



NC Justice Center

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BTC Brief

▶ NC BUDGET & TAX CENTER

June 2009

*Timely,
accessible,
and credible
analysis of
state and local
budget and tax
issues*

PEER PRESSURE: Lessons for North Carolina from How Other States are Addressing Budget Gaps

Key Findings:

- 1 - Most states with large budget gaps are increasing revenues to fill a part of the gap. In fact,
- 2 - No state with a projected gap as large as North Carolina is attempting to balance its budget with spending cuts alone.

The current recession is presenting states across the country with deep budget deficits for this fiscal year and the next. Compared to the last recession in late 2001, this recession is already deeper and projected to be longer. In the current recession, national unemployment has reached 8.9%, compared to 6.3% in the last recession.

North Carolina's economy has taken a substantial hit in the recession. The state's unemployment rate is 10.8%, well above the national average. In addition, North Carolina faces one of the largest current-year budget gaps of any state -- 14.9% of the General Fund budget. Only Arizona and Illinois face larger gaps for this fiscal year.

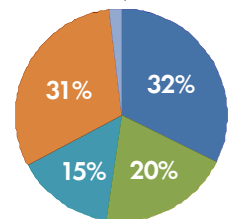
In total, across all states the budget gap for the current year represents 9.2% of General Fund budgets. The situation worsens for the next fiscal year, when the total gap represents 19% of General Fund budgets for those states projecting gaps. Most states face gaps in 2010 that represent more than 10% of their General Fund budgets. North Carolina is one of 13 states with gaps representing more than 20% of their General Fund budgets. **See Figure 8 (over).**

A Balanced Approach

Few states have passed budgets for the next fiscal year (2009-10), but almost all are now considering proposals from their governors and legislators. Sixteen states have already enacted tax increases, with another 17 considering tax increases. Most states with a large budget gaps are using new revenues to address a portion of the budget gap, and no state with a gap as severe as North Carolina is attempting to balance the budget with spending cuts alone.

For fiscal year 2009-10, several states have adopted a balanced approach to close their gaps, which has included using stimulus dollars and reserve dollars, raising revenues, and making spending cuts. New York (see Figure 1), for example, faced a \$20 billion shortfall for its fiscal year 2010-11 budget. The state cut spending by only \$6.5 billion, addressing 32% of the shortfall, and used American Reinvestment and Recovery Act (ARRA) dollars to address another 31%. State legislators covered another 20% with a three-year income tax increase on the wealthiest taxpayers,

FIGURE 1:
New York
2%



(See reverse for legend)

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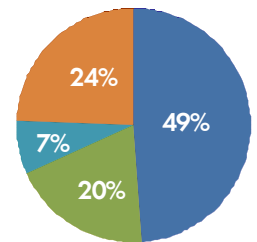
FIGURE 8: DEPTH OF THE CRISES

STATE	BUDGET SHORTFALL (billions)	SHORTFALL AS % OF GF BUDGET
California	\$33.90	33.50%
Nevada	\$1.20	31.70%
Arizona	\$3.00	29.80%
New York	\$17.90	29.00%
Illinois	\$7.00	24.70%
Connecticut	\$4.10	23.70%
Florida	\$5.80	22.60%
Washington	\$3.40	22.60%
Wisconsin	\$3.20	22.50%
Louisiana	\$2.00	21.70%
New Jersey	\$7.00	21.60%
North Carolina	\$4.60	21.40%
Vermont	\$0.25	20.80%
Minnesota	\$3.20	18.30%
Massachusetts	\$5.00	17.80%
Pennsylvania	\$4.80	16.80%
Kansas	\$1.10	16.70%
New Hampshire	\$0.25	16.10%
Delaware	\$0.56	15.30%
Georgia	\$3.10	14.50%
Idaho	\$0.41	13.90%
Rhode Island	\$0.45	13.70%
Colorado	\$1.00	13.00%
Maryland	\$1.90	12.50%
Iowa	\$0.78	12.20%
Utah	\$0.72	12.10%
Hawaii	\$0.68	11.90%
South Carolina	\$0.73	10.50%
District of Columbia	\$0.65	10.40%
Virginia	\$1.80	10.40%
Missouri	\$0.92	10.30%
Mississippi	\$0.48	9.40%
Oklahoma	\$0.60	9.20%
Tennessee	\$1.00	9.00%
Kentucky	\$0.82	8.80%
Texas	\$3.50	7.60%
Ohio	\$2.00	7.10%
Michigan	\$1.60	6.90%
Alabama	\$0.54	6.50%
Maine	\$0.18	5.80%
New Mexico	\$0.35	5.70%
Indiana	\$0.72	5.50%
West Virginia	\$0.20	5.10%
Nebraska	\$0.15	4.30%
Arkansas	\$0.15	3.20%
South Dakota	\$0.03	2.70%
Oregon	\$4.15	18.90%
TOTAL	\$133.40	18.90%

a solution supported by economists as sound policy during a recession. Renowned economists Joseph Stiglitz and Peter Orzag concluded in a paper written at the outset of the previous recession that tax increases on higher-income taxpayers are preferable to cutting spending for closing state fiscal deficits in the short run. The remaining portion of the shortfall was closed with less significant revenue actions, including increased assessment on utility companies, delaying payments, and smaller tax measures. By leveraging tax increases and ARRA money, New York legislators crafted a budget that maintains public investments at a time when they are needed most.

Legislators in Oregon (Figure 2) are considering a proposal that includes increased taxes on high-income earners as well as businesses that have not been deeply affected by the recession. While still requiring \$2 billion in cuts, they hope to raise \$800 million in new revenues and use \$900 million of ARRA money to close their gap.

FIGURE 2: Oregon



Furthermore, 44 states used revenues to close budget gaps in the recession during the early 1990s, and 30 states did so during the 2001 recession. North Carolina was among the states that raised revenues to combat the recession in 2001. The same was true of the recession in the early 1990s. By raising income taxes on the highest income earners during both recessions, North Carolina used sound economic policy to protect important public investments..

Moving Forward in North Carolina

Legislators around the country are recognizing the importance of protecting vulnerable populations by preventing deep cuts to government. By implementing a balanced approach to closing budget gaps, the states highlighted in this brief and many others are protecting the public programs that protect vulnerable populations and educate the next generation.

- OTHER STATES WITH A BALANCED APPROACH -

FIGURE 3: Arizona

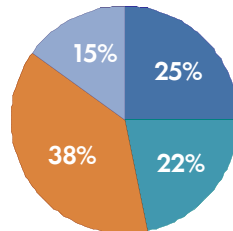


FIGURE 4: Massachusetts

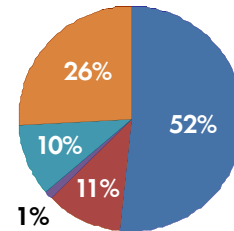


FIGURE 5: Georgia

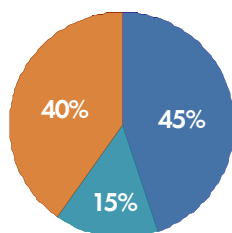


FIGURE 6: Maryland

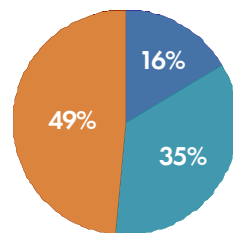
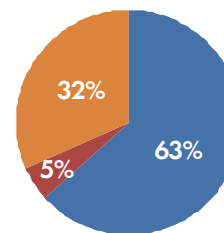


FIGURE 7: Maine



- LEGEND**
- Other Revenues/Fees
 - Sales Tax
 - Income Tax
 - Fund Sweeps/Reversions
 - Spending Cuts
 - ARRA

SOURCES: Center on Budget and Policy Priorities State Budget and Tax Briefs – <http://www.cbpp.org/research/?fa=topic&id=40>
 Correspondence with State Fiscal Analysis Initiative Organizations – <http://www.statefiscal.org/>
 Orzag, Peter and Joseph Stiglitz, "Budget Cuts Vs. Tax Increases at the State Level: Is One More Counterproductive than the other during a recession?" November 6, 2001