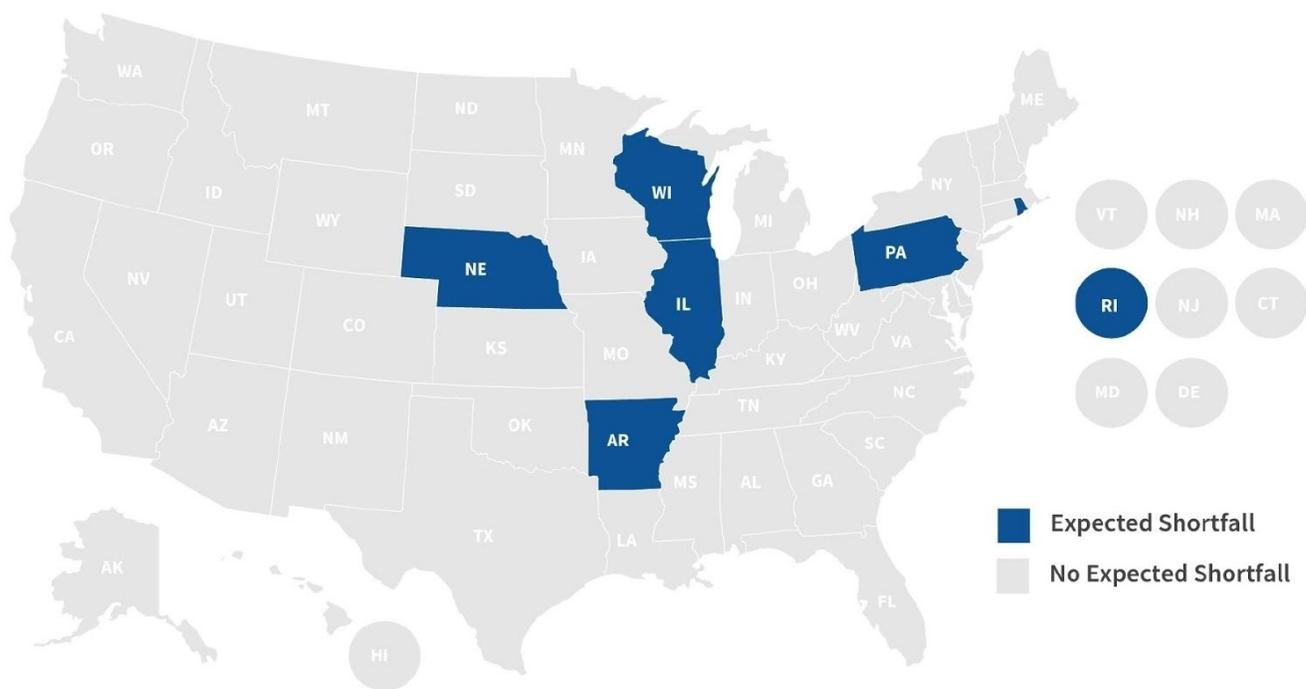


# Six States Face Revenue Shortfalls in 2019

By Ryan Maness and Morgan Scarboro

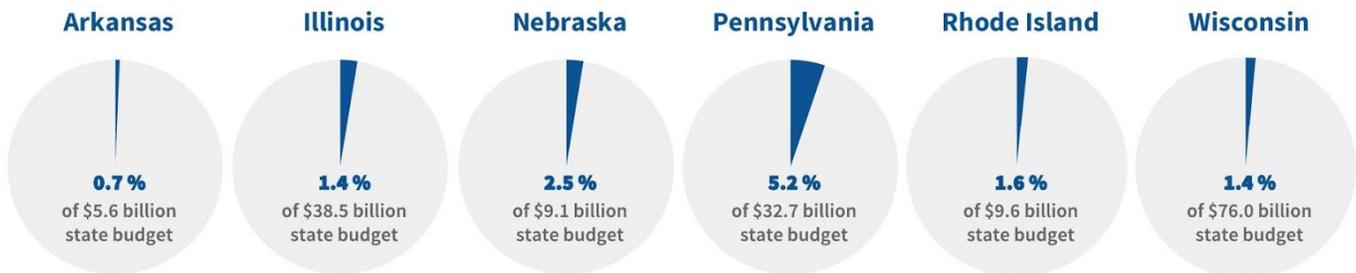
State budgets are in a strong position headed into 2019, with only six states projecting revenue shortfalls for the upcoming fiscal year.<sup>1</sup> More than four times as many states faced budget deficits in 2018<sup>2</sup> and five times as many states did in 2017.<sup>3</sup> A primary driver of this improved fiscal picture is the rise in income tax collections, which spiked as taxpayers pushed their liability to 2018 to take advantage of federal tax reform provisions. Overall, personal income taxes were up 9.8 percent in 2018 and corporate income tax revenues were up 3.7 percent.<sup>4</sup>

## States with Projected Shortfalls in 2019



Based on each state's most recent publicly available revenue projections, Arkansas, Illinois, Nebraska, Pennsylvania, Rhode Island, and Wisconsin will have to address revenue deficits during their 2019 legislative sessions. However, as a recent National Association of State Budget Officers report noted, "Budget gap projections tend to be moving targets,"<sup>5</sup> with new budget, revenue, and economic data frequently being released. This uncertainty means that this list could change over the course of the fiscal year. For example, some states, such as Alabama, will not release their updated budget projections until later this month. Other states, such as Delaware and Missouri, are not currently predicting deficits for this year, but they face challenges, such as expanding pension liabilities or flagging revenues. And, with half the fiscal year remaining in most states, other shortfalls may emerge due to lower than projected revenue or increasing expenditures.

## Revenue Shortfalls Relative to Total State Budgets



Despite this variability, monitoring early session budget gaps offers important insights into a state's potential political future. Because states are required to enact balanced budgets every year, a budget gap can upend lawmakers' legislative agendas and make closing the gap a top priority, or constrain the universe of policy issues that they're able to consider. If the gap is too large or lawmakers take too long to resolve it, they may start examining more drastic policies than they would consider ordinarily.<sup>6</sup> For example, when West Virginia faced a \$500 million deficit in 2017,<sup>7</sup> lawmakers engaged in a debate about whether to completely overhaul the state's sales tax system.<sup>8</sup> These bills ultimately died, but the fact that they were debated at all demonstrates how revenue shortfalls can drive policy priorities.

Although the current revenue picture is encouraging for economists and budget writers,<sup>9</sup> it is possible the good news is temporary. Some experts, such as the Committee for a Responsible Federal Budget, warn that the federal Tax Cuts and Jobs Act has provided a short-term economic stimulus, but that longer-term growth could be slower due to increased debt levels.<sup>10</sup> If true, this dichotomy may create a trap for states: if lawmakers use this year's surplus to fund new, multi-year programs, they may exacerbate later fiscal troubles if revenues dry up. The temptation to pass big, expensive new policies could be particularly acute for the newly elected Democratic majorities,<sup>11</sup> many of whom campaigned on promises of enacting sweeping, expensive social programs.

The key takeaway? The six shortfall states will likely have to act in the coming months to resolve their deficits and pass balanced budget plans, and this will impact legislative priorities in the 2019 legislative sessions. Their steps may include cutting expenditures (or more likely reducing the growth in expenditures), boosting revenues, some combination of the two, or using technical accounting maneuvers to wave the deficit away. More broadly, based on the warnings of an economic slowdown or recession,<sup>12</sup> every state — not just these six — should be wary of fiscally overextending themselves in 2019, or risk joining this list in 2020.

## State Highlights

### **Arkansas** | \$38.5 million shortfall<sup>13</sup> (compared to \$5.6 billion biennial budget)<sup>14</sup>

On Election Day, voters approved a constitutional amendment legalizing four Arkansas casinos, which officials say has created a modest \$38.5 million shortfall (owing to the fact that prior to this, activities in these facilities were taxed as electronic games of skill, which has a higher tax rate) in the state's budget. However, this shortfall is so small that it should not cause significant headaches for lawmakers. Governor Asa Hutchinson (R) seems confident that he will still be able to pursue his other fiscal priorities,<sup>15</sup> including increasing teacher salaries and cutting the top personal income tax bracket.

### **Illinois** | \$546 million shortfall<sup>16</sup> (compared to \$38.5 billion annual budget)<sup>17</sup>

Illinois is facing a myriad of fiscal problems headed into 2019: \$133.5 billion in unfunded pension liabilities,<sup>18</sup> a 2018 budget that, while purportedly balanced, was actually \$1.2 billion in the red;<sup>19</sup> and the continued possibility that credit agencies might relegate the state's debt to junk status.<sup>20</sup> The state's official projected deficit could increase to over \$1 billion if state employees prevail in their labor dispute against the state and could increase to \$2.8 billion<sup>21</sup> if lawmakers do not enact reforms. The Land of Lincoln has been struggling with significant budget deficits for years (decades really), but there is growing pressure for the state to enact radical tax and spending reforms. Governor-elect J.B. Pritzker (D) seems poised to take up a number of fiscal changes, including enacting a progressive income tax,<sup>22</sup> legalizing and taxing marijuana,<sup>23</sup> and expanding sports betting.<sup>24</sup> It remains to be seen whether these policies alone will be enough close the budget hole, or if more drastic measures will be necessary — but it seems unlikely that Illinois will be able to avoid a systemic overhaul of its fiscal infrastructure.

### **Nebraska** | \$232 million shortfall<sup>25</sup> (compared to a \$9.1 billion biennial budget)<sup>26</sup>

The Nebraska Economic Forecasting Advisory Board announced in October that the state is facing a \$232 million biennial revenue deficit due to slowing economic growth and lower-than-expected revenue growth.<sup>27</sup> Still, state Senate Appropriations Committee Chairperson John Stinner said he was “cautiously optimistic” that the state could resolve the shortfall by reining in spending. A tighter budget will likely make it more difficult for Governor Pete Ricketts (R) to achieve his goal of cutting property taxes,<sup>28</sup> which he has been pushing since at least his 2014 gubernatorial campaign.

### **Pennsylvania** | \$1.7 billion shortfall<sup>29</sup> (compared to a \$32.7 billion annual budget)<sup>30</sup>

Attributing Pennsylvania's shortfall to declining birth rates, a contracting labor force, and government spending outpacing revenues, the Pennsylvania Independent Fiscal Office (IFO) projects that the state must overcome a \$1.7 billion budget deficit. This is not the first time lawmakers in Harrisburg have faced a billion dollar budget hole, but their previous attempts to address shortfalls involved short-term solutions (such as transferring money from other funds and utilizing one-time moneys) that have not solved the structural imbalance.<sup>31</sup> The IFO also found that Pennsylvania's fiscal predicament would become significantly worse in the event of an economic downturn. Governor Tom Wolf (D) disagrees with this assessment, saying that the state's revenue situation is not as dire as the IFO projects.<sup>32</sup> If the conditions do not improve, however, Wolf may feel emboldened to renew his past tax change proposals, such as taxation of services,<sup>33</sup> combined reporting,<sup>34</sup> and a natural gas severance tax.<sup>35</sup>

**Rhode Island** | *\$158 million shortfall*<sup>36</sup> (compared to a \$9.6 billion annual budget)<sup>37</sup>

Governor Gina Raimondo (D) says that Rhode Island's \$158 million deficit (\$260 million over the biennium<sup>38</sup>) will constrain her state's ability to enact all of the programs on which she campaigned, including providing tuition-free college at public universities and a planned phase-out of the car tax (a local tax on some personal property, mainly autos). Citing increased municipal education aid, expanding Medicaid rolls, and the opioid epidemic, the governor said the gap was significant but that expanded sports betting and marijuana legalization could help close it.<sup>39</sup>

**Wisconsin** | *\$1.1 billion shortfall*<sup>40</sup> (compared to a \$76 billion biennial budget)<sup>41</sup>

In November, a Wisconsin Department of Administration report projected<sup>42</sup> that the state will face a \$1.1 billion shortfall if lawmakers fund all state agencies at the levels they requested. The legislature was never going to pass a budget without any agency cuts (outgoing Governor Scott Walker [R] had already warned departments to brace for spending reductions)<sup>43</sup>, but the size of the deficit suggests significant work needs to be done. During his campaign, Governor-elect Tony Evers (D) said that he was open to shoring up the state's finances by increasing taxes,<sup>44</sup> but Republicans leaders say that any tax increase proposal would be dead on arrival in the legislature.<sup>45</sup>

# Endnotes

1. Data is current as of January 4, 2019. Most state legislatures will be developing full or supplemental budgets for their upcoming fiscal years, which will generally be referred to as Fiscal Year (FY) 2020. In 46 states, the fiscal year begins on July 1, 2019 and runs through June 30, 2020. Alabama and Michigan fiscal years run from October 1 to September 30, New York is April 1 to March 31, and Texas is September 1 to August 31.
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