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Deepest state deficits in 50 years

States are poised for another round of belt-tightening next month, but they're rapidly running out of notches.

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WASHINGTON - A visit to the website **stateline.org**, which tracks news from the states, can be a sobering experience. Here's a sampling of recent headlines:

From Oklahoma, "State plans for cuts up to 20 percent."

From California, "More cuts face lawmakers."

From Kansas, "Budget woes cut deep: Services for elderly, disabled will be reduced."

When governors, many of them newly elected, and state legislators get down to business next month, they will face a sea of red ink in their budgets, and few pain-free solutions. Those on the front lines who will feel the cuts most are working poor families, children, and the elderly.

Two Republican governors - Mike Huckabee of Arkansas and John Rowland of Connecticut, both fiscal conservatives - and one Democrat, Jim McGreevy of New Jersey, have already proposed major tax increases. Many states have already cut their budgets down to the bone and are draining their "rainy day" funds and money from the national tobacco settlement.

These state deficits are the largest in more than 50 years, say budget-watchers. Already this year, states have grappled with nearly $50 billion in shortfalls and now face an additional $17.5 billion deficit before the fiscal year ends. In the next fiscal year, beginning July 1 in most states, the deficits will run between $60 billion and $85 billion - between 13 percent and 18 percent of state expenditures.

"It's a long-run structural problem, and it's going to take states - [with] maybe even some help from the federal government - a number of years to work their way through it," says Raymond Sheppach, executive director of the National Governors Association. The situation is different from the last recession, in the early '90s, when the economic recovery solved the problem, he adds. "That's just not going to happen this time."

The problem, simply put, is that tax revenues are way down and costs are exploding, particularly in healthcare, which represents 30 percent of state budgets. Eleven states have cut or are considering cuts in their Medicaid programs, which provide healthcare to the poor. If they follow through with the reductions, a million low-income people will lose their health insurance, says the Washington-based Center on Budget and Policy Priorities. If additional states cut Medicaid, as expected, these numbers will swell.

States may also end up cutting education spending, resulting in teacher layoffs and increased class sizes. Highway maintenance could halt. Kentucky has gone so far as to release some prisoners early. Other states are slowing down prosecutions, because there is no room in the courts or the prisons.

Tax increases are another obvious measure, but there's not a lot of enthusiasm for that. For new governors, there's an advantage: You can blame your predecessor. "But the downside is you don't want your first action as a new governor to be to raise people's taxes," says Nicholas Jenny, state fiscal analyst at the Nelson Rockefeller Institute of Government in Albany, N.Y.

"The philosophy has changed a lot among governors and legislators ... partly because of what happened to some of the people who raised taxes in the early '90s. [Former Gov.] Jim Florio of New Jersey is the great example of that - the backlash against him was very severe."

What's left is for governors to appeal to Washington, hat in hand. While 49 of the 50 states are barred from running deficits, the federal government faces no such prohibition. Besides, governors argue, the states owe at least part of this crisis to Washington, which has saddled them with unfunded mandates in education, healthcare, election reform, and homeland security. After 9/11, President Bush and the Congress promised $3.5 billion to the states to help train and equip "first responders" - police, firemen, rescue workers. Congress has yet to authorize the money.

Bush's 10-year tax cut has also cut into state revenues, because of the links between state and federal tax codes.

To start, the governors want a one-time subsidy of $12 billion to cover the states' portion of Medicaid costs. So far, Washington has not been inclined to help. In the Congress that just ended, a bipartisan Senate plan to help the states died for lack of support from the White House and the House of Representatives.

But when the 108th Congress convenes, just as governors and state legislatures sit down to start drawing up their 2004 budgets, the level of urgency will be a lot higher.

Presidential politics could also intervene as the 2004 election approaches: If electoral-vote-rich states such as Pennsylvania and Michigan are perceived as being ignored by Washington, the Republicans could feel the heat.

Some conservatives argue that a period of fiscal stringency would be good for the states, forcing them to act more like corporations. Stephen Moore, a proponent of supply-side economics, cites the case of Michigan in the early '90s, when Gov. John Engler (R) took office amid a recession and a budget deficit. Engler cut spending and taxes, and the state economy boomed.

Experts on state budgets say the analogy doesn't work. The magnitude of the current crisis is so large that retiring the next round of expected deficits just through budget cuts is impossible.

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