Fiscal 2004 Begins: States in Maelstrom

by Mary Jane Freeman

Forty-six of the 50 American Federal states began a new fiscal year on July 1. At least five or six of them started Fiscal Year 2004 with no budget, or only a stop-gap measure to keep government open. Another four squeaked by, passing a budget in the wee hours of June 30-July 1. Three others saw their governors use executive powers to suspend payment of already-appropriated funds, warning that they deemed adopted budgets out of balance. Turmoil abounds as states face the worst fiscal crisis in 50 years.

In California, where the deficit ($38 billion) is the gravest and where no budget was adopted, Democratic Gov. Gray Davis had to issue an order July 1 to keep a hiring freeze in effect and eliminate all currently unfilled state positions, to save $250 million. All remaining California state workers' salaries were reduced to the Federal minimum wage, $6.25 per hour, as of July 1, by a court order mandating the action if no budget were adopted.

In Connecticut, where a brutal budget battle raged for months and the deadline was missed, Republican Gov. John Rowland is running state finances by executive decree. No grants for cities and towns, libraries, museums or pharmacies were issued. Nursing homes, mental health programs, and some hospitals won't receive any money until a budget is passed.

Nevada, as the deadline passed, adopted a partial budget, lacking sufficient funding for education. This led Gov. Kenny Guinn to file suit to force legislators to pass a tax hike that would fund education. Pennsylvania Gov. Ed Rendell cut $4 billion to prevent the adopted budget from taking effect July 1, and forced renewed debate. Deals and compromises struck in the wee hours got budgets passed in New Jersey, North Carolina, Missouri, and Rhode Island. How long these can last is a question: Days after adoption, Missouri Gov. Bob Holden used executive powers to withhold $240 million from appropriated funds. Maryland and Massachusetts Governors had already done the same, and Wisconsin's may do so too.

'An Impossible Situation'

Lyndon LaRouche, Democratic Presidential pre-candidate, in his July 2 campaign webcast, declared that the states are in an "impossible situation" as he forecast publicly nearly two and a half years ago. Legislators, he said, "can not possibly balance the budget of these states. It can't be done. . . . Take the case of California: It's way beyond that." LaRouche Youth Movement organizers brought this reality to dozens of state capitals, and provided elected officials with LaRouche's alternative to their genocidal slash-or-tax insanity: a "Super-TVA" job creation initiative. To undertake this, LaRouche reminded his audience how American System economics works: "There's only one way to deal with it. The Federal government has the power to create credit. No other agency in the United States has the legal, constitutional power to create credit. . . . [W]what is needed, is Federal funding, which would . . . the states would participate in, for infrastructure projects."

Budget battles intensified in legislatures as revenues plunged. At least 16 states have held special sessions since January, to slash budgets and/or hammer out new ones. The upheaval began in January when expected revenues fell short by $26 billion (cumulatively, for all states). By fiscal year's end, 37 states had cut their FY 2003 budgets by a combined $14.5 billion, on top of the nearly $49 billion which had been cut from those budgets before adoption in July 2002). All told, states juggled a revenue gap of nearly $80 billion in FY 2003.

How did they do it? According to a recent national survey, 28 states made across-the-board cuts to services and programs; 17 laid off state workers; 10 furloughed workers without pay ("temporary layoffs"); and 10 cut aid to localities. Ten states hiked fees to increase revenues; 22 tapped rainy-day funds. Medicaid's health insurance coverage was cut. Finally, states borrowed $224 billion in FY 2003—double the 2001 level—to cover everything from salaries, to capital projects, to debt service payments.

At a Dead End

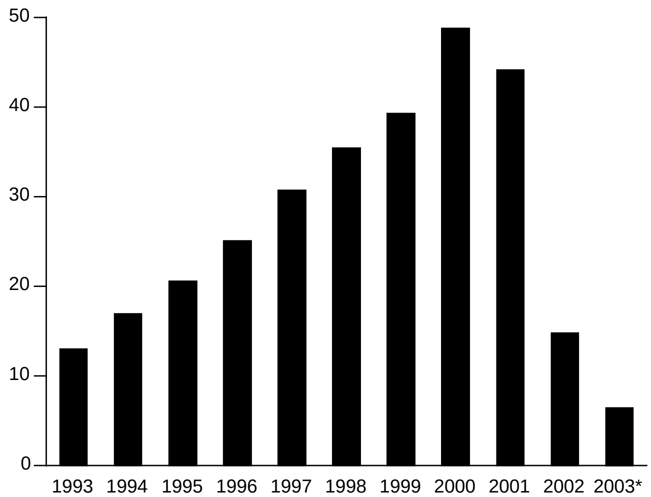
To pass 2004 budgets has been no small task. In 2001-03, states suffered a $200 billion revenue loss, due to the collapse of the productive economy, which threw millions of workers out of jobs; and to states' foolish previous reliance on revenues from the speculative economy.

The lack of a real wealth-generating, productive economy is epitomized by the near-insolvency of California's unemployment insurance fund. On July 3, the state's Employment Development Department announced it will raise unemployment taxes by a record 51% to stem losses. The fund dropped from $5.6 billion in 2001 to $2.9 billion in June 2003, a 48% decline in three years! The tax increase will raise employers' premiums to 6.2% on the first $7,000 of a worker's pay, or $434 per employee. The collapsed job market, putting more people on unemployment for longer periods; and higher benefits paid, especially to the high-tech employees who have lost their jobs *en masse;* have combined to cause rapid draw-down of the fund. Should the tax hike fail to stem the rate of loss, California may, for the first time in its history, have to borrow from the Federal government to pay benefits.

FIGURE 1

States' Total Reserve Balances Plummet as Speculative Economy Crashes

($ Billions)



* Estimated.

Source: NASBO June 2003 Fiscal Survey of States.

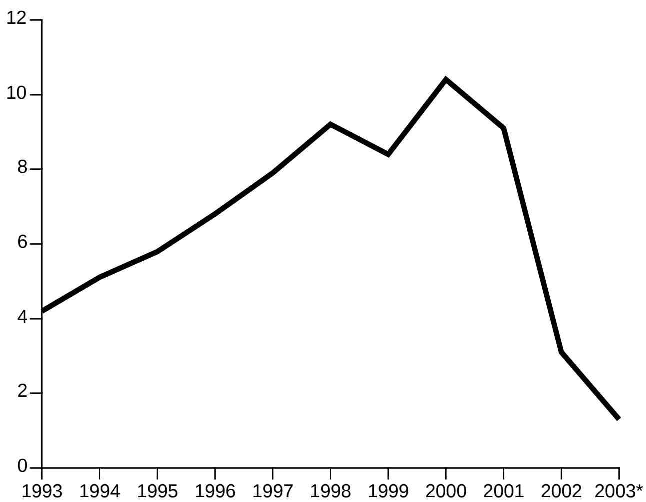
Going into FY 2004, the cumulative projected revenue shortfall of all the states was $80 billion-plus. Since states must have balanced budgets—no deficit spending—that meant slashing budgets. But that wasn't enough. Rainy-day funds had been largely drained; one-time revenue fixes from tobacco settlement or other sources had been used up.

This end-game situation is reflected in the drastic collapse of states' total reserve balances. These balances include year-end balances, rainy-day funds, and other special funds for unforeseen events. **Figure 1** shows that during the high-flying 1990s speculative binge of taxable capital gains, states built up reserves. They peaked in FY 2000 at $48.8 billion. But then the New Economy's bubbles burst, and with no buildup of the manufacturing base whereby regenerative revenues could have been created, these reserves were liquidated. They dove from $48.8 billion in 2000 to an estimated $6.4 billion in 2003—a whopping 87% decline.

A safe ratio of reserves to expenditures is a minimum of 5%. **Figure 2** shows the ratio has plummeted to 1.3%, based on 2003 estimates.

States without budgets as of July 1 have already felt the consequences of their delay; inability or difficulty in borrowing money in the face of growing shortfalls. Moody's credit-rating agency downgraded Connecticut's state bond ratings from AA-2 to AA-3, saying the state's "balance sheet will remain weak at least over the next few years." The Fitch agency has Connecticut on a watch list due to its "very high

FIGURE 2
States Reserve Balances Collapse as Percent of Expenditures
(Percent)



* Estimated.

Source: NASBO June 2003 Fiscal Survey of States.

debt" level and weak job growth. Similarly, in California, Standard & Poor's and Moody's issued downgrade warnings for the state's already low credit rating. Moody's said the warning was due to the "political climate" of the budget debate and recall efforts targetting Governor Davis. A local newspaper wrote, "Moody's . . . could drop California from A2 to 'the Baa category,' that is regarded as junk-bond status."

For California, Wall Street's move has serious consequences: 1) the state would have to pay a $33 million penalty to eight banks that just guaranteed an $11 billion loan, to tide it over the Summer months; 2) market value of the states', cities', and counties' bonds would fall by perhaps 10% or more; and 3) bankers have told Davis that without a budget by July 15, a $3 billion loan needed by the state in August, may be delayed. With or without the downgrade, California has entered into a deadly loan-debt to loan-debt cycle. The recent $11 billion loan was largely needed to pay back a $12 billion loan taken out last Fall.

More Pain, or Prosperity?

Just how dire the crisis is, was suggested by National State Budget Officers Association executive director Scott Pattison, who was quoted in the *Washington Post:* "Here comes the bleeding, the real pain. We've crossed the line where this has lasted long enough and the budget shortfalls are deep enough that states really do have to do painful actions, whether it's [to] cut politically popular programs or raise taxes."

Such so-called solutions are nothing but fascist austerity with ideological spin one way or the other. Republicans insist on "no new taxes," and cut programs. Democrats want tax hikes, and no cuts. Both are no-win options—this is not a state problem.

The problem is the imminent collapse of the world monetary-financial system. In the current situation, the depression reality has nearly all states both slashing *and* taxing, in hopes of managing the hemorrhaging; whereas in recent recessions of 1981-82 and 1990-91, two-thirds of states increased taxes, and one-third cut budgets.

A bittersweet irony of President Bush's tax-cut "stimulus" package is that, while he claims he'll put dollars in Americans' pockets, 29 governors have asked for tax and fee hikes in their plans for 2004 budgets. California and Pennsylvania would increase personal income taxes to rake in $2 billion each in new revenue. Fifteen states plan to raise sales taxes, while 19 plan to hike fees on everything from driver's and fishing licenses, to motor fuels, cigarettes and alcohol, and nursing homes.

Contrast this approach to that of economist and candidate LaRouche. He noted the quandary: "Forty-six, at least, of the 50 states are in a virtual state of bankruptcy: They can not raise the taxes to balance their budgets! And if they don't, something is going to collapse inside the state economy." At his July 2 webcast, LaRouche pointed to the way out of the mess. "Look at the state budget as a total state budget—not just a state budget, but the total income of the state. Look at it from a physical standpoint first, rather than money first."

Using FDR's Reconstruction Finance Corp. as a model, he called for "the Federal government . . . to create credit." The states would participate in a "special fund outside the regular budget, . . . for infrastructure projects: water projects, transportation projects, things of that sort, which are long term—15-, 25-year investments."

This, LaRouche said, "will create employment [and] production. So the trick here is to increase the total employment level, to the level that the income of the population is now able to pay the bills of the state."