

Introduction: State Budgeting in FY 2002: Dealing with the Bust Phase of the Boom and Bust Cycle, Again!

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There's nothing equivocal about the fiscal crisis in the states.
—David S. Broder, *The Washington Post*, May 22, 2002

In this symposium, we examine state budgeting in the context of the recession that officially began in March of 2001¹ by looking at the size of state deficits, the causes of those deficits, the “remedies” selected by lawmakers, the extent to which deficits were “fixed,” and the consequences of those remedial actions. The basic objectives of this minisymposium are to provide a portrait of the early experience of the states in the current recession and to extend the scholarship that was generated on the states’ experiences during the 1990–1991 recession.

A variety of approaches could be employed for such an examination, but the method selected here is to compare the experience of two states, Georgia and Wisconsin. These states have very different geographic locations, histories, and political cultures, and their experiences during the past two recessions have been very different. During the 1990–1991 recession, Georgia experienced a high level of fiscal stress while Wisconsin skated through it.² During the current recession, the fiscal condition of the states is reversed.

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1. James C. Cooper and Kathleen Madigan, “The Surprise Economy,” *Business Week*, 18 March 2002.

2. Russell S. Sobel and Randall G. Holcombe, “The Impact of State Rainy Day Funds in Easing State Fiscal Crises during the 1990–1991 Recession,” *Public Budgeting and Finance* 16, no. 3 (Fall 1996): 28–48. Sobel and Holcombe measure Georgia’s fiscal stress during the 1990–1991 recession as a cumulative deficit of \$3125.6 million for fiscal years 1989–1992, 34.31% of its FY 1988 budget. In contrast, Wisconsin’s cumulative deficit for the same period is measured as \$37.3 million, or 0.41% of its FY 1988 budget.

Whereas the sudden onset of the current recession seemed a surprise to many, its effects were quickly visible in the states. In January of 2002, only nine months after the recession officially began, at least 45 states were experiencing budgetary problems. According to the National Conference of State Legislatures (NCSL), the fiscal year (FY) 2002 budgetary problems were primarily the result of “anemic” revenues.³ At least one half of the states revised revenue estimates downward during the first one half of FY 2002, and, in at least half of those states, revenues failed to meet revised levels. Many states were also experiencing pressure on the expenditure side of the budget. Twenty-eight states reported that expenditures were above expected (estimated) levels.⁴

The recession that began in 2001 marks the fourth time in the past 30 years that most states have faced current year and future budget deficits.⁵ In fact, over the past 30 years, the fiscal condition of the states has swung between large surpluses and large deficits. Often described as the “boom and bust cycle” in state budgeting, this fiscal pendulum is both associated with and driven by swings in the national economy. During the early and middle stages of the boom, or economic growth phase, state revenues tend to grow at a more rapid rate than expenditures. At least in the short term, this gives elected officials the opportunity to cut taxes and raise spending without creating deficits. In the long term, however, these actions may put the state budget permanently out of balance.

During the bust phase of the cycle, state revenue growth slows—or even becomes negative—while ongoing expenditure commitments, new program requirements, and increased entitlement spending often drive spending up beyond estimated revenues. Elected officials may respond to the economic downturn by cutting spending, raising taxes, or both, in order to balance the budget. State officials may also resort to accounting gimmicks, such as pushing payments due in the current fiscal year into the next fiscal year, in order to balance the budget.

The size of state expenditure cuts and tax increases required during the “bust” period of the business cycle depends on several factors, including the amplitude of cyclical fluctuation and whether past policy decisions made by state lawmakers have created a structural imbalance between state revenues and expenditures. If the recession is mild and a state has no structural deficit, state lawmakers may be able to fix the cyclical gap between estimated revenues and expenditures with modest adjustments to expenditures, revenues, or both. Where cyclical effects are large and piled on top of underlying structural deficits, however, the budgetary “medicine” is much more difficult to swallow.

3. National Conference of State Legislatures, “State Fiscal Outlook for FY 2002: January Update” (February 2002), 1.

4. *Ibid.*

5. Cooper and Madigan. The three previous national recessions were: November 1973–March 1975, July 1981–November 1982, and July 1990–March 1991.

During the 1970s, 1980s, and 1990s, scholars, journalists, and state lawmakers identified a variety of ways in which the boom and bust budgetary cycle in states could be smoothed out. For example, the Rainy Day Fund has been widely recommended as a device for ameliorating the cyclical effects (particularly on the revenue side) that states experience during recessions. Another commonly recommended antidote is that state lawmakers exercise “self-discipline” during good economic times. Specifically, lawmakers have been urged not to allow expenditure increases to exceed the rate of inflation or the rate of revenue growth. Lawmakers have also been urged to reduce expenditures commensurate with tax cuts, if they decide to cut taxes.

Recent scholarship on state budgeting during the 1990–1991 recession includes a number of interesting comparative studies, as well as several interesting case studies. The comparative studies consist of investigations of whether states had Rainy Day Funds in place when that recession hit, the extent to which those funds helped to reduce the negative effects the recession had on state budgets, the extent to which states are vulnerable to high, medium, or low levels of fiscal stress during a recession, and whether a particular percentage of a state’s budget must be set aside in Rainy Day Funds in order to make these funds effective instruments of countercyclical policy.⁶ The case studies provided more detailed background on the experience of individual states, and they served as useful complements to the comparative studies.⁷

The minisymposium provided here is designed to extend scholarship on state budgeting during times of fiscal stress. As noted earlier, the focus of these studies is Georgia and Wisconsin. Here is a brief overview of some of the differences between the two states that are covered more extensively in the articles that follow. First, during FY 2002, Wisconsin was among the ten states that experienced the greatest degree of fiscal stress while Georgia appeared to be among the ten states least affected. Second, Georgia’s governor decided not to use the state’s Rainy Day Fund to balance the FY 2002 budget, even though he could have drawn upon a substantial balance in that fund. In contrast, Wisconsin’s governor and legislators certainly would have used up most or all of the money in the state’s Rainy Day Fund to offset the effects of the recession in FY 2002, but there were no funds to employ.

Third, experiences in the previous recession may have contributed in interesting ways to the different circumstances of the two states in FY 2002. For example, the mild effects of the 1990–1991 recession may have lulled Wisconsin’s lawmakers into believing that

6. See Philip G. Joyce, “What’s So Magical about Five Percent? A Nationwide Look at Factors that Influence the Optimal Size of State Rainy Day Funds,” *Public Budgeting and Finance* 21, no. 2 (Summer 2001): 62–87; Brian Knight and Arik Levinson, “Rainy Day Funds and State Government Savings,” *National Tax Journal* 52, no. 3: 459–472; John C. Navin and Leo J. Navin, “An Evaluation of State Budget Stabilization Funds among Midwestern States,” *Growth and Change* 25, no. 4: 445–466; and Sobel and Holcombe, 28–48.

7. See James D. Savage, “California’s Structural Deficit Crisis,” *Public Budgeting and Finance* 12, no. 2 (Summer 1992): 82–97; and Doug Barney, “Funding State Budgets during a Recession: A Case Study of Tennessee,” *Journal of State Taxation* (Spring 1992): 61–70.

they could get by without putting money into the state's Rainy Day Fund, while the severe effects of that recession in Georgia probably spurred state lawmakers to set money aside.

Fourth, even if Wisconsin lawmakers had put money into the Rainy Day Fund during the 1990s, these funds would only have reduced the effects of the cyclical downturn in 2001–2002. The structural component of Wisconsin's budgetary crisis during FY 2002 would not have been offset by such funds. In contrast, Georgia had neither a structural problem nor a large cyclical problem to address, and its Rainy Day Fund contained ample cash to address either one.