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NCSL FISCAL BRIEF: TOP FISCAL ISSUES FOR 2011 LEGISLATIVE SESSIONS

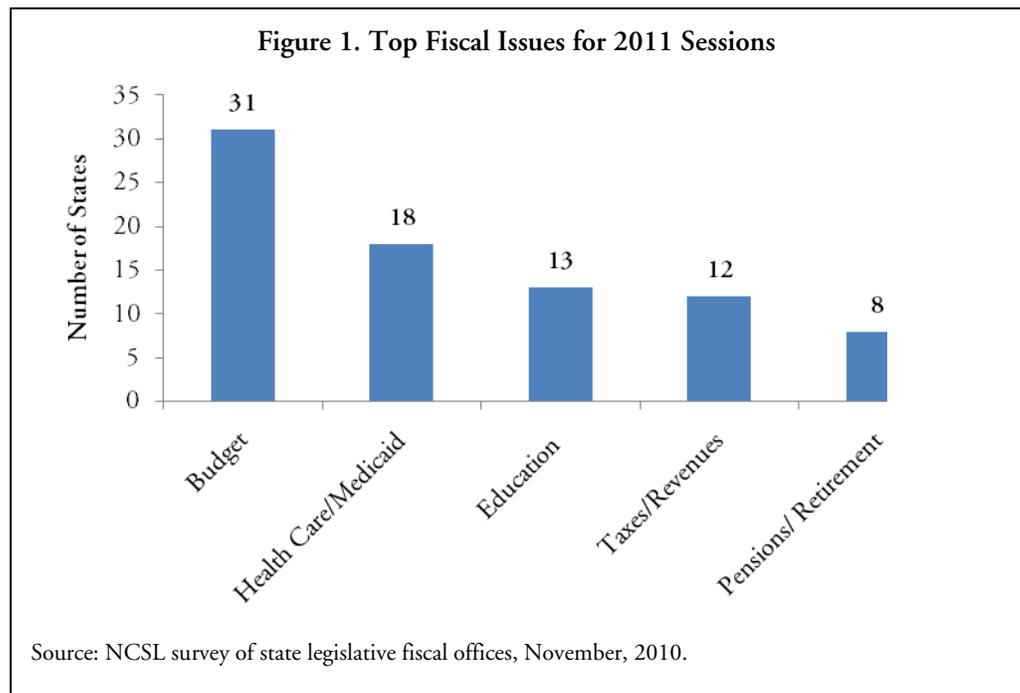
January 3, 2011

Although a recovering national economy is helping stabilize state revenues in fiscal year (FY) 2011, serious fiscal challenges await state lawmakers in their 2011 legislative sessions. Diminishing federal stimulus funds, slow revenue growth and spending pressures have opened new budget gaps totaling \$26.7 billion this fiscal year. And a cumulative gap of \$82.1 billion is estimated for FY 2012.¹

Closing new budget gaps is but one of the significant tests officials face in the new year.

Legislative fiscal directors are keenly attuned to the fiscal pressures confronting their states, which is why NCSL asked these experts to identify the top three fiscal issues their states expect to address in the

2011 legislative sessions.² With large budget gaps on the horizon, it is not surprising that the budget is anticipated to top legislative agendas in two-thirds of the states (see figure 1). Concerns about Medicaid, education, revenues, and pensions also loom large for what is expected to be a very difficult budget year ahead.



¹ *State Budget Update: November 2010*. National Conference of State Legislatures.

² Alabama, Florida and Kentucky did not provide information for this report.

Budgets

Fiscal directors in 31 states indicated that addressing the budget will be the top fiscal priority in 2011 sessions. Concerns about budget shortfalls, structural gaps and diminishing federal stimulus funds are expected to capture the most attention.

- Georgia reports that the loss of ARRA funds will require some additional budget reductions to offset the deficiency.
- Officials in Minnesota report that budget problem is so large that is hard to imagine other distinctive fiscal issues.
- In Montana, balancing the budget while prioritizing state funded services and funding K-12 education, in a manner that does not incur litigation, will be a significant challenge.
- Officials in Tennessee indicate the need for balancing recurring expenditures with recurring revenues. One-time funding from ARRA and reserves has been used to address budget gaps as reductions were being phased-in over the last three years.

Medicaid and Other Health Care Related Costs

Medicaid and health care costs will be priorities in 18 states. Issues to be addressed include enrollment and utilization growth, the reduction in the Federal Medical Assistance Percentage (FMAP) and implementation of federal health care reform.

- Officials in Arkansas reported that the Medicaid program, both in terms of expenditures and number of beneficiaries served, continues to grow at an accelerated rate.
- Idaho indicates that, with the loss of enhanced FMAP, a major issue will be how much of the funding loss will be borne by cuts in Medicaid.
- Massachusetts reports that Medicaid costs continue to escalate, and after FY 2011 there will be no enhanced FMAP to offset growth.
- In Missouri, Medicaid spending is expected to rise by \$200 million, which would require revenues to increase 3 percent to cover the growth.

Education

Education will be another fiscal priority in 13 states. Discussions will center on adequate funding levels, school finance formulas and increased student enrollment.

- Officials in Connecticut note that education funding remained flat the last two years when stimulus money was available. These funds will be gone in FY 2012, but the demand will be higher.

- In New Hampshire, the cost of education is driven by formula. The Legislature is expected to revisit the formula and/or propose a constitutional amendment.
- Oklahoma reports that maintaining the current education budget without stimulus funds will be difficult.
- In Utah, state officials indicate that next session the Legislature will face even more enrollment growth and will need to make-up the current year's structural deficit in public education.

Taxes and Revenues

Twelve states expect tax and revenue issues to dominate legislative discussions. The focus for most will not be tax increases, but an examination of existing tax and revenue structures.

- In Georgia, a special council is examining the state's tax structure for potential adjustments to be considered during the 2011 session.
- Officials in Missouri indicate that revenues have experienced significant declines the last two years and have fallen back to FY 2005 levels.
- Puerto Rico reports that the government is implementing tax reform over six years, which will lower average individual income taxes by as much as 50 percent in some cases.
- In Virginia, the governor has made the privatization of state-owned liquor stores a top priority.

Pensions and Other Retirement Issues

Also garnering top attention in eight states are pension and retirement issues. Addressing unfunded liabilities and enacting significant reforms may lie in the year ahead for state lawmakers.

- In Alaska, pension costs are increasing rapidly. Without intervention, by 2015, annual costs will approach those of K-12 education and Medicaid.
- Officials in Kansas note that the unfunded pension liability continues to increase, which may require higher employer contributions or revised benefits.
- New Jersey reports that state administered retirement systems are underfunded. State payments (as an employer and on behalf of local school districts) are at zero.
- Due to a looming pension crisis in Pennsylvania, state officials anticipate that there will be an increase in pension costs of approximately \$1.7 billion.

Other Fiscal Issues

Other top fiscal issues include the level of state employee benefits and compensation, the potential insolvency of state unemployment trust funds, transportation and other infrastructure projects and managing or replacing rainy day funds.

- In Delaware, the employee share of health insurance costs was subsidized by the general fund in FY 2011, and will have to be addressed in FY 2012.
- Officials in Colorado report that the Unemployment Insurance Trust Fund is insolvent. It is expected that proposals to address this will be debated during the 2011 session.
- Maryland reports that a commission is reviewing options for supporting mass transit and highway needs.
- In Texas, officials indicate that the rainy day fund balance is likely to reach \$9 billion by 2012. The Legislature will need to balance the use of these reserves with spending reductions so that sufficient reserves are available in the future.

All of these issues underscore an unfortunate fact: lawmakers' endurance to resolve extraordinary fiscal problems will be tested yet again in 2011.

Table 1. Top Three Fiscal Issues to Be Addressed in 2011 Legislative Session

| State | Issue | Comment | Issue | Comment | Issue | Comment |
|------------------|-------------------------|--|--------------------------|---|-------------------------|--|
| Alabama (N/R) | | | | | | |
| Alaska | Pensions/ Retirement | State costs are increasing rapidly. Without intervention, annual costs will approach those of K-12 and Medicaid by 2025. State officials are currently exploring solutions. | | | | |
| Arizona | Budget | Resolving FY 2011 and FY 2012 budget shortfalls. | | | | |
| Arkansas | Education | Arkansas courts have held that adequate education must be provided to all school children on a substantially equal basis. It is the state's responsibility to define adequacy, assess, evaluate and monitor the education opportunities being provided and determine how state revenues are being spent. | Health Care/ Medicaid | The Medicaid program, both in terms of expenditures and number of beneficiaries served, continues to grow at an accelerated rate. | | |
| California | Budget | In the November 2010 Fiscal Outlook, the Legislative Analyst's Office recommended that the Legislature adopt a multi-year approach to addressing persistent budget deficits using a mix of on-going and temporary budget solutions. | | | | |
| Colorado | Budget | Addressing the budget shortfall. | Taxes/ Revenues | The General Assembly enacted a package of bills that rolled back sales and use tax exemptions and limited some income tax incentives during the 2010 legislative session. It is anticipated that the repeal of these bills will be a focus in the 2011 session. | Unemployment Trust Fund | The Unemployment Insurance Trust Fund is insolvent. It is expected that proposals to address this will be debated during the 2011 session. |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
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| Connecticut | State Employees | The state will again enter negotiations to reduce employee costs and benefits, including about \$50 billion in long-term liability. | Education | Education funding remained flat the last two years when stimulus money was available. These funds will be gone in FY 2012 but the demand will be higher. | Health care/ Medicaid | Medicaid continues to require the single largest increase of all accounts; however, the enhanced match from ARRA will be gone. |
| Delaware | State Employees (extra pay cycle in FY 2010) | The state is on a bi-weekly payroll, so every 11 or 12 years there is a 27th pay cycle whereas all other years it is 26 pay cycles. The extra pay cycle has an estimated cost of \$50 million. | State Employees (health insurance) | The employee share of health insurance costs was subsidized by the general fund in FY 2011 and will have to be addressed in FY 2012. | Bond Bill | Requires general funds to augment bonding authority. |
| Florida (N/R) | | | | | | |
| Georgia | Budget/ End of ARRA | The loss of ARRA funds will require some additional reductions to offset the deficiency. | Taxes/ Revenues (reform) | A special tax study council is examining the state's tax structure for potential adjustments to be considered during the 2011 session. | Lottery | Lottery-funded program expenditures have exceeded lottery revenues for the first time. The Legislature will examine revenues and programs to restore balance. |
| Hawaii | Health Care/ Medicaid | The state could see Medicaid increases of over \$100 million just accounting for the general fund portion of these increases. These are primarily utilization and benefit cost increases, not related to FMAP changes. | State Employees (collective bargaining) | Another round of collective bargaining is beginning. Two day a month furloughs are projected to end when the current contract ends on June 30, 2011. In addition, the employee's share of EUTF (health fund) premiums and a rate increase for health premiums is still undecided. | Budget/ End of ARRA | The end of federal stimulus funding, primarily the State Fiscal Stabilization Fund for the Dept. of Education and the university, is going to require roughly \$60 million in general funds alone. This does not count any increase because of FMAP changes. |
| Idaho | Taxes/ Revenues | Determining whether or not there is any interest in raising taxes. Taxes have not been raised since the economic downturn and there is no support to raise them now, even with the loss of stimulus and reserves. There is minimal discussion of raising sin taxes. | Health Care/ Medicaid | With the loss of enhanced FMAP a major issue will be how much of the funding loss will be borne by cuts in Medicaid. | Education | Public schools took a 7.5 percent total fund cut in FY 2011. With public schools at over 50 percent of the general fund budget and modest revenue increases for FY 2012, they could take significant cuts. |
| Illinois | Budget | | Budget | | Budget | |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
|----------------|-----------------------|--|-------------------------------|--|--|--|
| Indiana | Budget | | Unemployment Trust Fund | | Education | School funding. |
| Iowa | Health Care/ Medicaid | The estimated need for the Medicaid program is projected to increase by 10.8 percent in FY 2012. The projected shortfall in state funding for Medicaid is \$600 million, which is 50 percent of the estimated need. A major reason for the state funding shortfall is the loss of one-time funding used in FY 2011 for the Medicaid program. | Education | School aid is projected to increase by \$231.1 million over the FY 2011 level. This assumes a zero percent allowable growth rate. | Budget/ End of ARRA and Other One-Time Funding | Replacing non-general fund sources appropriated in FY 2011 used to fund recurring costs of general fund programs. Many of these sources (i.e., federal stimulus funds) will not be available in FY 2012. |
| Kansas | Budget/ End of ARRA | Projected revenue growth is not strong enough in FY 2012 to replace federal stimulus funding. | Education and Social Services | Social service caseloads continue to increase. Education funding continues to increase because of reduced property valuations, increased school enrollments and participation in free and reduced school lunches (all of which affect the state's school finance formula). | Pensions/ Retirement | The unfunded pension liability continues to increase, which may require increased employer contributions or revised benefits. |
| Kentucky (N/R) | | | | | | |
| Louisiana | Budget/ End of ARRA | Shortfall due to the expiration of federal stimulus support. | Health care/ Medicaid | Restructuring Medicaid health care provision and financing. | | |
| Maine | Pensions/ Retirement | A constitutionally established deadline for fully funding the unfunded actuarial liability (at the end of FY 2028) and recent investment performance has resulted in significant increases in employer contribution rates. | Health care/ Medicaid | Maine is tasked with implementing managed care for Medicaid/ MaineCare and other measures in order to manage costs in the face of growing caseloads. This is further complicated by the implementation of health care reform. | Education | Statutory language (enacted by a citizens' initiative) requires the state to increase its share of K-12 education costs to 55 percent. The achievement of this has been continually delayed. |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
|---------------|-----------------------------|---|-------------------------------|---|-------------------------------|--|
| Maryland | Budget (structural deficit) | The state continues to face a structural shortfall in excess of \$2 billion, due largely to the end of federal stimulus funding. | State Employees (benefits) | A commission is reviewing employee health and pension benefits. An interim report is expected in December 2010. | Transportation Funding | A commission is reviewing options for supporting mass transit and highway needs. |
| Massachusetts | Health care/ Medicaid | Costs continue to escalate and after FY 2011 there will be no enhanced FMAP to help offset growth. | Local Aid | Local aid has been cut substantially during this recession and there have been many calls to restore it. | Pensions/ Retirement | Pension costs for the next few fiscal years could rise due to market losses and a statutory date for full funding. |
| Michigan | Budget | Passing a balanced budget for FY 2012. | Taxes/ Revenues | Examination of the state tax and revenue structure. | | |
| Minnesota | Budget | Balancing the budget. The budget problem is so large that it is hard to imagine other distinctive fiscal issues. | | | | |
| Mississippi | Budget | Lawmakers will deal with projected general fund revenue for FY 2012 that is below FY 2007 actual collections. Crafting the FY 2012 budget will be a challenge. | Taxes/ Revenues | Legislation to increase taxes or fees will be proposed in the 2011 session. The Legislature will need to address these proposals. | Health Care/ Medicaid | Lawmakers will be faced with a growing cost of the Medicaid program and a change in the FMAP. |
| Missouri | Taxes/ Revenues | Revenues have experienced significant declines the last two years and have fallen back to the level of revenue in FY 2005. | Health Care/ Medicaid | The state is expecting growth of approximately \$200 million, which would require revenues to increase 3 percent to cover the growth in Medicaid. | Taxes/ Revenues (tax credits) | Tax credits have grown more than 400 percent since FY 1998. |
| Montana | Budget | The largest single issue will be how to balance the state's budget. Prioritizing state funded services and funding K-12 education in a manner that does not incur litigation will be two of the significant challenges. | Health Care/ Medicaid | Addressing the cost of health care with or without health care reform will be a significant issue. | Pensions/ Retirement | The retirement system is significantly underfunded. The state will need to start developing a plan to reduce the underfunding. |
| Nebraska | Budget | Construct a balanced general fund budget for the biennium ending June 30, 2013. | Budget (structural imbalance) | Reducing the structural imbalance. | Rainy Day Fund/ Reserves | Manage cash reserve fund (rainy day) assets as part of budget balancing. |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
|---------------|----------------------|---|----------------------|---|--|--|
| Nevada | Budget | With a budget gap of approximately \$3.0 billion facing the state in the 2011-2013 biennium, revenue enhancements, budget reductions, or both will be necessary. | Economic Development | Due to the impacts of the "Great Recession" on the state's economy, the governor and the Legislature may need to take action to promote economic development and to decrease the nation's highest unemployment rate. | Health Care/ Medicaid (federal health care reform) | In the midst of a massive shortfall, the state will need to evaluate whether information systems must be augmented to meet the requirements of the federal health care reform legislation. |
| New Hampshire | Budget | State spending across the board will be cut and where feasible, state reorganization will occur. | Education | The cost of education is driven by formula; however, the legislature is expected to revisit the formula and/or propose a constitutional amendment. | Budget/ End of ARRA | Replacing federal stimulus funds with additional cuts or revenue. |
| New Jersey | Pensions/ Retirement | State-administered retirement systems are underfunded. State payments (as employer and on behalf of local school districts) are at zero. The governor has called for benefit modifications and higher employee contributions. | Transportation | The current (five-year) program for financing \$1.6 billion annually has run its course; officials await a proposal from the governor to renew and/or restructure the program. No resources are in place at present to fund any capital program in FY 2012 or beyond. | Property Tax Relief (reform) | New Jersey's high reliance on property taxes for revenue results in property tax relief/reform being a perennial issue. In 2011, tighter local property tax levy caps will be in place, and both the governor's and legislature's proposals to assist local governments to cope with tighter caps will be considered. Also, the level of state support of local school districts and the level of direct property tax relief, especially for senior citizens, will be under consideration. |
| New Mexico | Budget | The FY 2012 budget gap of 4.6 percent must be addressed. Agencies outside education and Medicaid have already been cut by 15 percent. | Economic Weakness | Zero employment growth is forecast for FY 2011. | Rainy Day Fund/ Reserves (inadequate reserves) | FY 2011 ending reserves are projected at 3.5 percent of appropriations. |
| New York | Budget | Dealing with a budget gap in excess of \$9 billion. | Budget/ End of ARRA | Loss of \$5.4 billion in federal stimulus funds. | Taxes/ Revenues (sunsets) | Several large tax increases enacted over the last two years will sunset over the next three years. |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
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| North Carolina | Budget | Closing the budget gap. | | | | |
| North Dakota | Property Tax Relief | The 2011 Legislative Assembly will need to consider the continuation of property tax relief enacted during the 2009 legislative session. | Health Care/ Medicaid (FMAP Decline) | The 2011 Legislative Assembly will need to address the declining FMAP (from 64.9 percent in June 2011 to an estimated 55.4 percent for federal fiscal years 2012 and 2013). | Transportation/ Other Capital | With the substantial increase in energy activity in the state, additional funding for maintenance and expansion of state infrastructure, including roads and water-related projects, will be considered. |
| Ohio | Budget | Enacting a balanced budget for the 2012-2013 biennium. | | | | |
| Oklahoma | Budget (structural imbalance) | A significant structural imbalance is due to a lack of rainy day funds, stimulus funds and other cash sources. | Education | Maintaining the current education budget without stimulus funds will be difficult. | Health Care/ Medicaid | Growth in the program combined with a decrease in the FMAP will be difficult to absorb. |
| Oregon | Budget | Determining where expenditure reductions occur. | | | | |
| Pennsylvania | Pensions/ Retirement | Due to a looming pension crisis for the state's cost of public employee pensions, it is anticipated that there will be an increase in pension costs of approximately \$1.7 billion. | Transportation/ Other Capital | This is a non-general fund issue. | | |
| Puerto Rico | Taxes/ Revenue (reform) | The government is implementing tax reform during a period of six years, which will cut average individual income taxes by as much as 50 percent in some cases. | Budget | FY 2010 budget approval. The government will continue with the Economic and Fiscal Reconstruction Plan. | Labor Reform | A very necessary reform to obtain more competitiveness in the global world. |
| Rhode Island | Taxes/ Revenue (tax policy) | Incoming governor campaigned on a platform that includes sales tax base expansion. | | | | |
| South Carolina | Budget/ End of ARRA | Exhaustion of federal stimulus funds. | Budget | Effect of current year deficits on next year's obligations. | Taxes/ Revenue | Anemic revenue growth for the foreseeable future. |

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| State | Issue | Comment | Issue | Comment | Issue | Comment |
|--------------|-----------|---|------------------------------|---|--------------------------------|---|
| South Dakota | Budget | Determining if budget reductions are necessary, including the magnitude and across-the-board versus specific programs. | Economic Development | New cabinet-level agency will be proposed by newly elected governor. | Budget/ End of ARRA | End of federal stimulus and maintaining the level of effort for “big five” departments by reducing general funds to other agencies. |
| Tennessee | Budget | Balancing recurring expenditures with recurring revenues. One-time funding from ARRA and reserves have been used to address budget gaps as reductions were being phased-in over the last three years. Going forward, any future budget adjustments will need to be balanced with the desire to maintain a balanced budget (recurring funding for recurring expenditures). | Budget | Implications of enacted reductions. There may be interest in restoring some reduction items. | State Employees (salaries) | State employees have not had a pay increase since July 1, 2007. |
| Texas | Budget | Overall spending. Revenues are beginning to rebound but not likely at historical rates. Appropriations reductions will be necessary to adjust spending trends to match new revenue trends. | Rainy Day Fund/ Reserves | The state is fortunate to have a rainy day fund balance that is likely to reach \$9 billion by 2012. The Legislature will need to balance the use of these reserves with spending reductions so that sufficient reserves are available in the future. | Jobs | The state is producing new jobs while some parts of the nation are losing jobs. Budget and policy decisions in the upcoming session will focus on preserving the engines that promote job growth. |
| Utah | Education | The state did not fund student growth for the current year, but did provide ongoing appropriations for existing public education costs. Next session the Legislature will face even more enrollment growth and will need to make-up the current year’s structural deficit in public education. | Health Care/ Medicaid (CHIP) | Utilization increases and inflation will be exacerbated by loss of favorable FMAP rates. | State Employees (compensation) | Health insurance and retirement costs continue to increase. State employees have not seen a salary increase in two years. |

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| Vermont | Budget | Lawmakers may consider a two-year approach to deal with the budget gap. Next steps in the Challenge for Change initiative will be under consideration. | Education | Obligations to the K-12 education fund represent 50 percent of the deficit. | Health Care/ Medicaid | Continued roll out of health care reform. Next steps in state health care reform. |
| Virginia | Taxes/ Revenues | Privatization of ABC (state-owned liquor stores) activities. The governor has made privatization of ABC stores a top priority. The current plan endorsed by the government reform panel (executive) would generate roughly \$400 million to \$500 million in one-time funds, which would be dedicated to transportation. However, the plan reduces state general funds generated from ABC profits by about \$45 million per year. | Education (higher education reforms) | The governor has indicated that he will submit legislation related to higher education reform, including increasing the number of degrees produced, more investment in research and efforts to improve access and affordability. | Transportation/ Other Capital | The governor has indicated that he plans to introduce legislation to address the state's transportation funding issues. |
| Washington | Budget | Balancing the FY 2011 budget. This will likely be the first fiscal related task facing the Legislature. The governor has asked each caucus to provide a list of reduction options by Nov. 29, 2010, in preparation for a special session in December 2010. | Budget | Balancing the FY 2012 and FY 2013 budgets. This will be a large challenge and will likely involve policy and fiscal discussions in almost all areas of state government. It could lead to broader discussions around government reform, K-12 finance, human services programs, personnel related issues, etc. | Other | The broader budget discussion may result in other issues being discussed including pensions, employee benefits, K-12 finance government reform, human services programs and higher education funding. |
| West Virginia | Unemployment Trust Fund | | Pensions/ Retirement | Dealing with retirement unfunded liabilities. | Pensions/ Retirement | Post-employment liabilities such as retiree health premium subsidies. |
| Wisconsin | Health Care/ Medicaid | Medical assistance funding. | Other | Court ordered repayment of \$200 million plus lost earnings and interest from the general fund to the Patients Compensation Fund. | Taxes/ Revenues | Necessary actions if revenues do not meet the estimate. |

| Table 1. Top Three Fiscal Issues to Be Addressed in 2011 Legislative Session | | | | | | |
|---|-----------|---|-----------------------|---|-----------|--|
| State | Issue | Comment | Issue | Comment | Issue | Comment |
| Wyoming | Education | Recalibration of the current school funding model will occur. | Health Care/ Medicaid | Additional funding for Medicaid demand and reserves likely. | Local Aid | Local governments are requesting additional state aid. |
| (N/R) = No response. | | | | | | |
| Source: National Conference of State Legislatures survey of legislative fiscal officers, November 2010. | | | | | | |