Deep Cuts to Government Mark Fiscal Year 2011, Budget May Yet Be in the Red

Overview of the Final Budget

By Alan Essig, Executive Director

Summary

The "Great Recession" has resulted in Georgia facing the worst fiscal crisis in more than 70 years. State revenues have dropped dramatically over the past two years, resulting in multi-billion dollar budget deficits. Although federal Recovery Act funds have helped Georgia avoid cuts to Medicaid and limited somewhat cuts to education and public safety, most state agencies have seen their budgets slashed by 15 percent or more.

Compared to the pre-recession, Original General Budget for fiscal year (FY) 2009, the $16.6 billion FY 2011 General Budget has decreased by 17.4 percent ($3.5 billion). When including more than $1billion in Recovery Act funds, it is *$2.5 billion* less than the Original FY 2009 budget, or 12.2 percent less. Lawmakers added or expanded revenues only very slightly, barely making up at all for the dramatic loss in state revenues.

Lawmakers' strategy to slash the budget is impacting every facet of state government and is resulting in severe cuts to government services as well as layoffs and furloughs of thousands of teachers and state employees. The irony is that now, as the state is less equipped to provide Georgians services, more and more families require basic help such as food stamps, child care, post-secondary education, and job training as they also are hit hard by the Recession.

The FY 2011 budget could face additional cuts in that it may be out of balance by hundreds of millions of dollars as FY 2010 revenues continue to come in below the revenue estimate in the final months of the year and if the U.S. Congress does not extend enhanced federal Medicaid funds. Without new revenues, lawmakers will cut services even more.

Although the FY 2011 budget does take a somewhat balanced approach to deficit reduction by adding some new revenues, particularly in regards to Medicaid, most are temporary in nature. Of

great concern are new tax cuts totaling almost $250 million that will be phased in over five years and will further weaken Georgia's revenue base.

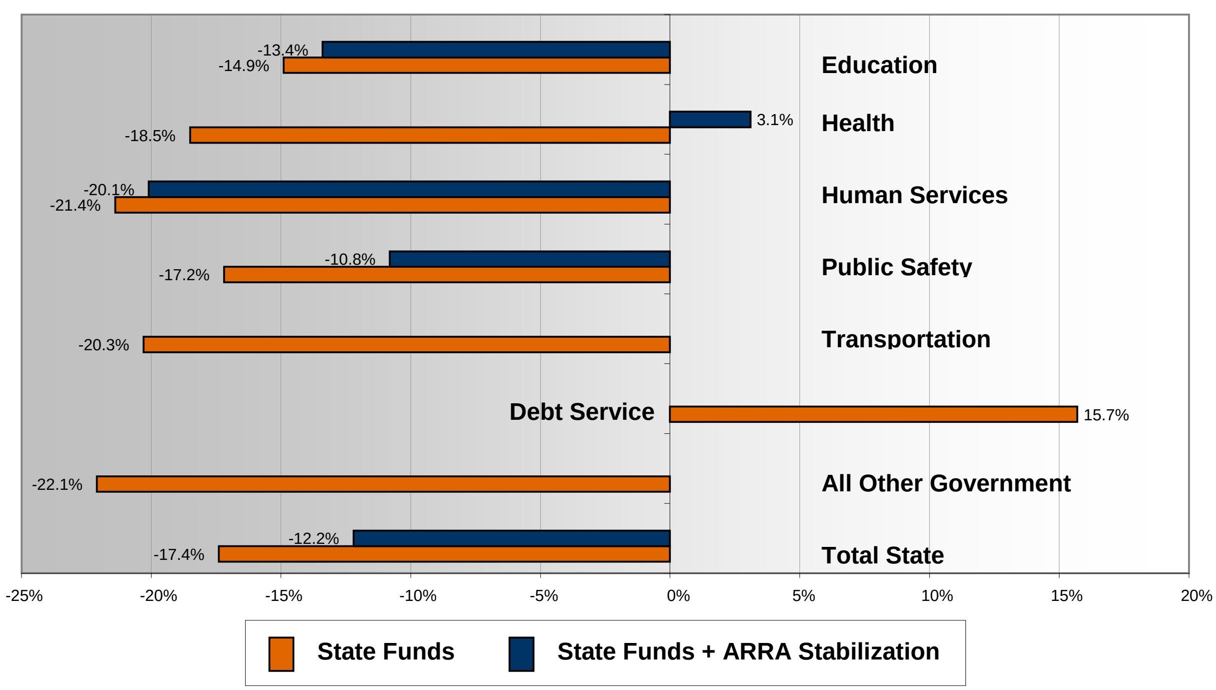
Without new revenues, additional budget cuts can be expected in FY 2012 of at least $1 billion. This is due to: normal budget growth in K-12 education, Board of Regents, technical colleges, Medicaid, corrections, etc.; more than $1 billion in federal Recovery Act funds that expire the end of FY 2011; and more than $400 million in other one-time revenues used in FY 2011 that will no longer be available. Even accounting for new revenue growth and keeping all of the existing budget cuts in place in addition to whatever additional budget cuts are needed to balance the FY 2011 budget during the year, the FY 2012 budget is facing a projected deficit of between $1 billion and $2 billion.

Beyond FY 2012, Georgia is facing a more stubborn structural deficit. Due to further erosion of the tax base, projected sluggish economic growth, normal budget growth due to a growing population resulting in an increased demand for state services, and the importance of growing the Revenue Shortfall Reserve, the existing tax base is inadequate to balance the state budget in the long-term.

FY 2011 Budget Overview

The FY 2011 General Budget totals $16.6 billion and is based on a 17.4 percent revenue decline from the Original FY 2009 General Budget, resulting in an overall $3.5 billion shortfall. It incorporates and annualizes most of the budget cuts implemented in the FY 2010 Amended General Budget. By using $1.05 billion in Recovery Act funds, actual budget cuts are $2.5 billion, or 12.2 percent of the budget (see Chart 1).

***Chart 1* FY 2011 Compared to Pre-Recessionary FY 2009 Budget: Percent Change in Funds**



Expenditures

As shown in Table 1, 96 percent of the $16.6 billion of the State General Fund is expended on education, health, public safety, human services, transportation, and debt service.

Table 1 **FY 2011 State Budget Breakdown**

	General Funds	General Funds and Recovery Act Funds
Education	55.7%	53.3%
Health	16.3%	19.6%
Public Safety	9.9%	10%
Human Services	2.9%	2.7%
Transportation	4.1%	3.9%
Debt Service	7%	6.6%
All Other Government	4.1%	3.9%

State Revenues

The budget is based on 8.7 percent increase in State General Fund revenues over the projected FY 2010 revenues (see Table 2), for a budget growth of approximately $1.3 billion; however, the budget remains overall at less than 2007 levels.

The increased revenues consist of:
1) Securitizing certain Georgia Environmental Facilities Authority (GEFA) loans for $288 million in one-time revenues.
2) Implementing a new temporary (sunsets after three years) 1.45 percent provider fee on managed care organizations and hospitals for $229 million.
3) Increasing various fees, raising $96 million.
4) Eliminating the Medicaid Care Management Organization (CMO) exemption on the existing Insurance Premium Tax for $68 million.
5) A 4.2 percent growth in revenues from those projected for FY 2010, equating to $638 million.

Included in the $638 million estimated revenue growth is $63.5 million projected to result from improving tax collections due to the following:

- Georgia has now joined the national Streamlined Sales Tax Agreement, enabling it to align definitions in Georgia's sales tax code to definitions of other participating states (House Bill 1211 passed this session). This is projected to raise $23.5 million this year.
- The legislature increased financial investments in the Department of Revenues (DOR) tax compliance and fraud prevention efforts. The legislature also passed HB 1093, which requires counties and cities to provide information to the DOR about businesses paying local occupation taxes, which will allow DOR to determine whether or not businesses

paying local occupation taxes are also collecting and remitting state sales taxes. It is projected that these actions will increase revenues by $40 million.

The FY 2010 revenue estimate assumes a 9.3 percent decline from the FY 2009 actual revenues. However, revenues through May are running 10.3 percent below FY 2009 revenues. Unless June revenues increase significantly, the FY 2010 state budget will have a shortfall of between $150 million and $200 million. Most likely, the governor will handle the shortfall by transferring federal Recovery Act Funds budgeted for FY 2011 to FY 2010. Such a transfer combined with the decrease in the FY 2010 revenues would open up a $300 million to $400 million hole in the FY 2011 budget.

Table 2 **Changes in FY 2011 Revenue Estimate Compared to AFY 2010 Estimate**

	FY 2010 Amended Budget Revised Revenue Estimate	FY 2011 Revenue Estimate	Revenue Increase/Decrease	Percent Change
Taxes and Fees	**$15.207 billion**	**$15.845 billion**	**$638 million**	**4.2%**
GEFA Securitization		$288 million	$288 million	
Managed Care/ Hospital Fee (HB 1055)		$229 million	$229 million	
Medicaid CMO Insurance Premium Tax (HB 1170)		$68 million	$68 million	
Increased Fees (HB 1055)		$96 million	$96 million	
Total General Revenues	**$15.207 billion**	**$16.525 billion**	**$1.319 billion**	**8.7%**
Lottery Funds	$1.044 billion	$1.127 billion	$83 million	7.9%
Tobacco Settlement Funds	$308 million	$140 million	-$168 million	-54.5%
Other Funds	$87 million	$95 million	$8 million	9.2%
Revenue Shortfall Reserve	$259 million		-$259 million	
Mid-Year Adjustment Reserve	$168 million		-$168 million	
Total Revenues	**$17.074 billion**	**$17.890 billion**	**$816 million**	**4.8%**

<u>State Revenue Changes in the Future</u>

Although efforts passed this year to balance the budget include new revenues, by 2016, the state will actually lose more than $475 million a year from provisions in the new laws.

- Legislation that includes the temporary new hospital fee and the increase in state fees also includes a tax cut for wealthy seniors (HB 1055). Currently, a senior's income up to $35,000 a year is exempt from state income tax, but now all seniors' income will be exempt, costing the state $150 million a year when fully phased in 2016.
- The state portion of the property tax will also be eliminated per HB 1055, costing the state $96 million a year when phased in fully.
- If not renewed, the new hospital fee will sunset in FY 2014, causing the state to lose $229 million thereafter.

Using Federal Recovery Act Funds in the FY 2011 Budget

The FY 2011 General Budget contains $1.05 billion in Recovery Act funds that help balance the budget. As originally proposed by the governor, the budget contained $1.4 billion in Recovery Act Funds. The decrease of $350 million is due to the transfer of Recovery Act funds from FY 2011 to FY 2010 in order to close an FY 2010 budget deficit prior in the year.

Without the more than $1 billion in Recovery Act funds in the base of the FY 2011 budget, thousands of teachers and state employees might have lost their jobs, and thousands of low-income pregnant women, children, elderly, and disabled Georgians likely would have joined the ranks of the uninsured. See Table 3 for a breakdown of how the state used the Recovery Act funds.

The state budget includes $748 million in an enhanced federal Medicaid match. The enhanced Medicaid match is set to expire on December 31, 2010. The state budget includes $375 million from the enhanced match under the assumption that the U.S. Congress will extend the enhanced Medicaid match for six months until June 30, 2011. As of the date of this publication, Congress has not acted on the extension. If Congress does not pass an extension and, instead of finding additional state revenues to replace the expiring enhanced match, the Medicaid program is cut by $375 million, the state would also forgo more than $650 million in additional lost federal funds that are in the state's Medicaid base budget. In total, this $1 billion loss would reduce Georgia's Medicaid program by 15 percent.

All Recovery Act funds will expire by the end of this year, therefore without additional revenues either through revenue growth of existing revenues or new sources of revenues, the FY 2012 budget will be faced with $1 billion worth of additional cuts.

Table 3 **Recovery Act Funds Supplement State General Funds**

	Governor's Original Proposal	Budget as Passed	Change
Education Stabilization Funding			
Department of Education	$342,626,224	$140,709,507	-$201,916,717
Board of Regents	$140,205,158	$23,186,142	-$117,019,016

Technical College System	$23,690,491		-$23,690,491
Total Education Stabilization Funding	**$506,521,873**	**$163,895,649**	**-$342,626,224**
	Governor's Original Proposal	**Budget as Passed**	**Change**
General Fiscal Stabilization Funding			
Department of Corrections	$84,877,989	$84,877,989	
Georgia Bureau of Investigation	$6,132,772	$6,132,772	
Department of Juvenile Justice	$28,020,203	$28,020,203	
Department of Public Safety	$8,872,757	$8,872,757	
Total General Fiscal Stabilization Funding	**$127,903,721**	**$127,903,721**	
Medicaid Funding (Dept of Comm Health)	$757,081,618	$748,909,573	-$8,172,045
Other			
Department of Human Services (Title IV-E)	$7,177,918	$7,177,918	
Total Recovery Act Fiscal Stabilization and Medicaid Funding	**$1,398,685,130**	**$1,047,886,861**	**-$350,798,269**

Budget Cuts

The FY 2011 General Budget is $699 million (4 percent) less than the Original FY 2010 General Budget. Including Recovery Act funds, and accounting for their decreased use in FY 2011, the FY 2011 budget is $1 billion less than the Original FY 2010 budget, or 5.6 percent less.

However, the FY 2011 General Budget is $3.6 billion, or 17.9 percent less than the pre-recession Original FY 2009 General Budget. When including the $1 billion in Recovery Act funds, the FY 2011 budget is $2.5 billion less than the 2009 budget, or 12.2 percent less.

Without $748 million from the enhanced federal Medicaid match through the Federal Recovery Act, the Medicaid budget within the Department of Community Health Budget would not have had the funds for the increased number of Medicaid patients.

See Tables 4 and 5 below for details of how much agencies were cut between FY 2011 and the pre-recession budget, and how the Recovery Act supplements funding for Georgia state government.

Table 4 **Agency Budget Cuts From the State General Fund: *FY 2011 Compared to Pre-Recession FY 2009***

Agency	Difference	Pct. Change	Agency	Difference	Pct. Change
Judicial Branch	-$15,968,465	-9.4%	GBI	-$16,872,147	-21.8%
General Assembly	-$6,047,427	-14.5%	Juvenile Justice	-$78,672,398	-22.8%
Audits	-$5,493,158	-15.5%	Labor	-$16,282,567	-29.2%
Accounting Office	-$1,618520	-29.7%	Law	-$2,669,900	-13.6%
Administrative Services	-$3,176,636	-23.0 %	Natural Resources	-$39,773,948	-30.4%
Agriculture	-$16,727,411	-35.8%	Pardons and Parole	-$7,591,917	-13.0%
Banking and Finance	-$1,648,547	-12.8%	Public Defenders	-$2,001,012	-5.0%
Behavioral Health & Developmental Disabilities	-$56,729,896	-7.0%	Public Safety	-$34,217,156	-25.3%
Community Affairs	-$27,760,929	-52.0%	Public Service Commission	-$1,908,023	-18.4%
Community Health	-$585,334,332	-22.0%	Regents	-$366,622,155	-16.1%
Corrections	-$185,772,839	-16.1%	Revenue	-$19,419,224	-15.0%
Defense	-$3,056,093	-26.1%	Secretary of State	-$9,088,868	-22.4%
Driver Services	-$4,586,968	-7.3%	Soil and Water	-$797,996	-22.3%
Early Care and Learning	-$3,297,283	-72.1%	Student Finance	$1,202,941	3.8%
Economic Development	-$11,078,828	-28.0%	Teachers Retirement	-$558,000	-36.6%
Education	-$1,205,666,497	-14.7%	Technical College	-$51,064,606	-13.8%
Employees Retirement	$1,638,958	22.9%	Transportation	-$174,104,072	-20.3%
Forestry	-$10,734,596	-27.3%	Veterans	-$4,518,989	-17.6%
Governor	-$7,114,480	-14.9%	Workers Comp.	$3,255,328	18.4%
Human Services	-$136,660,722	-21.4%	Debt Service	$157,576,034	15.6%
Insurance	-$3,476,978	-18.1%	**Total**	**$-3,502,942,873**	**-17.4%**

Table 5 **State Agency Budget Cuts From State General Funds When Supplemented by Recovery Act: *FY 2011 Compared to Pre-Recessionary FY 2009***

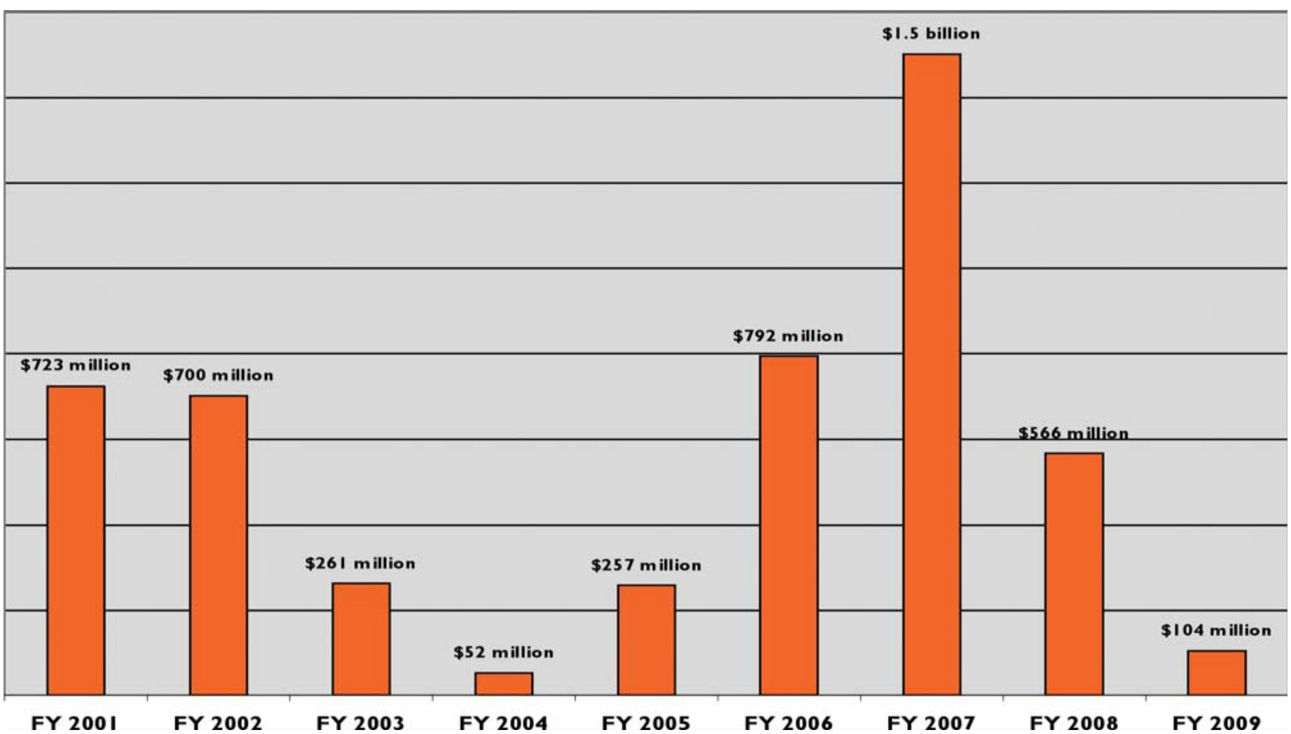
Agency	Amount of Cut/Increased Funds	Pct. Change	Agency	Amount Cut	Pct. Change
Community Health	$163,575,241	6.2%	Juvenile Justice	-$50,652,195	-14.7%
Corrections	-$100,894,850	-8.7%	Public Safety	-$25,344,399	-18.7%
Education	-$1,064,956,990	-13.0%	Regents	-$343,436,013	-15.1%
GBI	-$10,739,375	-13.9%			
Human Services	-$128,437,804	-20.1%	**TOTAL**	-$2,455,056,012	-12.2%

Revenue Shortfall Reserve

The Revenue Shortfall Reserve (RSR) is Georgia's rainy day fund, established to help the state in tough economic times. State funds are not appropriated directly to the RSR by lawmakers. The state auditor automatically places end-of-year surplus funds in the RSR. During good economic times governors traditionally use a conservative revenue estimate to drive a surplus in order to grow the RSR. The surplus is then available for use to minimize budget cuts during inevitable recessions.

At the end of FY 2007, the RSR contained $1.5 billion. The RSR at the end of FY 2009 contained only $104 million; therefore, this is what the governor has had available to use to cover budget shortfalls in FY 2010. The governor appropriately used more than $1.4 billion in RSR funds to help balance the state budgets in fiscal years 2008, 2009, and 2010 (see Chart 2).

Chart 2 **Revenue Shortfall Reserve: FY 2001 to FY 2009**



Due to new legislation, Senate Bill 421, the maximum size of the RSR increased from 10 percent of the previous year's revenues to 15 percent of the previous year's revenues. Based on the governor's projected FY 2010 revenues, the maximum RSR on July 1, 2010 would be $2.3 billion (15 percent of 2009 revenues). In order to increase the RSR to $2 billion over the next 4 to 5 years, the governor must plan for surpluses totaling $400 million to $500 million each year. In other words, if the governor thinks revenues are going to increase by five to seven percent, the budget should be based on a revenue estimate of only two to four percent, resulting in hundreds of millions of dollars in surplus at the end of the fiscal year. The state auditor would then place those funds in the RSR. Significant surpluses are highly unlikely in FY 2010 or FY 2011; in fact FY 2010 will most likely end up with a deficit.

Rebuilding the RSR is not only important in planning for the next economic downturn, but it is important in order for Georgia's to keep its AAA bond rating. The AAA bond rating saves Georgia tens of millions of dollars in interest payments. Moody's Investor Service published the following statement in their bond rating report for Georgia:

> The extent to which the coming fiscal year's budget allows for reserve rebuilding, through prudent economic assumptions and conservative revenue projections, will be a critical factor to the state's rating and outlook.

Beyond FY 2011

Due to normal budget growth in K-12 education, Board of Regents, technical colleges, Medicaid, corrections, etc., the expiration of more than $1 billion in Federal Recovery Act funds and over $400 million in other one-time revenues the FY 2012 budget is facing a projected deficit of between $1 billion and $2 billion. This deficit takes into account revenue growth in FY 2012. In other words, without new sources of revenues and without restoring funds to any services cut since the Recession took hold, the budget would need to be cut by at least $1 billion more.

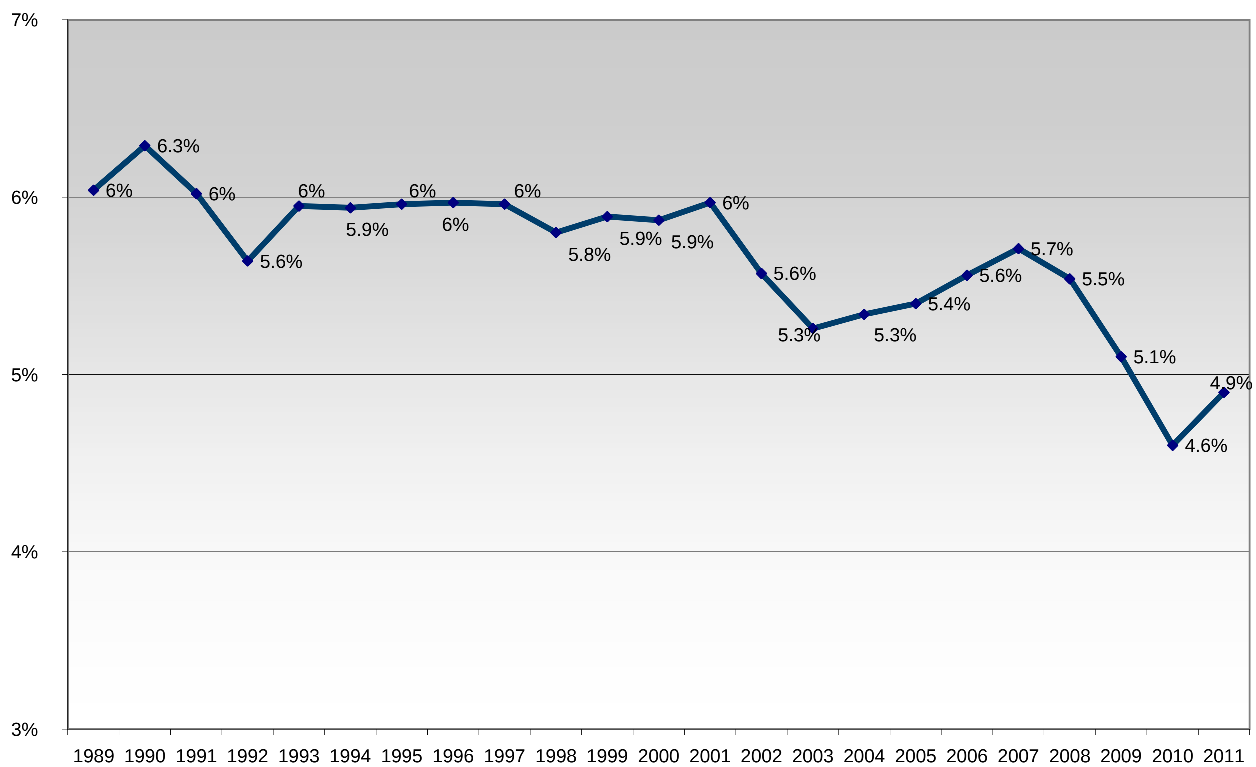
Looking beyond FY 2012 the state will still be facing a more stubborn structural deficit. Due to the further erosion of the tax base, projected sluggish economic growth, normal budget growth due to a growing population resulting in an increased demand for state services, and the importance of growing the Revenue Shortfall Reserve, it is doubtful that the existing tax base will be adequate to balance the state budget in the long-term.

Conclusion — It's a Revenue Problem

Georgia is going through the worst fiscal crisis since the Great Depression. The Great Recession has resulted in multi-billion dollar deficits. State spending is not a driving factor in these deficits, considering that Georgia ranks in the bottom 10 for spending per capita in the nation, yet it has one of the top 10 worst deficits. The current budget shortfall is due to the combination of a historically weak economy and an antiquated tax code.

State revenue collections, as a percentage of personal income, have declined dramatically over the past 10 years. In other words, as Georgians' incomes increase, state revenues collected from Georgians are not keeping pace. See Chart 2 for an illustration. This decrease is the result of 20 years of tax cuts, a narrowing tax base due to an economy changing from manufacturing to services, an out-of-date tax system developed more than 50 years ago, and a weakening economy.

Chart 2 **Total State Revenues as Percent of Personal Income FY 1989 – FY 2011**



Revenue Solutions for the Revenue Problem

Although Governor Perdue and the General Assembly took a more balanced approach to the FY 2011 budget by passing legislation to increase revenues, their short-term solutions to the state's financial problems puts the long-term fiscal health of the state in jeopardy.

In light of billion dollar plus deficits projected in FY 2012 and the structural deficit Georgia has, how does the state fairly and equitably raise the funds necessary to provide the quality public services and infrastructure that Georgians demand?

Georgia's financial problems are significant: an eroding tax base; continued growing demands on the state budget due to increases in the number of students, state prisoners, and those eligible for Medicaid; and the need to rebuild the Revenue Shortfall Reserve. The newly formed Tax Reform Council (a result of HB 1405) is an opportunity to undertake the fundamental tax reform and modernization that Georgia so desperately needs.

In the long term, fundamental tax reform and modernization that ensures Georgia can make investments in its human and physical infrastructure and rebuild its lost revenue system are necessary for Georgia to prosper and be a regional leader.

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