.

**Effects of Unsuccessful Stoppag Measures.** Many of the methods states use to plug budget holes are one-time measures, such as accounting changes, accelerated tax collections, and fund balance draw-downs. These techniques work well if a booming fiscal year follows a tight one, but they can help prolong budgetary pain if the fiscal

situation does not turn around quickly. States may be able to sustain spending by meeting revenue shortfalls with one-time fixes, but without permanent corrections or economic recovery, the budget woes will continue.

**Concentration of Effects in a Single Year.** The causes of gaps between actual and planned revenues and spending often last multiple years, while their fiscal affects are concentrated in a single year. For example, because of legislative cycles, the need for hearings, and adequate time to prepare a complex spending plan, states begin to construct their budgets roughly a year prior to enactment. (See NASBO's *Budget Processes in the States* for more information on budget cycles.) Because the budget cycle is stretched over such a long period, states must base some budgetary assumptions on older information. Thus, when the economy sours quickly, states are hit from both sides: spending was planned based on economic assumptions proved to be too rosy, and revenues have fallen too short to meet that spending.

#### Exacerbating the Problems

**The Ratchet Effect.** To maintain programs, taxes are more likely to be raised during a budget crunch than during a fiscal boom. If a tax increase is continued after the economy recovers, spending also increases. That additional spending then ratchets up the new base of expectations that—if it is to be maintained during a subsequent budget crunch—will require another revenue increase, repeating the cycle.

#### The Consequences of Instability: Improving Financial Management

**Instability Looks Like Bad Management.** To many observers, the results of budget uncertainty seem like poor fiscal management. Spending cuts and other cost-saving measures taken during a budget crunch cause organizational turbulence. Morale suffers as employees are laid off, as fewer workers are obliged to do more with less, as projects they are vested in are cancelled, and as pay increases, promotions, and professional development opportunities are put on hold. Policies that make exceptions to such cuts can trigger animosity among vested parties, undermine attempts to cut costs, and create

additional bureaucratic burdens.

Similarly, during budget windfalls state agencies, advocacy groups and lobbyists scramble to boost funding for their projects and procure new equipment while money is available so they can better weather the next fiscal downturn. Program funding thus becomes inherently unstable.

#### **Instability Generates Volatile Financial Management.**

Instability leads governors and legislatures to support policies that they would be unlikely to enact if the fiscal situation were more stable. Examples include:

- Preventing stable program management through wild spending fluctuations. Leaving an agency budget level in one year and increasing it by 10 percent the next year, rather than boosting its budget by 5 percent each year;
- Jeopardizing stable funding for pension systems. Making contributions to retirement funds that are first below, then above, those called for by the state's actuarial calculations;
- Causing difficulties for consumers of higher education. Increasing university tuition by more than 10 percent in a single year;
- Delaying regularly scheduled replacement plans for critical information systems and vital equipment;
- Laying off employees and denying promotions to those who merit them;
- Raising taxes.

**Budget Cuts are Painful.** Budget instability and tough fiscal times trigger difficult choices that have tangible affects. Budget cuts might result in longer lines at motor vehicles offices, delays in issuing professional licenses, cancellation of after school programs, and postponement of road repair (see the Appendix for a range of strategies that states have employed to close spending and

revenue gaps), although if services fall below levels deemed acceptable by citizens, support for tax increases to enhance them may grow.

### 3. DEALING WITH BUDGET INSTABILITY

#### Saving for a Rainy Day

State budget officials long have understood the hazards of revenue and expenditure estimating, the perils of business cycles, and their impact on the budget. To provide a cushion for lean fiscal times, 48 states have some form of budget stabilization (“rainy day”) fund. During the late 1990s boom, states did a good job of building up those budget reserves despite pressures to spend more on programs and provide larger tax cuts.

**State-Specific Solutions are the Only Answer.** Different states have varying degrees of fiscal flexibility built into their budget processes that affect how they can meet a budget shortfall. For example, when funds are left over in an agency’s budget, different options exist to deal with them. In some states such as lapsed funds are subtracted from estimated spending to determine an actual picture of budget balance. In other states, the full amount of appropriated funds is compared with available resources. Indeed, many states define balances differently from one another.

The volatility of revenues also varies considerably between states, as do the bases of their economies. A state that relies heavily on corporate and personal income taxes and has an economy dominated by recession-prone manufacturing has a more unpredictable revenue stream than a state with a large percentage of retired persons and that relies on sales taxes. Depending on demographics and how functions such as school aid or Medicaid are structured, expenditure instability between states varies also. In some states, school aid payments are based on factors such as enrollment which may not be known until after the start of the fiscal year. If enrollment exceeds earlier expectations, a supplemental appropriation may be necessary. Such differences among states mean that no national rules about balances and budget reserves are applicable; instead, states in fiscal crisis must look at their specific circumstances and the tools available to them within their own budget process and laws.

**States React Differently Depending on the Circumstances.** Factors in some states might mean that they can avoid budget problems longer than others. For example, while most states started experiencing severe budget shortfalls in 2001 and 2002, similar fiscal pain has arrived more slowly in oil and gas producing states where healthy prices provided budgets with some protection.

The most rapidly growing states, are not immune from budget instability and indeed, face unique issues that may cause it. While rapid growth stimulates these states’ economies as new factories, housing, and infrastructure is built, subsequent decline in those industries will likewise create a drag on the budgets in those states. Although a state may benefit from population growth and rapidly expanding industry, they may be affected adversely in a downturn as demand for unemployment insurance, other cash assistance, job training and Medicaid increase.

Changing circumstances also affect how state revenues respond to business cycles. The increased reliance on personal income taxes—as illustrated by the most recent boom and the explosion of capital gains—similarly has increased the sensitivity of state budgets to the economic cycles.

#### Inherent Volatility

A degree of instability is built into state budgeting, particularly on the revenue side. Changes in economic activity impact different revenue sources in several ways. A recession quickly can turn corporate profits into losses and severely diminish corporate income tax collections. Indeed, amid recession and the economic fallout of September 11, corporate income tax collections were 21.5 percent lower than states’ original estimates. Understanding the volatility of a state’s revenue structure is important in deciding the need for stabilization measures and may provide a basis for reconsidering reliance on variance types of revenue.

State officials have little control over the factors that affect the demand for state spending such as

the health of welfare recipients, the number of students who attend school, and others. The ability to stabilize spending depends primarily on controlling how much will be spent to meet needs, not on the capacity to stabilize such needs themselves.

#### Adding Flexibility to the Process

**Contingencies and Taxes.** In some instances, revenue and spending are linked to fiscal conditions. A tax reduction or rebate can be triggered automatically by a specific economic indicator, such as the rate of growth or the size of a state's balance. Conversely, an appropriation can be made contingent on the existence of specific fiscal conditions.

Contingent tax increases act as ways to force agreement between decisionmakers with different perceptions of fiscal conditions. Contingent tax rebates occur when revenues exceed a benchmark set in a state constitution or other law. Such rebates are administratively and politically cumbersome, however. They involve either the time and expense of issuing checks to taxpayers or creating a credit against tax liabilities. Rebates can be politically difficult because many taxpayers maintain that it is more expensive to collect taxes and issue rebates than to collect the tax at all.

**Contingencies and Expenditures.** Contingent expenditures are common even when specific language that makes spending contingent on future tax collections or fiscal positions does not exist. During tight fiscal times, legislatures may be asked to make supplemental appropriations which include proposals held over so they could be reconsidered based on future fiscal conditions. This may occur as a matter of course in some states: for example, funds available for capital outlays each year may be a portion of the previous year's ending balance. Thus, one year's capital budget is contingent on the prior year's results.

In some states, certain expenditures are contingent on fiscal circumstances. The amount of state employee pay increases may be tied to certain fiscal markers. Similar to contingent tax

increases, contingent expenditures offer state leaders a way to avoid certain spending, but also raise political problems.

Certain types of funds are more amenable to contingent funding than others. Releasing funds for operating costs mid-year will shift the next year's budget upward, due to annualization. One-time expenditures such as capital outlays, repayment of debts, or payments to retirement funds carry fewer side effects.

#### Mitigating the Impact of Fiscal Instability

Economic fluctuation and natural destabilizers make it impossible for state finances to operate steadily without measures in place to mitigate their effects. While most of the measures states use to alleviate budget shortfalls deal with revenues and expenditures, fiscal pain can be bad enough that it has an overly adverse impact on states' budget balance. Because nearly every state requires that its budget be balanced at the end of the fiscal year, states use a variety of methods to maintain a positive ending balance.

**Debt.** The prudent use of debt is one way that states can moderate the effect of instability. Most state officials agree that borrowing to meet operating costs is a bad habit that might be turned to too often when budgets soften. As a result, most states have constitutional prohibitions against borrowing to meet operating expenses. The states that use such short-term debt typically do so within a limited set of circumstances, such as for deficits that arise after a budget is balanced, or for seasonal cash flow needs.

**Understanding General Fund Balances.** The balance is not the difference between revenues and spending. The difference between current year revenues and current year expenditures is what many people refer to as a surplus or deficit. Most states look at their balances differently, however. For states, the ending balance is the cumulative result of all revenues and spending over time. When funds are left over at the end of a fiscal year they are carried over to the next (or at least a portion of them are, depending on the state and whether any of those funds were previously

committed to other functions). State debts for capital outlays are maintained outside the general fund and do not affect the ending balance.

Reported balances are not cash balances. When state officials report that they finished a year with a zero balance that does not mean that the state has no money. State balances are not equivalent to the net worth reported on corporate balance sheets, although a state following generally accepted accounting principles (GAAP) would show what amounts to a net worth figure. Further, state balances are not necessarily amounts left over from one year that can be spent in the next. Different states define ending balances in different ways or have different targets for them. In some states, the ending balance target is large; if it is missed the state will not have sufficient funds to pay its bills. In other states, the target balance is zero, indicating the absence of a surplus. Treatment of this subject by the media suggest that a state with a balance of 1 percent of expenditures is necessarily better off than a state with no balance. But if one state has defined its balance to mean that it needs 1.5 percent of expenditures to avoid a cash crunch, and another has defined a zero balance to leave a cash cushion, such a comparison may distort the true fiscal health of both states. To paint a more complete picture of state finances NASBO examines total balances—ending balances and the amounts in budget stabilization funds combined.

#### 4. REVENUE STABILIZATION FUNDS

##### The Economics of the Cushion

Maintaining a financial cushion increases state assets over what they otherwise would be. While a fully-funded cushion has no effect on the level of state spending or taxation, it represents funds that the state holds and does not return to the taxpayer in the form of services or rebates.

##### The Politics of the Cushion

Maintaining a financial cushion can be politically difficult. Resources diverted to a budget reserve cannot be used for alternatives such as spending increases or tax reductions. Using a budget reserve can be equally politically thorny. Other than constitutional or other legal limits on using reserve funds, decisionmakers may not agree on whether conditions are bad enough to use them or whether other methods of budget stabilization should be used instead. The pressure is great to spend all of the money coming in to provide tax cuts.

##### Rainy Day Funds

Forty-eight states have some sort of dedicated budget stabilization or “rainy day” fund available to fill gaps during fiscal downturns. For years, many budget observers consider balances of 5 percent of expenditures to be a prudent level to cushion against unexpected revenue decreases or other fiscal emergencies. While NASBO has not established its own guidelines regarding the size of budget stabilization funds, it is interesting to note that between fiscal 1979 (the first year NASBO collected such data) and estimated fiscal 2003, total balances as a percentage of expenditures average 5.2 percent.

The past two years illustrate unmistakably the role budget stabilization funds play in pulling states through tough fiscal times. While total balances peaked in fiscal 2000 at \$48.8 billion or 10.4 percent of expenditures, in fiscal 2003 they are estimated to fall to \$14.5 billion, or 2.9 percent of expenditures. Indeed, in fiscal 2002 26 states used their rainy day funds and midway through fiscal 2003, 12 states report using them already. Although in most states use of the budget stabilization fund has not insulated states

from having to take other austerity measures, they have softened what could have been far harsher budgetary blows.

Healthy budget stabilization funds and the willingness of states to use them also has implications in the credit market. Because most bonds are paid off using a states’ general revenues, the bond rating agencies look at how healthy a state’s ability to weather a fiscal crunch is—or is not. More specifically, the ratings agencies examine a state’s economic base, its general financial condition, the amount of debt outstanding and the burden it represents, and other administrative factors (such as tax and expenditure limits, professional financial management, budget processes, labor relations, and long-range fiscal planning).

While budget stabilization funds obviously do not affect states’ economic base, maintaining an adequate one can help protect them from economic fluctuations. The amount of debt states have issued previously or will in the future similarly is not influenced by the budget stabilization fund, although it provides funds states might otherwise have to borrow to face a budget crunch. Indeed, a budget stabilization fund adds assets to a states’ balance sheet.

##### Building Rainy Day Funds

The methods used to build rainy day funds vary considerably between states. Some states’ constitutions mandate that a certain percentage of revenues go to budget stabilization funds, while others have statutes that require a percentage of general fund appropriations or revenues, and some states make individual appropriations to them. Which option a state has chosen depends on the willingness of state officials to bind themselves and their successors to making contributions to the fund. It is interesting to note the potential problems that may arise from putting only the year-end balance in a stabilization fund. By doing that, building the budget stabilization fund is not based on economic performance or total revenues, but on the difference between estimated revenues and actual revenues received. Thus, even in the most prosperous times, a state that estimated a revenue windfall correctly would

not add substantially to its budget reserve. See the Appendix for detailed information on states' specific rainy day fund provisions.

#### Using Rainy Day Funds

The constitutional provisions and statutes that govern budget stabilization funds employ various methods to allow—or prevent—states from using them. In some states, using the rainy day fund requires authorization of the legislature and the governor. In others, the legislature has sole control over rainy day funds, and others use automatic triggers, or a mixture of methods. The current budget crunch illustrates how different perceptions of the fiscal situation can complicate matters. As state budgets worsened, some elected officials argued that the real problem was spending and that rainy day funds should not be used, while others contended that they should be used to maintain service levels. Further complicating the decision process was the fact that while states strive to maintain adequate reserves, they were unsure of the future economy and hesitated to use them, concerned that they might not have enough available in a slow recovery.

#### Building Balances in Other Funds

Funds other than the budget stabilization fund also may be available for rainy days and can be useful tools for states in a budget crunch. During a period of fiscal stress such as the current one, states scour every available source that might supply additional cash. Alternate sources states might exploit include self-insurance funds, legal claims reserves, tax refund reserves, and working capital funds.

## 5. NORMALIZING THE BUDGET

Budget shortfalls usually are corrected in a crisis atmosphere. As a state's finances improve, the arithmetic is simply reverse, but the politics and management option are completely different.

During budget shortfalls, the options come down to increasing revenues, reducing expenditures, drawing down balances, and borrowing. When revenues exceed baseline expenditures, the opposite options are available: reducing revenues, increasing expenditures, building rainy day funds, and paying off debt. However, although no less demanding, the management context and political pressures are completely different.

The same immediate pressure to take action when revenues falter does not exist when they recover. It is possible to reflect, set goals, establish strategies, and plan.

This does not mean that the state can meet ever budgetary demand. The regular appetites of increased funding as well as the release of pent-up demand after a period of austerity will overwhelm the available resources in any possible recovery. Many budget directors say that in some ways, the lean times are easier to manage than the fat times. When there is no money, requestors understand being told "no." When the coffers are flush, requests multiply out of proportion to the amounts available.

Indeed, it is a budget officer's role to provide some discipline in this process, and to assist the governor in setting priorities and maintaining fiscal discipline. As tempting as it is to use all the available resources for spending programs and tax cuts, the wisely-run state will exercise self-control to set its fiscal house in order.

### Restoring Fund Balances

**Rainy Day Funds.** Building the Rainy Day Fund back to its target level in a reasonable time period should be a high priority during the recovery. The considerations in building and maintaining a rainy day fund are discussed earlier in this report.

**Other Funds.** Other special funds may have been

used for budget balancing during a shortfall period. As the recovery begins, there should be a conscious determination of whether and how each fund should be replenished. States should explore the appropriate amount of each fund's balance; whether they should implement a schedule to rebuild each fund from the general fund; whether a fund's revenues should be allowed to exceed expenditures until the target balance is reached; and whether the existing sources of use of the fund are appropriate.

### Unfunded Liabilities.

Some funds may be intended to cover future liabilities. The most obvious examples are pension funds and self-insurance funds. Other examples include loan guarantee funds and construction contingency funds. There may be other unfunded liabilities for which states should consider establishing reserves; retiree's health coverage is a cost frequently mentioned in this context. The state should establish policies and timetables for restoring these reserves to appropriate levels. In some cases, actuarial or financial studies may be warranted.

### Accounting and Payment Adjustments

Many states alter the timing of payments or accounting procedures in order to increase the revenues or reduce the expenditures that fall into a particular fiscal year. Of course, these actions only improve the budget on paper, but they can carry a state through a crucial fiscal year.

When the budget improves, it is useful to examine each timing and accounting change to determine if the new arrangement is more consistent with the state's general accounting and cash management principles or if it should be reversed. Reversing the practice will "lose" money on paper during a fiscal year. For example, if a state counted 13 months of sales tax revenue to get through a lean year, it would have to count 11 months in a good year to get back on the old schedule. Tactically, it may be wise to reverse accounting and timing changes in good years, so that the method is available again during the next shortfall.

**Debt Management.**

During a fiscal downturn, a state may have increased debt of different types to help relieve the current burden on the general fund. After a fiscal crisis, it is wise to implement or review debt management policies. These guidelines generally look at projected measures of debt affordability. These might include debt per capita, debt services as a percent of revenues, and debt outstanding as a percent of personal income. The trends in these ratios then guide recommendations regarding new issuances and redemptions.

**Compensation Issues.**

Employee compensation is a large component of state budgets. During tight budgets, state employees often lose ground compared with private sector, federal, or local employees. However, the cost of catching up within one or two fiscal years may not be affordable. A well-articulated strategy could set a clear goal and spread over several years the costs of attaining the goals. In states with collective bargaining, this strategy should be an explicit element in management's proposals.

**Long-Range Budgeting**

Projecting revenues and expenditures past the next annual budget or biennium is an inexact business. Nevertheless, it is important to examine long-term revenue and expenditure trends. A multi-year budget projection may help to fend off short-term expenditure increases or revenue reductions that are not sustainable in the long term.

## **6. FACING THE FUTURE**

As the difficult and unpleasant fiscal situation in the states gives way to better times, elected officials, budget officers, and other policymakers will have the opportunity to focus on long term strategies to improve fiscal stability. There is no better time to present positive reforms than when the memory of budget shortfalls and tight fiscal times are fresh. The challenge is to avoid falling into the same cycle as the past when higher than average revenues were spent on on-going expenditures. The dramatic drop off in revenues over the last two years has certainly been worse than anyone could have predicted based on a relatively mild economic slowdown. Additionally, states acted responsibly during the boom: they built up reserves of more than 10 percent, cut taxes and in many cases held down spending growth. However, the situation reminds us that states should focus on more ways to deal with the cyclical nature of the economy and future drops in state revenues. State officials should debate and examine structural reforms that may be appropriate for their particular situations.

## **APPENDIX**

### **STRATEGIES FOR CLOSING SPENDING AND REVENUE GAPS**

General (represent the most commonly used approaches):

#### **Across-the-board cuts**

A fixed percentage cut imposed on all state agencies.

#### **Targeted cuts**

Cut state employee pay raises, eliminate or reduce funding for lower priority programs or high priority programs (e.g., optional Medicaid services, drug treatment and rehabilitation programs for prison inmates, reduce flu vaccine stockpile, reduce pay for substitute teachers, delay school start date, support for people with developmental disabilities by reducing staff or closing offices, eliminate the federally required sex offender registration program, and reduce state assistance to the aged, blind and disabled, reduce programs for troubled youth). Also, defer or cancel capital projects and much needed repairs.

#### **Budget stabilization fund/other reserve funds or borrowing against them**

Loans taken from the budget stabilization fund to be reimbursed annually until loan is paid off. Also, using reserve funds to increase the portion of pay-as-you-go capital, issuing debt for shorter periods of time, and shortening the span of time for bill payments.

#### **Tobacco settlement funds**

States may draw down or borrow from tobacco settlement trust funds or endowment funds to cover shortfalls. States can also securitize state tobacco settlement funds. States can also securitize tobacco settlement funds by issuing bonds backed by future tobacco settlement payments, in exchange for cash up-front. This strategy is short-term and future expenditures will require a steady funding source or another revenue windfall. Increased debt service, substantial bond broker commissions and fees, and other tax implications will also result.

#### **Revenue transfers**

Transfers of excess revenues from various special funds to the general fund (e.g. transfer money from the Great Treasure Hunt trust fund, which serves as a clearinghouse for unclaimed property; tap capital projects fund to make up for education funding cuts; shift money in unemployment taxes from the compensation trust fund into general fund, draw from health care account designed to pay for future benefits to retired public employees; and dip into dedicated accounts, such as insurance failure and hospital construction accounts).

#### **Layoffs, furloughs, early retirement, and hiring and salary freezes**

Removing personnel from the state payroll (layoffs) require state employees to take a specified number of unpaid days off (furloughs), and freeze all hiring or create a “freeze committee” to review every state government job opening to determine if the position can remain unfilled. Also, by allowing state workers to start collecting their pensions at age 55 it would achieve a significant reduction in monthly state salary expenses (early retirement).

#### **Travel freezes**

Suspending out-of-state travel for state government employees.

**Program streamlining and reorganization**

Restructuring and overhauling government functions to address overlapping jurisdictions, management inefficiencies, and costly administrative overhead. (e.g. closing or consolidating divisions and programs creating compliance efficiencies, costs savings, and improve relationship between the public and state government---prisons have recently been consolidating or closing and issuing early releases for less violent criminals; revamp child care programs to keep rising costs in check and to aid more struggling families; develop a commission to comb state government top to bottom to find waste and make services more efficient; pursue budgeting, fiscal, tax, and human resource policies that improve performance; re-examine basic business practices and operations including payroll, travel reimbursements, purchasing strategies).

**Cut local government aid**

Delaying or reducing payments made to local governments for specific programs (education, environmental grants), or decreasing general tax sharing. Can be used as either a short-term cash flow measure (delay of payments) or a permanent reduction in the state budget (reduced local aid).

**Privatization and contracting-out**

Private sector assumes responsibility for public services. Public-private funding is viable for a variety of highway and bridge construction projects in the state. Most commonly, public-private toll roads, although in some cases there are “phantom tolls,” or annual fees paid by the landowners who benefit from the new or expanded roadways. Also, contracting-out for personnel (e.g. retired individuals on a part-time basis).

**Tax and fee increases**

Expanding the base and increasing the rates for existing sales, personal income, corporate income, and other taxes, or raising user fees. Also, creating new taxes. Other taxes include expanding tax bases to items that are currently exempt from taxation (e.g. labor charges; auto repairs; dry cleaning; cleaning of carpet, draperies, buildings and maintenance of buildings; pest control; home security and landscaping; barbering and cosmetology; massage; tanning; tattoos, photography studio services; pet grooming; horse boarding and training; fishing and hunting guide services; golf lessons; tennis; flower arranging lessons; movie tickets; bowling leagues; cruise ships; and escort and dating services) and extending taxes that are set to expire soon. Raising user fees for services such as vehicle registration and licensing, state parks, subscriber access to online services (e.g. residents requesting uniform commercial code filings records must pay an annual subscriber fee of \$50 for an individual organization to access information), health care examination and licensing; electronic waste; vehicle environmental impact fees; and increasing college tuition. Also, eliminating sales tax vendor compensation fees. Increase excise taxes for alcoholic beverages, cigarettes, and motor fuel.

**Freeze state spending**

Unlike a cut, the freeze keeps the money in an agency’s budget but blocks it from being spent, maintaining the agency’s base budget in the next fiscal year (i.e. limiting expenditures on travel, professional services, supplies, acquisitions, and/or major repairs of the various agencies in the executive branch of state government).

**Shift tax increase burden to citizens**

To increase taxes, put it to vote by the citizens in the form of a referendum. This helps to alleviate Governors and Legislatures from negative political fallout from increasing taxes.

**Spending controls**

Cap state spending at 1 to 2 percent of the previous year’s budget. The 1 to 2 percent annual limit on

increases in the state general fund and other non-federal funds is necessary to build confidence that new taxes won't be wasted on additional programs. Other examples, would be to cap permanent fund dividend checks, restrict state spending growth to the percent of state population growth and an inflation factor, and limit the spending growth of government by establishing a revenue target based upon personal income growth that applies to both state local governments.

### Revenues (adjustments that directly affect revenues)

#### **Close corporate income and individual income tax loopholes**

Examples include closing loopholes in corporate income tax deductions that allow out-of-state companies to profit in state without paying state income taxes; putting a cap on the losses suffered in any year that a company can deduct from profits in following years to reduce state income tax; ending consolidated filings that allow multi-state companies to count losses in other states to lower their tax burden in their own state; change the law to require limited liability firms to pay franchise and excise taxes on net worth and profits just like corporations, thwarting companies that were forming LLC's to avoid paying taxes.

#### **Corporate tax surcharge**

Initiate a percent surcharge on corporate tax incentives.

#### **Change state tax filings**

Change state tax filings to reclaim revenue that would be lost as a result of congressional action, such as the depreciation-tax deduction.

#### **Delay tax cuts**

Delay the claiming of tax credit for job training expenses for two years. Also, institute a trigger rule that would postpone tax cuts in the event of a revenue shortfall.

#### **Debt finance**

Use of debt (general obligation and/or revenue bonds) to finance ongoing capital projects, freeing up cash for general fund obligations. Also, issuing short-term tax anticipation notes to offset general fund deficits. Tax anticipation notes are short-term, tax-exempt notes issued to offset general fund deficits—similar to a line of credit with a bank. For example a state government would issue short-term debt to finance fixing the roads knowing that it could repay the debt with the taxes it will receive in the next month or two.

#### **Add income tax bracket**

Add an additional income tax bracket for high-income taxpayers.

#### **Create state lotteries and gaming**

Create a state lottery or join multi-state lotteries, or increase other gaming options (e.g. increase tax on riverboat gaming receipts; increase riverboat gaming admission fee; and eliminate loss limit on riverboat gaming; require slot route operators to pay a tax on gross receipts rather than a flat fee per slot machine).

#### **Creative tax adjustments**

Implement a state sales tax (raise tax above) coupled with an earned-income tax credit to offset its regressive effects; levying a commuter tax on non-residents that work in one state and live in another; withhold state reimbursements to cities and counties by moving up a local-option sales tax that would currently be available to communities at a later date to an earlier date; removing earmarking provisions from certain taxes.

#### **Amnesty programs**

Institute an amnesty program to collect overdue taxes. Amnesty program participants agree to pay past-due taxes and fees but escape paying fines or interest. The state promises not to file criminal or civil charges against anyone who paid up during the 60-day amnesty.

**Enhance penalties**

Enhance penalties on non-filers and those that underpay taxes. Also, stiffening penalties for income tax planners who aid in filing fraudulent documents.

**Federal government assistance**

Seek assistance from the federal government to institute emergency revenue sharing (e.g. ask for additional federal money for Medicaid, road construction and terrorism); waive, reduce, or suspend state match requirements for targeted federal grant programs, especially construction programs; increase federal match rates (e.g. Medicaid); accelerate the disbursement date of Reed Act of excess unemployment insurance funds by amending the Social Security Act's Reed Act provisions (Administered by states, Disaster Unemployment Assistance provides additional financial assistance to individuals whose employment, or self-employment, has been interrupted or lost as a direct result of a major disaster. Increased numbers of eligible individuals is being projected and Reed Act funds can serve to provide additional financial assistance to eligible individuals in the affected states); release currently authorized Low Income Home Energy Assistance Program to protect the poor and the utility industry from the impact of an energy price hike (would help the retail sector, and thus, state and local sales tax revenues); Restore transferability for TANF to SSBG of 10 percent; reduce federal requirements that increase state spending, such as HIPAA; lift private activity volume cap to permit more contracting out for school construction and repairs etc.; Also, pass state provided services on to the federal government (e.g. eliminate a program within the Department of Water Resources and pass the service of providing stream channel alteration permits to the federal government).

**Enhance standards for exemptions**

Change the state's property tax exclusion provisions to now require animal waste management systems to meet certain effectiveness standards to qualify for an exclusion from the property tax base.

**Loosen legislation on local government**

Adopt a proposal to loosen limits placed on local government that will allow them to generate more revenues mitigating state financial obligations (e.g. loosen school districts' property-tax-rate limits in light of plans to cut state school aid).

**Divert a portion of the sales tax**

Divert a portion of the state sales tax (could be a half-cent or whole cent) now dedicated to another program (e.g., transportation).

**Sell or sale-leaseback**

Sell or do a sale-leaseback on certain state property (e.g. sale of state owned planes).

**Bond refinancing**

Refinance existing state bonds to take advantage of low interest rates.

**Speedup tax collections**

Require businesses to accelerate their tax payments once a year. (e.g. create a bill that would require businesses by June 25 to pay 75 percent of the taxes they expect to collect during June instead of waiting until July 20 to pay. This is assuming the fiscal year begins July 1. Payments could be made on sales taxes, use taxes, payroll withholding taxes, insurance premium fees, etc.) Also, changing the timing and collection methods for existing taxes gives state's a better opportunity to earn investment income.

**Step up donation solicitations for colleges and universities**

Encourage increased financial support from alumni, parents, corporations, foundations and other private sources.

**Develop a baseline**

The approach of developing a baseline more accurately assesses balances over a long period of time (usually five years). Under this concept, both expenditures and revenues are projected under current law. Developing a baseline and multi-year projections would highlight both cyclical and structural problems.

**Revenue forecasting**

Use consensus forecasting in order to bring together varying perspectives on the economy and thereby minimizing risks. Also, be relatively conservative in assessing revenue expectations.

**Use multi-year forecasting**

Allow decision-makers to assess the affordability of policy decisions, such as expanding programs or reducing taxes.

**Expenditures (adjustments that directly affect expenditures)****Appropriation controls**

Appropriate less than 100 percent of estimated revenues and limit expenditures to less than 100 percent of revenues, dedicating the remaining portion to a reserve fund; develop contingency budget reductions (If a revenue shortfall should occur, this would immediately trigger an action, like budget cuts, to bring the budget back into balance.

**State employee retirement and benefits adjustments**

Reduce or suspend employer contributions to the state employee retirement system for a specified amount of time or raising state employee contributions to health care plans (e.g., reduce the rates used to determine how much the state contributes to the system. The effect is much like when refinancing at a lower interest rate reduces a homeowner's mortgage payment; asking the retirement system for a short-term bridge loan; reschedule retirement contributions. Recent investment declines have increased actuarial contributions to pension systems. However, due to prior gains, pension system funding may actually be ahead of schedule; restructure contributions to the public employee's retirement system with the state agreeing to repay the money over the next 30 years and bolster inflation protection for current and future retirees beginning in 3 to 4 years).

**Delay program expansions**

Delay program expansion (e.g. delay a plan to extend Medicaid coverage to low-income parents for two years).

**Use of technology**

Use of technology (E-Governance and streamlining administrative processes) to reduce the number of FTE's and improve service delivery practices; create savings by consolidating computer systems and providing more government services online; better planning, budgeting and tracking of information technology spending; increase federal research and development funding to industry and state colleges and universities; increase commercialization of intellectual property from laboratories, entrepreneurs, colleges and universities; fostering economic development in rural areas by developing high-speed wireless internet access.

**Accounting gimmicks**

Accounting gimmicks such as artificially shifting expenditures to a later fiscal year or simply raising revenue estimates without economic justification.

**Alter end of year spending practices**

Change state expenditure practices to prevent end of year spending by state agencies.

**Use of one-time revenues**

Using one-time, non-recurring revenues to fund ongoing expenditures.

**Bond sales**

Sell bonds to finance capital spending and/or operating expenditures. Also, bond fund prior capital authorizations. If there are prior year general fund authorizations for capital projects that have not been expended, bonds can be authorized to support the project and the general funds used to support the budget.

**Defer or cut reimbursements**

Defer or cut the distribution of reimbursements for business personal property taxes or for hiring special education teachers.

**Suspend tax credits and deductions**

Scale back or temporarily suspend tax credits and deductions (e.g. new business property tax credit; homeowner income tax deductions; teacher tax credit; business equipment income tax deductions).

**Close parks**

Close state parks.

**Freeze COLA for programs and employees**

Freeze cost-of-living adjustments for programs (e.g. health and welfare programs). Also, freeze state employee annual cost-of-living adjustments for employees.

**Delay payments**

Delay pay to state employees and payments to vendors.

**Defer tax refunds**

Defer tax refunds until the beginning of the next fiscal year.

**Keep employment open**

Keeping unfilled jobs open.

**Review contracts**

Reviewing contractual services for cost savings or deferment possibilities (e.g. negotiate reductions in bank fees and all purchasing contracts, such as computer contracts).

**Cut, reducing, or suspending university programs**

Suspending college scholarship programs, eliminate or reduce programs, provide fewer and bigger classes, and use more teaching assistants instead of faculty in classrooms.

**Prolong in-state-tuition qualifications**

Make it harder for out-of-state students to qualify for cheaper tuition rates by prolonging the number of years that a student must live in the state to qualify for in-state-tuition costs. Many students qualify for in-state tuition after a year of paying out-of-state rates.

**Providing fiscal incentives to save**

Develop fiscally responsible incentives for saving money (e.g. bonuses to employees who save money, agencies get to keep a certain percentage of all money saved at the end of the fiscal year; hold chief financial officers to higher certification standards to bolstering teacher training and improving fiscal accountability at schools).

**Accelerate capital projects**

Accelerate capital projects for positive economic effect.

**Stimulate tourism**

Use of grants to local municipalities seeking matching funds for tourism and entertainment-related projects, such as convention centers.

**Reduce allotments**

Reduce allotments for all state agencies.

**Suspend training**

Suspend employee training (e.g. teacher training).

**Eliminate state-subsidies**

Dropping one of two or more state-subsidized trains.

**Material cutbacks**

Cutback on supplies, equipment (including computer system upgrades), and energy.

**Change funding formulas**

Change funding formulas based on automatic cost escalators. Usually in programs that are open-ended in costs and eligibility.

