

Environmental Protection in a Recessionary Economy: Iowa Experiences in a Midwestern Context

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April 2004

The Iowa Policy Project

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The Iowa Policy Project

Founded in 2001, The Iowa Policy Project is a nonprofit, nonpartisan research organization. The Iowa Policy Project promotes public policy that fosters economic opportunity while safeguarding the health and well-being of Iowa's people and environment. By providing a foundation of fact-based, objective research and engaging the public in an informed discussion of policy alternatives, the Iowa Policy Project advances accountable, effective and fair government.

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Section A. Introduction and Organization

A1. Introduction

The lingering recession, the 9/11 terrorist attacks and the ensuing security concerns, and the war and reconstruction efforts in Iraq have all contributed significantly to a shortfall in revenues to state treasuries. In FY 2002, more than 80% of the states noted major shortfalls in their revenues (National Association of Budget Officers (NASBO), 2002). Recent estimates indicate that this trend has continued in FY 2003 and may extend into FY 2004 and beyond (National Council of State Legislatures (NCSL), February 2003).

Concerned citizens, agency decision-makers, and elected officials are confronted with this reality and have been coping with the budget shortfalls over the last two years. An analysis of budget shortfalls in the context of history and prevailing conditions in some of the neighboring states provides a comprehensive spatial and temporal perspective. Such a perspective would further enhance and inform the budget deliberations that take place at our town-hall meetings, state agency offices, legislative subcommittees, and the state legislature. In particular, gaining insights into a milieu of questions of the following type would be an essential component of attaining such a perspective:

- How long are these shortfalls expected to last?
- How does this recession compare to the last one of 1991-93?
- How does our state compare with our neighbors in terms of revenue shortfall?
- What strategies are adopted by different states to combat revenue shortfalls?
- What are the pros and cons of different strategies for the use of rainy day funds?
- How does the impact of a revenue shortfall on a particular department/agency (education, natural resources, etc.) in our state compare with that of neighboring states?
- Are some agencies or departments impacted more than others?
- Are some components of an agency/department impacted more than others?
- How has the allocation of resources for an agency/department changed over time?
- How do such temporal changes in allocation compare with neighboring states?

Developing a research study to understand, evaluate, and possibly act on some of these questions is quite complex for several reasons. The state economies are dynamic and are enmeshed in a network of regional, national, and global interactions. These interactions, small and big, take place on a continuous basis. Therefore, the results based on short term surveys, though beneficial to some extent, will require constant readjustments through new studies and surveys. This is one of the major types of service that many national organizations such as the NCSL, the NASBO, the National Governors Association (NGA), the Environmental Council of the States (ECOS), and others provide for their clientele. They do this by preparing and delivering a variety of periodic survey results, notes, and updates on taxes, revenues, appropriations, budgets, budget shortfalls, state innovations, and others to state agency executives and elected officials. In this research, we have attempted to place or situate the reality of the short-term budget shortfalls within the context of patterns in actual expenditures observed over the long haul. Furthermore, much of our analyses are focused and address issues within the specific realm of environmental expenditures.

A2. Limitations and Organization of this Research Study

A2.1 Limitations

In this research, our focus was on the defensibility of arguments. Legislative time-table, partisan positions, political commentaries, level of effort, and timely production of reports without detailed substantiation of data and facts were only of secondary concern. From the start, we decided to emphasize the production of a high quality, reliable, well researched and a defensible document with a lot of content in terms of process and observed results.

We were forced to resolve many contingencies based on the availability of digital data. In the early stages of our data gathering and library research efforts (July-August, 2002), we found that state governments, their personnel (budget and legislative), and professional organizations such as the NCSL, the NASBO, the ECOS, and state-level Legislative Fiscal Bureaus (LFBs) were totally consumed with estimating budget shortfalls and revenue forecasting. Questions like how to cope with a recessionary economy, where to make budget cuts, and how to bring in new revenues were on the front burner. They were interested in assisting us and providing us with access to digital data that was in the public domain. For non-digital printed data and reports, we were advised to seek the assistance of state and university libraries. Given this scenario, we had to scope our project within the context of what was digitally available.

In this research, analysis of financial data took precedence over employment data. In general, many states have made their comprehensive annual financial reports (CAFRs), consisting of budgets, revenues, and expenditures, readily available in digital form on the Web. Such data on employment figures (aggregated and disaggregated FTEs) are seldom produced and reported annually. This is a valuable research question that should be explored by labor-related professional and research organizations.

Why comprehensive employment data is not published to the same extent as budget data. Some thoughts: State and federal agencies are quite sensitive to FTEs. Flight of jobs to overseas destinations (outsourcing), unemployment in the private sector, and over-employment in the public sector (big government) are contentious issues. Many governmental organizations attempt to keep their full-time FTEs low by getting a significant part of governmental work accomplished through numerous sub-contracts, grants, subsidies, work-study programs, and other assistance programs.

Even the digitally available CAFRs are mired in complexity. We found that there was no consistent pattern in the collection and reporting of financial data in CAFRs. Variations were noted between projects, programs, divisions, agencies, states, and years. Creating a dataset of consistent quality and comparability was a major task in this project. Much of our data gathering and quality assurance effort was spent on methodically analyzing, evaluating, and winnowing down numerous spreadsheets from 40+ CAFRs containing hundreds of thousands of numbers to a few final comparative tables and graphics that you see in this report.

We decided to study the budget process in the states so that we can understand the variability in state budgets (as reported through CAFRs) in the context of environmental, as well as other departmental, budget allocations. The rules and regulations governing budget practices is one of the most important components that affect the fiscal condition of the states, which in turn affect the budgets of different departments. There is an extensive body of literature on this topic. We did not study the budget process for political reasons (though it is one of the hottest current topics).

For the sake of feasibility and reduce complexity, we had to scope and scale the project to the study of state DNRs only. Of course, we could have included many other environment-related programs, but then it would have become a never-ending project. The ECOS is a respected national think tank organization and has conducted numerous survey studies comparing state environmental budgets. In their research papers, they provide a sound rationale of why selecting DNRs is a sound and feasible approach. Following their approach of selecting DNRs gave us an opportunity to have a national benchmark to compare.

A2.2 Organization

We have focused heavily on the analysis of patterns in environmental appropriations and expenditures observed in Iowa during the last two years of the current recession. To provide a broader context and a measure of perspective to our analysis in space and time, we have zoomed in and out of different spatial and temporal scales. We have done this through the analysis of an extensive body of general, natural resource, and environment-specific financial data and related literature. What follows is an analysis of Iowa's environmental expenditures viewed from different spatial and temporal scales. Four spatial scales are considered in this research and they vary from Iowa to the United States (Iowa; the three comparison states of Iowa, Minnesota and Missouri; the eight neighboring states of Iowa, South Dakota, Nebraska, Kansas, Missouri, Illinois, Wisconsin, and Minnesota; and the United States). The temporal scales range from the analysis of the most recent natural resource and environmental budgets and expenditures in Iowa for the particular year of 2002 to that of a trend analysis of 15 years (1988-2002) of selected data for the three comparison states of Iowa, Minnesota, and Missouri.

The remainder of the report is organized as follows:

The Budget Process and Strategies to Manage Shortfalls: The process by which states develop and manage their budgets and deal with shortfalls is quite varied. In this section we provide a brief summary of the similarities and differences among the states in terms of their budget-making process. We also briefly describe some of the strategies states use to cope with revenue shortfalls and manage rainy day funds. As much as possible, we compare Iowa's strategies with those of its neighbors, especially Missouri to the south and Minnesota to the north.

The Breadth and Depth of Budget Shortfalls in the States: To couch our analysis within a broad national perspective, we provide a brief historical overview of recessions of the past with a sketch of current budget shortfalls and coping strategies in the states and how such shortfalls compare with Iowa's neighbors in the Midwest.

Environmental Protection in a Recession: This section goes to the heart of the report. Here we discuss the status of environmental budgets in the current climate. First we provide a brief summary of federal allocations to environmental and natural resource functions followed by an aggregated analysis of how the states in the US are coping and dealing with budget shortfalls. This is followed by a detailed 14-year (1989-2002) comparative analysis of environmental budgets in the three states of Iowa, Missouri, and Minnesota. Finally, we provide a thumb-nail sketch of the latest available budget information for the state of Iowa.

Conclusions and Notes on Further Research: A final section summarizes our conclusions and also lists a few areas where additional research would be beneficial.

Miscellaneous: A glossary of selected terms, spreadsheets of financial data tables, and a list of references are also included.

Section B. The Budget Process and Shortfalls

B1. The Budget Process

Setting priorities and allocating resources among the many competing claims are at the core of state governance. It is within this budget process that the governor, the legislature, and the departments or agencies articulate and debate their spending priorities. There is considerable diversity in the approaches and practices employed by the states in this process and the publication “Budget Processes in the States” by the NASBO (2002) captures this diversity. Much of what is presented here is adapted from this 92-page NASBO report with brief highlights of budget approaches used by Iowa and its neighbors, especially Minnesota and Missouri. The areas covered by this effort include: the budget cycle, budget requirements, budgeting tools, the budget document, and monitoring.

a. Budget Cycle

Most states, in principle, follow a systematic process that includes: budget submissions by agencies within the governor’s guidelines; followed by hearings, adjustments, and finalization of the governor’s budget; debates and discussion in the legislature; and the final adoption of an agreeable budget. The time of year in which this process takes place is somewhat similar in most states, beginning in May or June and ending prior to the start of the next fiscal year in July.

Iowa prepares its budget annually (see Box 1 for details), Minnesota prepares it biennially, and in Missouri there is constitutional authority to prepare both annual and biennial budgets. Since FY 1994, the operating budget is prepared annually and the capital budget biennially in Missouri.

At present about 35 states have liaison offices in Washington, DC to work with Congress, federal agencies, and other collective organizations such as the NGA, NCSL, and CSG to address specific concerns such as the fiscal impact of federal legislation on the states. Iowa, Missouri, and Minnesota have offices in the state as well as representatives in Washington that monitor federal legislation and report back to the Governor’s Office or other appropriate agency heads.

b. Budget Requirements

Almost all states have certain provisions in their laws (either in the constitution or in the statutes or both) to protect against unforeseen circumstances with reference to their budgets, especially those related to shortfalls, taxation, and spending. Four areas of common and pervasive interest include: the rules governing the relationship (checks and balances) between the governor and the legislature; balancing the budget; financing debt; and limiting expenditures and taxes.

To keep the balance of power, many states afford the governor the veto authority that can prevent the enactment of a bill and the item veto authority which can enable the governor to reject particular items in a piece of legislation such as a sentence, paragraph, or part of a sentence (syntax). In the context of budgets, there is also the line-item veto, whereby,

Box 1: Iowa's Budget Process (Excerpted from www.legis.state.ia.us)

The Governor and the State Legislature allocate state resources and set revenue collection levels through the budgeting process:

- The process begins in May or June of each year for the following fiscal year.
- State agencies prepare budget requests within the guidelines set by the Governor and submit their requests to the Department of Management by October 1st.
- The Revenue Estimating Conference meets by December 15th to set revenue estimates which will serve as a basis for the General Fund budget for the following fiscal year. This conference is made up of three members: the Governor (or Governor's designee), the Director of the Legislative Fiscal Bureau, and a third member agreed to by the other two. Revenue estimates are estimates of receipts to the General Fund from direct taxation (sales tax, personal income tax, corporate income tax, and use tax), as well as other sources of tax and fee revenue.
- The Governor reviews the budget requests by state agencies, conducts public hearings, and then submits his own recommendations to the Legislature in January. By statute, the Governor's budget must be balanced and must meet expenditure limitations.
- The Legislature conducts public budget hearings during January and February. Recommendations from the nine legislative joint budget subcommittees (Appropriations Subcommittees) are passed on to the full Appropriations Committees and to the floor for debate in each chamber.
- The Appropriations Subcommittees hold meetings jointly with members of both the Senate and House. The subcommittees are categorized according to general areas of interest in Iowa. Once approved by both chambers, a budget bill is sent to the Governor.
- The Iowa Constitution grants the Governor line-item veto authority over appropriations bills. If the Governor chooses to exercise this power, the General Assembly may override the item veto before adjournment or during a special session.
- Unless otherwise specified, the budget goes into effect beginning July 1, following the Legislative Session.

the governor can reject the legislative budget on a line-by-line basis. Iowa, Minnesota, and Missouri afford their governors the authority to veto line items and also veto items of appropriations. In Missouri the governor can veto selected words based on constitutional criteria.

To maintain fiscal stability and balance, many states preclude deficit spending by requiring the governor to produce a balanced budget, the legislature to pass a balanced budget, and the governor to sign a balanced budget. In Iowa, the governor must submit a balanced budget and the state must pass a balanced budget. In Minnesota, the governor must submit a balanced budget, the state must pass a balanced budget, and the governor must sign a balanced budget. In Missouri, the governor must submit a balanced budget and also sign a balanced budget.

To finance large capital projects for the common good of the taxpayers, states undertake debt and finance such debts through a variety of bonding and tax schemes. To protect the taxpayers from indiscriminate expenditures, many states have set tax and expenditure limits (TEs) and tie such expenditures to revenues and an index of inflation. Iowa has a \$250,000 government obligated debt limit, in Minnesota it is 3% of non-dedicated revenues, and in Missouri it is \$1,000,000. Voters in Missouri can authorize additional amounts. "Current authorization include \$250 million for corrections, higher education, and youth services facilities, \$725 million for water pollution control and \$200 million for storm water control" (NASBO, 2002). Iowa does not have ceiling for short-term debt limit, Missouri doesn't permit any short-term debts, whereas in

Minnesota a variety of considerations come into play and appropriations of bonded projects are authorized by 3/5 vote of the legislature.

About 29 states have guidelines limiting tax and expenditures. In Iowa, appropriations are limited to 99% of general fund receipts, in Missouri the limits are based on revenue estimated at 5.64% of prior year's personal income, and in Minnesota there are no such guidelines. In Missouri, the Legislature can approve tax and fee increases of no more than 1% of total state revenue, amounts over this limit must have the approval of the voters.

c. Budgeting Tools and Techniques

States use a variety of budgeting and accounting principles to manage the budget process. Some set limits on accumulation and disbursement of funds for combating unforeseen circumstances. Many have developed computing and web-based technologies for increasing efficiency, access, and awareness of the budget process among citizens, lawmakers and professionals. Current trends indicate that on-line collection, integration, and sharing of a myriad of budget related information is one of the important challenges facing budget officers across the United States.

A variety of methodologies are available for the states to develop, monitor, analyze, and evaluate the performance of their budget process. Some of the commonly used methods include line item budgeting, program budgeting, zero-based or modified zero-based budgeting, and performance budgeting. For a definition of each of these methods, refer to the glossary in Section F. The recent NASBO (2002) study found that incremental and program budgeting methods are widely used and that many performance measures are also incorporated as part of the regular budgeting process. In its budget procedures, Iowa follows program and zero or modified zero-based budgeting approaches, its budget reflects generally accepted accounting principles (GAAP), and all funds (federal and non-federal) are appropriated by the state. In Minnesota, the budget procedures include incremental, program, and performance-based approaches and all funds (federal and non-federal) are appropriated by the state with certain special provisions (NASBO, 2002). Similarly, in Missouri, the budget procedures include zero or modified zero-based, program, and performance-based approaches and all funds (federal and non-federal) are appropriated by the state with certain special provisions (NASBO, 2002).

To meet budget shortfalls due to a recessionary economy or other unforeseen expenditures, many states have budget stabilization funds (also known as Rainy Day funds) and other contingency funds. The next section provides a detailed analysis of budget shortfalls and the use of rainy day funds. These funds are contributed to during robust economic times and then are depleted in times of need, economic downturn, or budget shortfalls. Many states have caps on the size of such funds and also require the approval of the legislature for withdrawing from such funds. Iowa has a general fund reserve account consisting of two funds: the Cash Reserve Fund (CRF) and the Economic Emergency Fund (EEF), each with a maximum balance of 5% of the adjusted revenue estimate for the fiscal year (Iowa Legislative Fiscal Bureau, 2002; also see Box 2). Recent amendments have changed these maximum balances to 7 ½ and 2 ½ % each for CRF and EEF, respectively (Lyons, 2002). Minnesota also has two such funds: Budget Reserve and Cash Flow Accounts, with ceilings of \$622 and \$350 million respectively, set in the state statute. In Missouri, the Budget Reserve Fund is a minimum of 7.5% of the net general revenue and can go as high as 10% with legislative approval. To meet such special needs, in the state of Illinois the

comptroller can transfer needed amount to the general fund with the proviso that it must be returned by the end of the year. Kansas has no separate “rainy day” fund, but accomplishes comparable objectives through a statutory requirement to have a year end general fund balance of at least 7.5% of total expenditures of the forthcoming fiscal year.

To provide relief during disasters, many states have also established contingency funds (typically through appropriations); such funds are generally available with the governor’s authorization. All but 2 states have contingency funds, ranging from 14 thousand to 440 million dollars. Iowa’s Performance of Duty Fund (\$2.5 million), Minnesota’s General Contingency Fund (\$250,000), and Missouri’s Government Emergency Fund (\$150,000), Disaster Fund (\$66,264), Medicaid Supplemental Fund (\$438.4 million), and Corrections Growth Pool Fund (\$31.76 million) belong to this category.

d. The Budget Document

To plan, communicate, monitor, and evaluate fiscal conditions, states produce a variety of documents such as CAFRs, annual summaries, citizen reports, and fiscal facts. In some of these documents, the operating and capital expenditures are clearly identified and separately reported. For capital outlays, Iowa plans for 5 years beyond the current budget cycle, while Minnesota and Missouri plan for 4 years.

e. Monitoring the Budget

Enactment of the budget with appropriations is a first legislative step and many states follow this step with other provisions that enable the agencies and the governor to implement the intent of the budget through allocations and expenditures. Realizing the contentious nature of issues related to the transfer of funds from an appropriated use to some other use, many states have rules of varying specificity in allowing such transfers. In Iowa, “Transfers in separate departments that are not entitlements (indigent defense, foster care, state supplementary assistance, medical assistance, and the family investment program) may not be made while the Legislature is in session and may not exceed 50% of the original appropriation. Entitlements are exempt from both of these restrictions (NASBO, 2002).” In Minnesota, “Transfers between agencies are not allowed except pursuant to a reorganization order issued by the Commissioner of Administration. Agencies may transfer operational money between programs with Department of Finance review and reporting to legislature (NASBO, 2002).” In Missouri, such interdepartmental transfers are not allowed except for transfers within a program or a unit.

Box 2

In addition to the General Fund, natural resource and environmental protection activities in Iowa also receive appropriations from several other specially created funds such as the following:

1. Iowa's General Fund Reserve Accounts: To eliminate deficit spending under generally accepted accounting principles (GAAP), and to have sufficient cash balance to cover short-term borrowing and provide for rainy-day funds, the Iowa General Assembly in 1992 created the General Fund Reserve Accounts (codified in Sections 8.55-8.57 of the Code of Iowa). The law provides for two separate funds (the Cash Reserve Fund-CRF and the Economic Emergency Fund-EEF), CRF with a maximum balance of 7 ½ % and EEF with a maximum balance of 2 ½% of the adjusted revenue estimate for the fiscal year. The mechanisms of accrual, withdrawals, allocation, expenditures, and minimum and maximum level of reserve are all specified in the above referenced sections of the Iowa Code. The combined size of the two reserve funds were \$358, 430, 439, 444, 460, 405, 171, and 141 millions during the fiscal years 1996-2003.

2. Rebuild Iowa Infrastructure Fund (RIIF): To enhance and support infrastructure development, the RIIF was established in 1995 (Section 8.57(5), Code of Iowa). Provisions were made for crediting the interest earnings from the two general funds (the Cash Reserve and the Economic Emergency funds) to RIIF. House File 584 transferred \$50 million from the GAAP deficit Reduction Account to RIIF. In 1996, the General Assembly passed HF 2421 and dedicated all state racing and gambling receipts in excess of \$60 million to RIIF (retroactive to July 1, 1995). Considerable resources from RIIF are allocated to fund the programs of Environmental First Fund (EFF), the Iowa DNR, and Loess Hills infrastructure development. Total appropriations under RIIF have been \$125, 135, 170, 165, and 54 million during the five years FY 1998-2001.

3. The Resource Enhancement and Protection Program (REAP): REAP was created in 1989 by the Iowa Legislature to protect and enhance Iowa's natural resources. Provisions were made in the "Code of Iowa" so that REAP could receive appropriations of up to \$20.0 million from the General Fund for each year between FY 1992 and FY 2021. The Department of Natural Resources (DNR) administers the REAP funds. REAP acquires, manages, and upgrades public lands, parks and preserves; and enhances environmental protection through education, monitoring, and research. Its revenues include those appropriated from the Environment First Fund, interest earned on invested accounts, tax transfers, and license plate sales. REAP funds are distributed according to a formula specified in Section 455A.19 of the Code of Iowa. Bulk of the funds are expended by the Iowa DNR and the Iowa Department of Agriculture and Land Stewardship (DA&LS) for the management of open spaces (28%), water conservation projects (20%), conservation through county boards (20%), city park projects (15%), land management and maintenance (9%), historical resource preservation through school libraries (5%), and roadside vegetation projects (3%).

4. The Environment First Fund (EFF): As part of building Iowa's infrastructure, the 2000 General Assembly established the Environment First Fund to provide resources for the protection, conservation, enhancement, and improvement of natural resources. The General Assembly established a standing appropriation of \$35.0 million for the Fund beginning in FY 2001. The bulk of the funds are expended by the Iowa DNR and the Iowa DA&LS. Major activities supported by the DNR in FY 2002 included funding REAP, increasing water quality monitoring stations, building boat ramps, dredging lakes, abating waste tire hazards, assisting rural septic systems, planting trees, disseminating GIS information on local watersheds, educating local officials on floodplain protection, and reviewing the NPDES permitting process. Similarly, the major activities undertaken by DA&LS in FY 2002 included funding the Soil Conservation Cost Share Program, the Watershed Protection Program, and a variety of other conservation, nutrient management, and alternative drainage measures. Other departments such as of the Department of Economic Development were also funded to undertake clean up of contaminated commercial or industrial hazardous waste sites (Brownfields).

5. Groundwater Protection Fund (GPF): The Groundwater Protection Fund was created by the Iowa Legislature in 1987, as detailed in Section 455E.11 of the Code of Iowa, and is administered by the Department of Natural Resources (DNR). The objectives of the fund are to prevent groundwater contamination from point and non-point sources and to restore groundwater resources to a potable state, regardless of present condition, use, or characteristics. There are four major accounts (Solid Waste, Agricultural Management, Household Hazardous Wastes, and Storage Tank Management) from which GPF derives its funding. These accounts generate funding from tonnage fees collected at landfills, fees levied on agrichemicals, household hazardous waste products, and underground storage tanks. GPF funds in FY 2002 were distributed to a variety of programs related to "alternatives to landfilling," well closure, public health, and education. To carry out some of the stated objectives, the GPF also supports the activities of the Iowa Waste Reduction Center at UNI, the Center for the Health Effects of Environmental Contamination at the UI, and the Leopold Center at ISU.

B2. Budget Shortfalls and Rainy Day Funds

a. Budget Shortfalls

Shortfalls result when budgeted expenditures exceed revenues. In addition to error in budget estimates, surpluses and shortfalls are also affected by a myriad of other financial and economic activities that go on within and outside of the state. Effective financial planning requires that certain amounts are set aside as savings during surplus periods to cover shortfalls during downturns or recessions (3-5% according to some Wall Street Analysts, State of Utah, 2000).

b. Causes of Budget Shortfalls

There are two major types of shortfalls, the short-term resulting from imprecise revenue and/or expenditure estimates and the long-term due to structural deficiencies resulting from consistent expenditure overruns (Eckl, 1997a). The short-term deficits are the result of business cycles. When recessions are in the making, revenue growth is reduced while need for services increase. Whereas, during the growth periods of the cycle surpluses appear and in the long run cancel out the impact of deficits (State of Utah, 2000). In the case of structural deficits, the state consistently spends more than what it takes in as revenues and during a downturn the impact of such shortfalls is significantly exacerbated. There are many interrelated factors that lead to budget shortfalls and some of the major factors include the following (Eckl, 1997a and State of Utah, 2000):

External economic conditions. The performance of economies beyond the borders of the state will have significant impact on the state's economy depending on the strength of its import and export relationship with the outside world. For example, California's economy will be impacted by global market conditions in high tech products, Alaska by oil and natural gas, and Iowa by food products. For example, Senator Larson, chair of the Appropriations Committee in Wyoming says:

Anywhere from 40 percent to 70 percent of our revenues comes from the mineral extraction industry—oil, gas, trona, coal—so we're always on a roller coaster in Wyoming." "When energy prices spiked, our projected \$100 million deficit turned into a \$700 million surplus. But now we're coming to the down part of the cycle because the price of natural gas has dropped significantly and our oil reserves are diminishing. (Eckl, 2002).

Revenue and expenditure estimation. Accurately estimating future revenues is an inherently difficult task. Hopefully with the advent of high-speed electronic reporting, the time required to correct errors in estimates could be minimized. With the recent volatile global climate of recession and war, the problem is further exacerbated because the revenues are falling while the need for healthcare, education, corrections, and security concerns at the state level are increasing.

Federal actions. Federal tax policies, allocation of funds to the states, and in some cases the requirements of unfunded mandates have significant impact on revenues and costs at the state level. For example, President Bush's recently announced plan in January 2003 to cut taxes on dividends could cost New York State and City \$3.4 billion in lost revenues and added borrowing costs over the next four years (Havesi, 2003).

Court decisions. In some cases, courts could rule a tax to be unconstitutional and thus lead to revenue reduction for the state, while in other cases, certain funding formulas (such as those used for schools) could be upheld by the court that could increase expenditures.

Tax and expenditure policy. Lower taxes and higher spending rates on a consistent basis, year after year, will lead to structural deficits. Such deficits can only be alleviated by prudent fiscal policy driven by the legislative process. In several states, voters have started imposing guidelines and restrictions to influence such policy.

Earmarking. Earmarking is a process whereby funds are set aside from the state's regular stream of revenues for certain specific, statutorily defined purposes. In times of recession, such requirements limit the state's ability to flexibly manage its revenues and shortfalls. On the other hand, such requirements enable states to operate certain desirable programs (especially, those for which it is difficult to obtain sufficient funding) at some minimum threshold level (State of Utah, 2000).

c. Methods to Minimize or Avoid Budget Shortfalls

Though there are no absolute solutions to budget shortfalls, many states have put a variety of methods in place to reduce its impact. Some of the commonly used methods include: limiting appropriations, contingency planning, and creating budget stabilization or rainy day funds.

Limiting appropriations. Delaware, Iowa, Mississippi, Oklahoma and Rhode Island limit their appropriations to a set percent of their state's general fund revenue forecast. The percent limits range from 95 in Oklahoma to 99 in Iowa. Two of the above five states had these measures in the 1980s, while the other three implemented such measures following the recovery from the fiscal problems of the early 1990s.

Contingency planning. Under this strategy, most states grant the governor some authority to reduce appropriations when contingencies arise. In many cases, checks and balances are put in place so that the governor and the legislature must work together in approving actions.

Creating and funding budget stabilization funds. The coffers of such funds are filled during times of plenty so for the purpose of short-term backup during shortfall or recessionary periods. Almost all states (45 by 1996) have such funds in place.

d. Managing Budget Shortfalls

Most states require a balanced budget with the authority afforded either by the constitution or through statutes. To attain a balanced budget, states employ a mix of strategies. The components within strategies may vary between the states but almost all of them employ the two major strategies of expense reduction and revenue enhancement as shown in Table 1.

**Table 1. Selected strategies used to address budget problems of FY 1993
(Adapted from Eckl, 1997a)**

Strategy	Used by # of states (U.S.)	Used by In Iowa's Neighborhood
Temporary Measures		
Postponed capital projects financed by the general fund	4	Minnesota
Replaced appropriations for capital projects with borrowing	5	Missouri
Budget Reductions		
Imposed across-the-board cuts	17	Kansas, Nebraska
Imposed selective cuts	19	Illinois
Eliminated programs	8	Illinois, Nebraska
Reduced aid to local governments	9	Illinois, Nebraska
State Employees		
Implemented layoffs	10	Illinois, Minnesota
Imposed salary freeze	12	Minnesota, Missouri
Eliminated vacant positions	12	Illinois, Minnesota, Missouri
Reduced contribution to pension funds	8	Minnesota
Revenue Measures		
Raised fees	17	Minnesota, Nebraska
Transferred funds to the general fund	19	Illinois, Nebraska
Offered early retirement program	7	Illinois, Minnesota

Expense or budget reduction strategy. Under this strategy, the states either reduce the budget or postpone expenditures through a variety of means. Some of the commonly used budget cutting or reduction measures include (Eckl, 1997a, State of Utah, 2000):

- Implementing across the board cuts;
- Implementing selective cuts;
- Eliminating certain programs, boards and commissions;
- Reducing aid to local governments; and
- Reducing employee-related expenses, such as early retirement and travel and hiring freezes.

Since employee related expenses account for about 20 percent of all state spending (Eckl, 1997a), policy makers often explore savings in this area when reductions in expenditures become necessary. Early retirement schemes, privatizing governmental functions, and generating new

ideas through “reinventing government” commissions and boards are some of the strategies that are often employed to get a leaner and more efficient government. None of the strategies can match the great expectations of their proponents, and all solve some old problems while creating new problems. State aid to local governments is another major area of spending accounting for almost 30 percent of the states’ budget. Education accounts for a lion’s share of this (64%) component. A variety of factors such as funding formulas, earmarking, and transferring funds from one source to another come into play in this state-to-local resource allocation process. Also, there is considerable variability in this process between the states (Eckl, 1997a). Other often-used short-term measures to postpone expenditures include (Eckl, 1997a):

- Delaying/eliminating capital expenditures or shifting them to bond financing;
- Delaying payments to vendors;
- Creating budget hold back provisions; and
- Changing investment assumptions for state retirement systems.

The effect of budget reduction is immediate and there may also be political benefits if a majority of the constituents view the process as one leading to leaner government with minimal or no tax increases. On the other hand, services may be disrupted, distributional effects (on the elderly, low income, small departments such as DNR and others) may be severe, legislative priorities may be shortchanged, and finally if decisions to cut are made late in the fiscal year, agencies might find it difficult to implement the cuts (Eckl, 1997a).

Revenue enhancement strategy. Under this strategy states enhance revenues through a variety of means. Some of the commonly used measures (Eckl, 1997a) include:

- Broadening the tax base for major tax categories (income, sales, corporate, use, and others)
- Imposing new taxes or increasing tax rates (personal, sales, corporate, tobacco, alcohol, motor fuel, and others)
- Accelerating tax collections; and
- Increasing license fees.
- Shifting money to the general fund from funds that are not needed immediately or that have surpluses;
- Tapping budget stabilization funds;

The complexity of revenue enhancement is aptly illustrated by the following:

.... the choice of revenue-raising options is not as simple as picking from a menu, but must take into account political and economic considerations. For example: What are current tax rates and levels? How is the tax burden distributed between individuals and business? How would these tax increases affect the state's business climate and tax competitiveness? What kind of opposition will the tax generate? What federal provisions, if any, affect this tax? Will the action raise sufficient revenue to address the budget problem? The list is practically endless and raises many concerns. (Eckl, 1997a).

Excessive tax cuts during periods of growth without concomitant decrease in spending or government services could also lead to budget shortfalls. For example, in 2002, the states changed course by reversing the tax cut policies of the past seven years by raising taxes 1.2 percent. It is also known that states with narrow tax bases are more susceptible to budget shortfalls and recessions (State of Utah, 2000). Finally, the mix of strategies chosen by policymakers in any particular state and period may also be affected by the severity of the shortfall, the implementation period of the strategy, and other planned actions of the state or the federal government (State of Utah, 2000). Selected strategies used by Iowa and its neighbors to manage budget shortfalls of FY 1993 are shown in Table 1 presented earlier (Eckl, 1997a).

As discussed earlier, shortfalls occur due to a myriad of factors such as those from the local to the global, from the short-term to the long-term, and from the cyclical to the structural. They are the result of increasing expenditures, decreasing revenues, or both. In conclusion, there are no hard and fast rules for managing budget shortfalls, elected officials must tailor-make strategies suitable for their states. Of course, policy will be influenced by the prevailing social, economic and political perspectives in the states.

e. Rainy Day Funds

Funds created during surplus periods to stabilize the impact of shortfalls during economic downturns or recessions are called rainy day funds. Prior to 1981, few states had such funds (Gold, 1981). By 1984 the number of such funds had risen to 18, and by 1994, 45 states had such funds (ACIR, 1995). Thirty two of the 45 have capped the size of such funds; however, very few have reached such caps (Zahradnik and Johnson, 2002). Iowa has two such funds, the Cash Reserve Fund (CRF) and the Economic Emergency Fund (EEF), with caps of 7 ½ and 2 ½ percent, respectively. In 1996, in the United States, the estimated rainy day fund balances averaged \$135 per person or 6 percent of total state expenditures (Knight and Levinson, 1999). The starting year of a rainy day fund, deposit and withdrawal methods used, and ceilings or caps, if any, by states in Iowa's neighborhood are shown in Table 2. In some of the tables of information presented in this report, the states of Alaska, California, and New Jersey are included so as to enable comparison with states outside the region, in particular, those significantly affected by the current budget shortfalls.

According to the researchers Zahradnik and Johnson (2002) of the Washington DC-based think tank on budgets and policy priorities:

- Retaining rainy day funds while cutting budgets often is not the best use of resources.
- Preserving such funds for the future is tantamount to not having a rainy day fund at all.
- Using much of rainy day funds in FY 2003 would be most appropriate.

Table 2: State Rainy Day Fund Details as of April 1995

State	Deposit method	Limit (as % of expenditures)	Withdrawal method	Year Started (first balance)
Alaska	appropriation	no limit	appropriation	pre-1985
California	year-end surplus	no limit	revenue shortfall	pre-1985
New Jersey	year-end surplus	5%	revenue shortfall	1988
Illinois	None	None	None	None
Iowa	appropriation	10%	appropriation	pre-1985
Kansas	appropriation	no limit	appropriation	1993
Minnesota	year-end surplus	5%	revenue shortfall	pre-1985
Missouri	appropriation	5%	revenue shortfall	1992
Nebraska	year-end surplus	no limit	revenue shortfall	pre-1985
South Dakota	year-end surplus	5%	appropriation	pre-1985
Wisconsin	appropriation	no limit	appropriation	1993

Source: Adapted from Eckl, 1997b.

Pros and cons of Rainy Day Funds

A report prepared by the State of Utah (2000) lists some of the following as pros and cons of Rainy Day Funds:

Pros

- promote budget stability by avoiding ad hoc budget cuts or tax increases
- buy time for making better informed budget and tax decisions
- weigh in the state's favor with bond agencies

Cons

- excess revenues should be returned to taxpayers or used for programs
- serve as temporary crutches and delays permanent solutions to budget problems
- serve as a source of revenue to fund programs before shortfalls occur

What is an appropriate Rainy Day Fund balance?

Though it might be prudent practice to maintain a rainy day fund balance of 3-5 percent of general fund budgets (State of Utah, 1999), such balances may not be sufficient to effectively cope with a mild recession. For example, budget shortfall from a five percent error in revenue forecasts, would completely wipe out the Rainy Day Fund, a three percent error in revenue forecasts, would wipe out 2/3 of the Rainy Day Fund (assuming a rainy day fund size of 5% of general funds). Again, it is important to remember that the purpose of such funds is to carry the state through normal contingencies such as short-term business cycle fluctuations and forecasting errors and not for combating chronic structural deficiencies or recessions. Budget stabilization or rainy day funds as a percent of general funds by region of the country and also by selected states (Iowa and its neighbors) are presented in Table 3 for FY 1997 and FY 1998. States in the Far West (6.0-7.7%), the Plains (5.6-5.8%), and New England (5.2-5.5%) had healthy surpluses during that period. Iowa's funds were close to or at its ceiling of 10%. All such fund surpluses for FY 2003 have been significantly reduced by the current downturn.

What do we know about rainy day funds from contemporary research?

1. California's Proposition 13 tax reforms in 1978 functioned as a catalyst for opposition to high state budget surpluses (Gold, 1981). States leery of surpluses in general funds have created a politically acceptable form of savings through rainy day funds.
2. Sobel and Holcombe (1996) and Levinson (1998) provide evidence that states with rainy day funds do experience less volatile fiscal cycles.
3. Limits and constraints on rainy day funds. States with high balance limits or no limits on rainy day funds tend to save more than states with low limits. Similarly, states that provide access to the fund balances only during an economic downturn tend to have higher balances. Even more striking, balances saved in rainy day funds appear to increase total state savings *dollar-for-dollar* (Knight and Levinson, 1999).
4. Use of Rainy Day Fund Won't Hurt Bond Rating. Prunty, Fraser, and Murphy (2001) provide evidence to show that spending rainy funds would not hurt state's bond rating.
5. Using Rainy Day Funds Would Protect State Economies. The three available options for coping with short-term revenue shortfalls include: cutting expenditures, raising taxes, or drawing down on rainy day funds to meet current levels of spending. Assuming consumption to be an essential part of our economic engine, a considerable body of literature argues for the use of rainy day funds to maintain current levels of spending (Zahradnik and Johnson, 2002; Orszag and Stiglitz, 2001). Thinking along these lines, the governor of Missouri has proposed using \$135 million, or about 90 percent, of the state's \$152 million rainy day fund to reduce the level of spending cuts in the 2003 proposed budget from \$613 million to about \$480 million (Zahradnik and Johnson, 2002).
6. Rainy Day Funds Should Be First Response to Fiscal Stress. As discussed earlier, not all shortfalls can be covered by rainy day funds. A five percent budget shortfall could completely wipe out the Rainy Day Fund (of size 5% of general fund revenues). In addition to using rainy day funds, states also implement budget cuts and levy additional taxes to cover the gaps. Again the pros and cons of what and how much to cut and what type of additional taxes to impose are serious issues of economic significance (Zahradnik and Johnson, 2002; Johnson and Tenny, 2002; Lav, Lazere, Greenstein and Gold, 1993).
7. Rainy Day Funds and Structural Deficits. In states, where the economies do not generate sufficient revenue to support an adequate level of growth in government services, it is inappropriate to consider rainy day funds as part of a long-term solution. Modernizing personal and corporate income taxes with progressive tax brackets and broadening sales tax bases are potential options worthy of further attention (Tannenwald, 2001; Carey and Lav, 2002).
8. Using Rainy Day Funds Can Protect Programs for Low-Income People. When unemployment goes up, more people lose jobs and incomes, and spending in government programs to address such issues automatically increase. These programs known as "automatic economic stabilizers," generally serve low-income households. For example, they include unemployment insurance, food stamps, temporary assistance for needy families (TANF), and Medicaid. During economic downturns, the need for such programs increases. Assistance from rainy day funds to such programs would increase consumer spending by providing resources to the households most likely to spend immediately the financial assistance they receive (Zahradnik and Johnson, 2002). Additional research information on this topic is provided by (Lav, Lazere, Greenstein and Gold, 1993; and Carey and Lav, 2002).

9. In conclusion, rainy day funds could be considered to belong to growing class of fiscal instruments with potential benefits for state fiscal policy and hence on welfare (Knight and Levinson, 1999).

	FY 1997 Millions of \$	FY 1998 Millions of \$	FY97 %	FY98 %
New England	1,196	1,700	5.2	5.5
Middle Atlantic	1,511	2,051	2.6	2.8
Great Lakes	2,447	2,353	4.0	3.9
Illinois	0.0	0.0	0.0	0.0
Wisconsin	0.0	0.0	0.0	0.0
Plains	1,314	1,635	5.8	5.6
Iowa	430	439	10.0	9.7
Kansas	0.0	0.0	0.0	0.0
Minnesota	697	863	8.5	8.5
Missouri	121	170	2.6	2.5
Nebraska	41	133	6.7	5.3
North Dakota	0.0	0.0	0.0	0.0
South Dakota	25	30	4.2	4.8
Southeast	2,375	2,590	3.0	3.3
Southwest	760	818	2.2	2.3
Rocky Mountain	227	331	3.1	2.8
Far West	3,929	5,698	7.7	6.0

Source: Adapted from NCSL (1997)

Section C. The Breadth and Depth of Budget Shortfalls

C1. Introduction

In a survey done in March 2002, the analysts at the National Association of Budget Officers (NASBO) found that it took several months for state economies to recover from the impacts of recession of the early 90s. When the earlier recession ended in 1991, the average shortfall in the states was 6.2% of the general fund revenues and 28 states made cuts to their already enacted budgets (Figures 1-2). In 1992, the average shortfall was 6.5 percent of revenues, and 35 states were forced to continue cutting their budgets (Figures 1-2). Finally by 1998-2000, the impact of recession was small and only a handful of states, 1-3, had any measurable shortfall in estimated revenues (Figure 2). In contrast to the prior recession, FY 2002 budget shortfalls were estimated to be close to \$40 billion in early 2002, or 7.8 percent of estimated total general fund revenues [By June 30, 2002, the end of the fiscal year for 46 states, this figure was estimated to be \$37.2 billion, (Eckl, 2002)].

Several factors are known to impact and/or influence the magnitude and timing of economic recovery. Individual and corporate tax rates and collection policies, loss carry-forward and other provisions in the state tax codes, infrastructure and other strategic investment decisions, allocation and distribution of rainy day funds to certain priority areas, and a variety of other ad-hoc instruments have been used to influence the timing and recovery of revenue growth. In a recent op-ed piece in New York Times, Krugman (2002) suggested a federal fiscal stimulus plan (excerpted and adapted below) that will encourage spending until the business investment climate in the country revives and shows some strength.

- extend unemployment benefits which will do double duty, helping some of the neediest while putting money into the hands of people who are likely to spend it.
- provide aid to the states that are in desperate fiscal straits which will also do double duty, preventing harsh cuts in public services, with medical care for the poor the most likely target, at the same time that it boosts demand.
- if these elements don't add up to a large enough sum (\$100 billion over the next year), have another rebate, this time going to everyone who pays payroll taxes?
- how will we pay for all of this? Cancel tax cuts scheduled for the future. The economy needs stimulus now; it doesn't need tax cuts for the very affluent five years from now.
- this isn't rocket science. Its straightforward textbook economics, applied to our actual situation. It's also, I'm well aware, politically out of the question. But I think we're entitled to ask why.

Figure 1 (Source: NASBO, 2002)

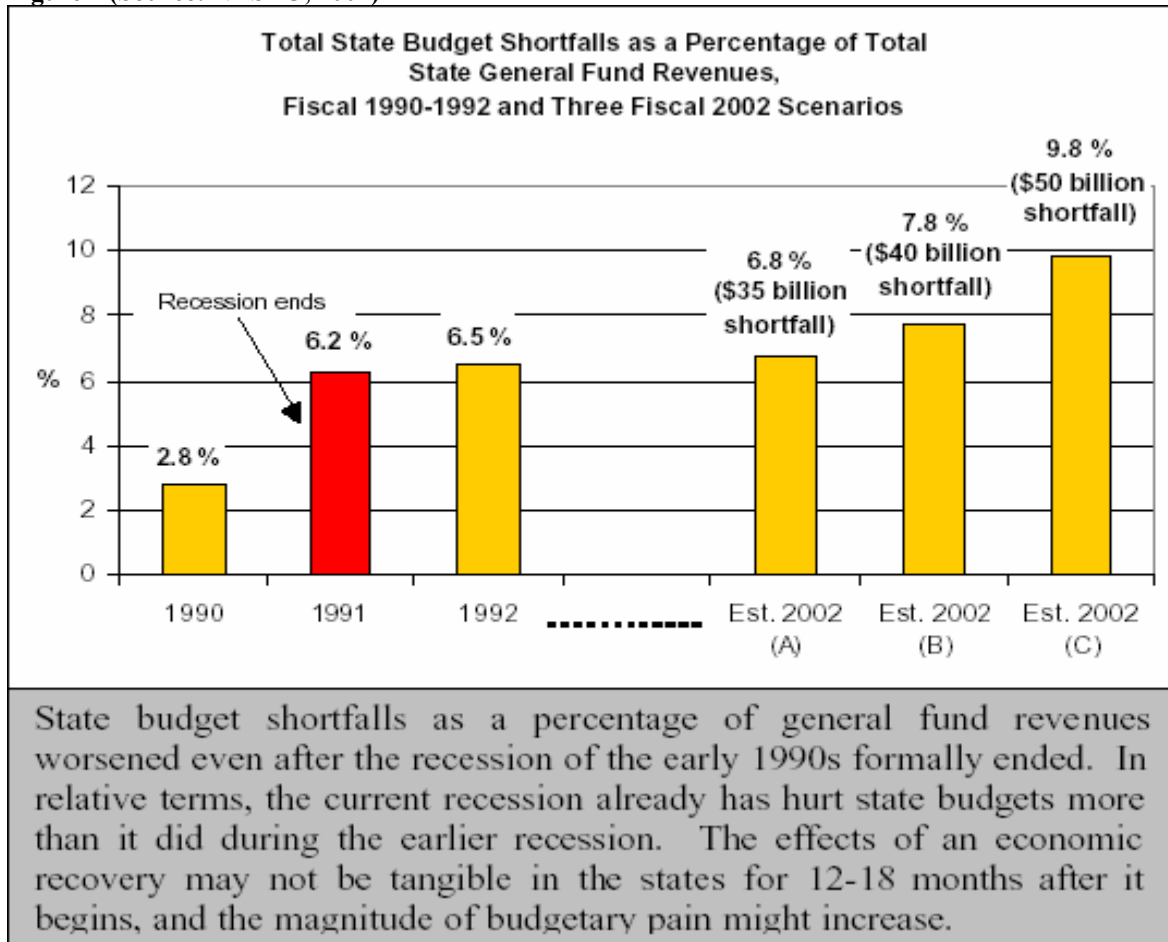
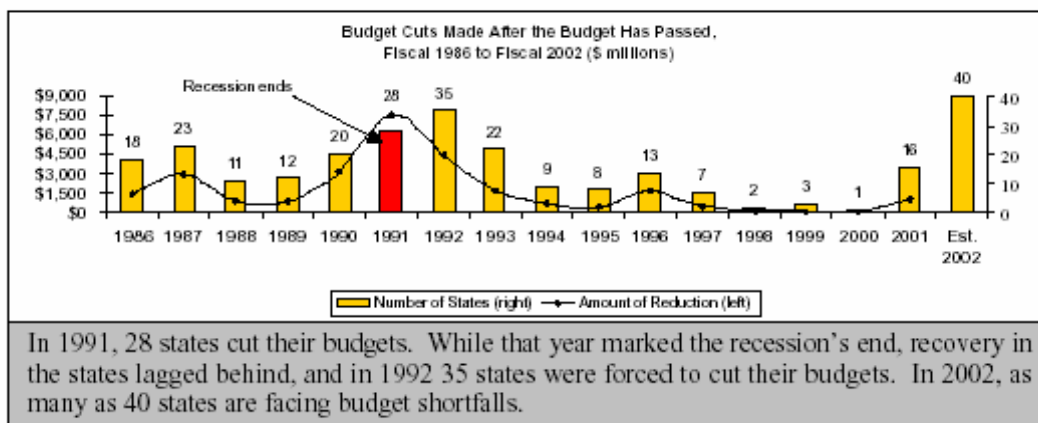


Figure 2 (Source: NASBO, 2002)



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C2. General Fiscal Condition in the States

Each summer NCSL surveys state fiscal offices/bureaus for budget and tax actions of recent legislative sessions. As the year goes by additional information keeps trickling in and NCSL prepares revised reports on such matters. What follows is an excerpted and adapted summary of several such reports (NCSL, July, October, 2002; Eckl, October/November 2002; Lyons, 2002; Reynolds, 2002; and NCSL 2003), supplemented with relevant highlights of conditions in Iowa and its neighboring states.

Widespread Budget Deterioration in FY 2002

- In April 2002, 43 states reported budget gaps totaling \$27.3 billion.
- By June 30, the end of FY 2002 for 46 states, the gap had grown to \$37.2 billion (see Table 4).
- Because of state balanced budget requirements, gaps will have to be resolved by the time states officially close their FY 2002 books. Actions to eliminate the gaps in the 42 reporting states included:
 - Implementing targeted or across-the-board budget cuts (29 states)
 - Tapping a variety of state funds (20 states)
 - Tapping rainy day funds (19 states)
 - Using tobacco settlement funds (12 states)
 - Increasing taxes (16 states)
 - Raising fees (12 states)
- Aggregate state balances fell nearly 42% from FY 01 to FY 02, declining from \$31.5 to \$18.4 billion for the 42 reporting states (Figure 3). The aggregate balance combines general fund ending balances with rainy day fund balances.
- Figure 4 shows the year-end balances for the last 25 years. Balance of \$18.4 billion represents 5% of FY 02 general fund spending (Figure 4). It is 3.8% lower than the FY 01 balance of 8.8%. This marks the biggest % drop in state balances since FY 1980.
- The number of states with balances above 5% has fallen. Of the 42 reporting states, 16 ended FY 2002 with a balance exceeding 5% (Figure 5), the level Wall Street analysts recommend. Of these 16 states, four ended with balances exceeding 10 percent. The comparable numbers at the end of FY 2001 were 36 and 14, respectively.
- State rainy day fund balances have fallen as states have tapped their funds. The aggregate balance dropped from \$16.5 billion at the end of FY 2001 to \$10.8 billion at the end of FY 2002 (Figure 3). Rainy day funds account for almost 60 percent of total year-end balances at the close of FY 2002.

Tax Highlights: States Raise Taxes for First Time in Seven Years

Changing course from the tax cut policies of the past seven years, states raised taxes by 1.2 percent in 2002 (Figure 6) fetching \$6.9 billion (Table 5). Tax changes for the past 11 years are shown in Figure 6, tax changes by state for FY 2002 are shown in Figure 7, and a listing of actual change and its value as a percent of total collections is presented below:

- \$6.9 billion increase in 2002 (1.2 percent)--48 states reporting

- \$1.5 billion reduction in 2001 (0.3 percent)
- \$9.9 billion reduction in 2000 (2.0 percent)
- \$7.3 billion reduction in 1999 (1.7 percent)
- \$7.1 billion reduction in 1998 (1.6 percent)
- \$2.6 billion reduction in 1997 (0.6 percent)
- \$4.0 billion reduction in 1996 (1.0 percent)
- \$3.3 billion reduction in 1995 (0.9 percent)

Of the 47 states reporting, 16 raised taxes by more than 1 percent of 2001 collections (Figure 7). Of the 16 states, only Kansas in our neighborhood increased taxes by more than 5 percent. Thirty states took no significant tax actions. States raised a total of \$8.6 billion in additional revenues from all sources (Table 6). States raised \$1.7 billion in non-tax revenues through fees, accelerations and other actions.

Personal Income Tax. Nebraska also raised income tax rates in all brackets for 2003 only. Minnesota reduced its K-12 education tax credit to 75 percent from 100 percent

Sales and Use Tax. Kansas raised it from 4.9 percent to 5.3 percent for \$156 million, and Nebraska raised its sales tax rate by one-half percent for one year only and expects to generate \$67 million. Nebraska also expanded the sales tax base to include a number of services that were previously exempt.

Health Care Provider Taxes. Only a few states took action around health care provider taxes and fees. Iowa adopted a new fee on intermediate health care facilities and Missouri adopted a temporary pharmacy provider tax with variable rates up to 6 percent.

Cigarette and Tobacco Taxes. The biggest increase was reported in the tobacco tax category. Eighteen states raised taxes on cigarettes and tobacco products for a total of \$2.9 billion. In our neighborhood, Illinois, Kansas, and Nebraska increased taxes on cigarettes or tobacco products.

Changes in Revenues and Spending in FY 2002

FY 2002 was year of belt tightening. Revenue shortfalls, spending overruns, use of rainy day funds, closing the budget gaps for FY 2002, and enacting balanced budgets for FY 2003 were the major themes that consumed legislative attention in almost all the states around the nation. Many were concerned about reduced personal income tax collections. Nationally, personal income taxes account for about 36 percent of state tax revenues, whereas in Iowa such taxes are expected to contribute over 47 percent of 2003 revenues. In addition to personal income tax, sales and corporate income taxes were also falling short of projections. In Iowa, sales and corporate income taxes are expected to contribute 29 and 4 percent of revenues in FY 2003.

FY 2002 revenues were 1.2 percent below collections for the 42 reporting states. Among those states, eight had drops in excess of 5 percent. Aside from Alaska's 29 percent decline, where oil-related revenues were well below near record collections in FY 2001, the other states with slippage greater than 5 percent were Idaho (-9.9 percent), **Iowa (-8.9 percent)**, Connecticut (-7.4 percent), Wyoming (-6.8 percent), Georgia (-6.6 percent), Vermont (-5.8 percent) and Utah (-5.7 percent). Twelve states reported declines in spending from FY 2001 levels. The largest drops were in **Iowa (-5.7 percent)** and Michigan (-5.6 percent).

To reduce the budget gap, a wide range of other actions such as hiring freezes, employee restrictions, layoffs, delaying capital projects, and freezing purchases were also employed.

Looking Ahead to FY 2003

Growing budget problems posed significant challenges for states as they deliberated their FY 2003 budgets.

- Because most states have enacted their FY 2003 budgets, they already have taken action. Latest estimates indicate a budget gap of \$49.1 billion (Table 4) for FY 2003. California's astonishing \$15.1 billion gap accounts for nearly 31 percent of the total. Thirteen states reported gaps in excess of 10 percent.
- General fund ending balances are expected to decline further from FY 2002 levels. For the 40 states providing FY 2003 budget data, the aggregate balance is expected to decline to 3.7 percent (Figure 4). Twenty-five states expect their balances to fall from FY 2002 levels, four expect no change and 11 expect improvement.
- Only six states are expected to end FY 2003 with a year-end balance over 5 percent, with two of these over 10 percent (such figures for FY 2001 and FY 2002 were 36 and 14; and 16 and 4 respectively).
- Reduction in revenues and the increased payout of income tax returns are of significant concern to the states because they account for more than a third of state tax revenues. In Iowa, such sources contribute to 47-48% of state revenues. In many states, sales and corporate income taxes are also failing to meet projected levels.

Similar to FY 2002 actions, FY 2003 also includes:

- Cutting spending (26 states)
- Tapping a variety of state funds (23 states)
- Using tobacco settlement funds (16 states)
- Increasing taxes (16 states)
- Tapping rainy day funds (12 states)
- Raising fees (10 states)

Once again, to reduce the budget gap, a range of actions similar to FY 2002 were initiated in FY 2003. These included hiring freezes, employee restrictions, layoffs, delaying capital projects, freezing purchases, and gaming expansion.

Revenue and Spending Projections for FY 2003

- State revenues are projected to grow 3.7 percent above FY 2002 levels in the 40 states providing revenue information. Spending is budgeted to grow 1.6 percent above FY 2002 levels.
- Medicaid will capture the largest percentage of new spending in FY 2003. With 40 states reporting, Medicaid is budgeted to grow 8.2 percent. This is two to three times higher than the other major categories of state spending: K-12 education (4.8 percent), corrections (3.2 percent) and higher education (1.8 percent).

Table 4. Reported Estimated Budget Gaps, July, 2002		
State	FY 2002	FY 2003

Table 4. Reported Estimated Budget Gaps, July, 2002				
	Amount (millions)	Percent of FY 2002 General Fund Budget	Amount (millions)	Percent of FY 2003 General Fund Budget
Alaska	777.4	32.0	842.7	35.0
California	7,500.0	9.6	23,700.0	28.0
New Jersey	3,500.0	14.8	6,000.0	25.6
Illinois	1,600.0	6.4	1,000.0	4.0
Iowa	579.8	11.9	492.9	10.7
Kansas	300.4	6.7	704.4	15.8
Minnesota	600.0	4.5	1,690.0	11.5
Missouri	520.0	6.5	848.3	10.7
Nebraska	221.0 (B)	4.2 (B)	250.0	9.3
South Dakota	19.6	2.3	36.1	4.1
Wisconsin	1,100.0 (B)	5.0 (B)	1,117.3 (B)	5.0 (B)
Total	\$37,221.0		\$57,974.1	

Revised Estimated Budget Gaps, October, 2002				
California	8,500	11.3	15,100	19.7
Total	\$37,152		\$49,074	

B = biennial amount

Note: Shortfalls amounts reflect what states eliminated or expect to eliminate by the end of FY 2002 and FY 2003.

Note: To arrive at the FY 2002 total estimated budget gap, the calculation includes half of the biennial shortfalls reported in Nebraska and Wisconsin.

Note: To arrive at the FY 2003 total estimated budget gap, the calculation includes half of the biennial shortfall reported in Wisconsin. Nebraska's number is for FY 2003 only.

Source: NCSL survey of National Association of Legislative Fiscal Offices, June 2002. NCSL (October, 2002).

C3. The Most Recent Budget Updates

A survey conducted by the NCSL in late January 2003 covering state revenue and expenditure situation through FY 2003 reveals that there is no immediate end in sight to these severe budget troubles. Revenue growth continues to be sluggish, with a worrisome outlook for future revenue performance. Expenditures are exceeding budgeted levels.

Figure 3. Diminishing Reserves (In billions of Dollars)
 (Source: NCSL, October 2002)

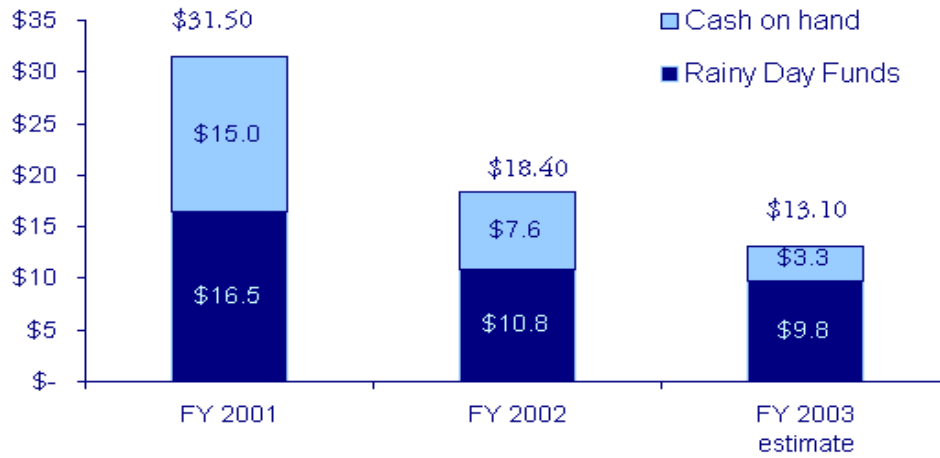


Figure 4. State Year-End Balances as a Percentage of General fund Expenditures FY 1978-FY 2003.
 (Source: NCSL, October 2002)

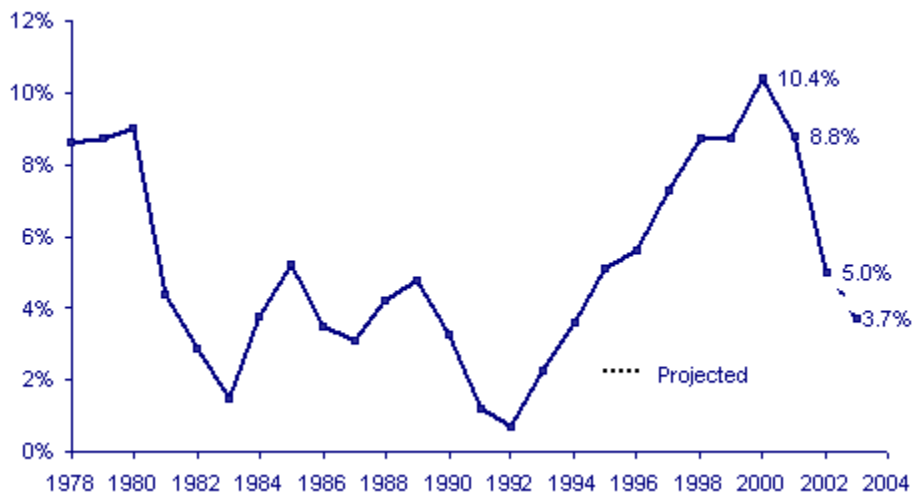


Figure 5. State Year-End Balances: FY 2002 as a Percentage of General Fund Expenditures.

(Source: NCSL, October 2002)

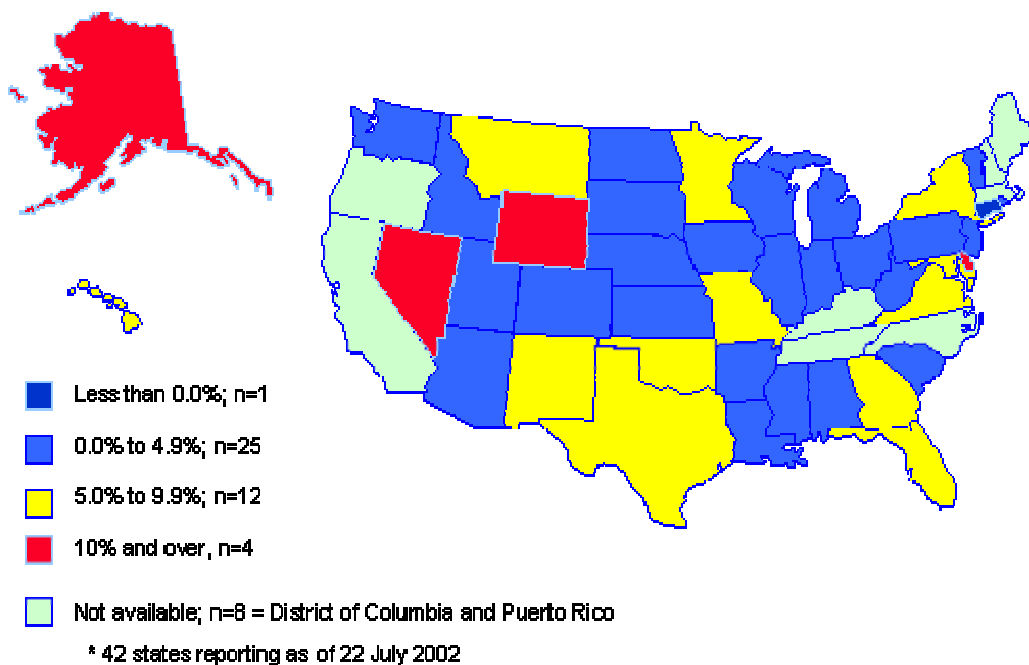


Table 5. 2002 Net State Tax Changes by Type of Tax (in millions)
(Source: NCSL, October 2002)

<u>Tax Type</u>	<u>\$ in millions</u>
Personal income	689
Corporate income	1,043
Sales and use	1,053
Healthcare	339
Motor vehicle	190
Cigarette and tobacco	2860
Alcoholic beverages	7
Miscellaneous	724
Net change	6,906

* 48 states reporting

Table 6. 2002 Net State Revenue Changes (in millions)

(Source: NCSL, October 2002)

Taxes	\$ 6,906
Fees	592
Other	1,102
Total	\$8,600

Midway through FY 2003, the performance of the general fund was below estimates in a large number of states. In our neighborhood and the comparison states of Alaska, California and New Jersey, 8 of the 11 states report performance below estimates (CA, NJ, IL, KS, MO, NE, SD, WI), two above (AL, IA), and one on target (MN). The 2003 NCSL survey also indicated that the outlook for the remainder of the fiscal year was one of concern in 7 of 11 states (AL, NJ, IA, MN, NE, SD, WI) and pessimistic in the remaining four (CA, IL, KS, MO). The major areas of overruns are healthcare (AL, CA, NJ, IA, MN, MO, SD, WI), human services (CA, IA, NE, SD, WI), and others (CA, NJ, IA, KS).

FY 2003 Highlights

The state of our economy is in flux and the roller coaster performance of the budget estimation process is illustrative of this fact. In early 2002, when states were developing their FY 2003 budgets, the aggregate gap was estimated to be of \$49.1 billion. In November 2002, the estimated gap was trimmed to \$17.5 billion. The current gap, based on the January 2003 survey, is approximately \$25.7 billion, or about 50% higher than the November 2002 estimate (see Table 7).

- Twenty-nine states have imposed across-the-board budget cuts. Specific program cuts include: Medicaid (13 states), higher education (13), corrections (9), K-12 (9), local revenue sharing (9), and TANF (1)
- State employees are affected through layoffs (8), furloughs (5) and travel bans (9)
- States are raising fees or tuition (5)
- States also are tapping rainy day funds (10), tapping other state funds (15), or eyeing tobacco funds (7). Nine states have delayed capital projects and four shifted some projects to debt.

FY 2004 Projections

- Looking ahead to FY 2004, the fiscal outlook is grim. The aggregate FY 2004 gap is \$68.7 billion (see Table 8) for the 36 states facing budget problems.
- On top of further spending reductions, some states acknowledge that they will consider tax increases.
- Like last year, cigarettes and tobacco are again the focus of most proposals to raise taxes. Six will look at higher taxes on alcohol. Six states already report that a sales tax rate increase or base expansion is possible, while four note that increases in the personal income tax are under consideration.

Figure 6. Net State Tax Changes by Year of Enactment, 1992-2002
 (Source: NCSL, October 2002)

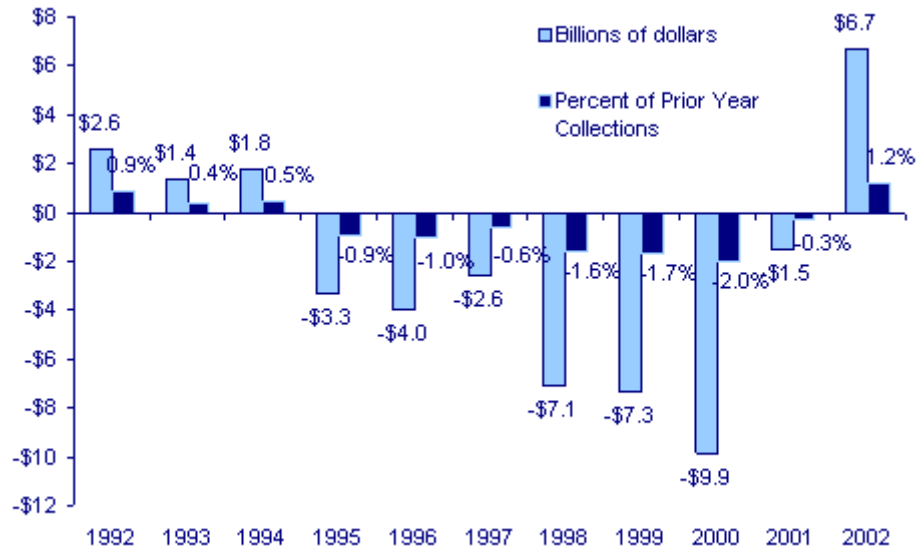
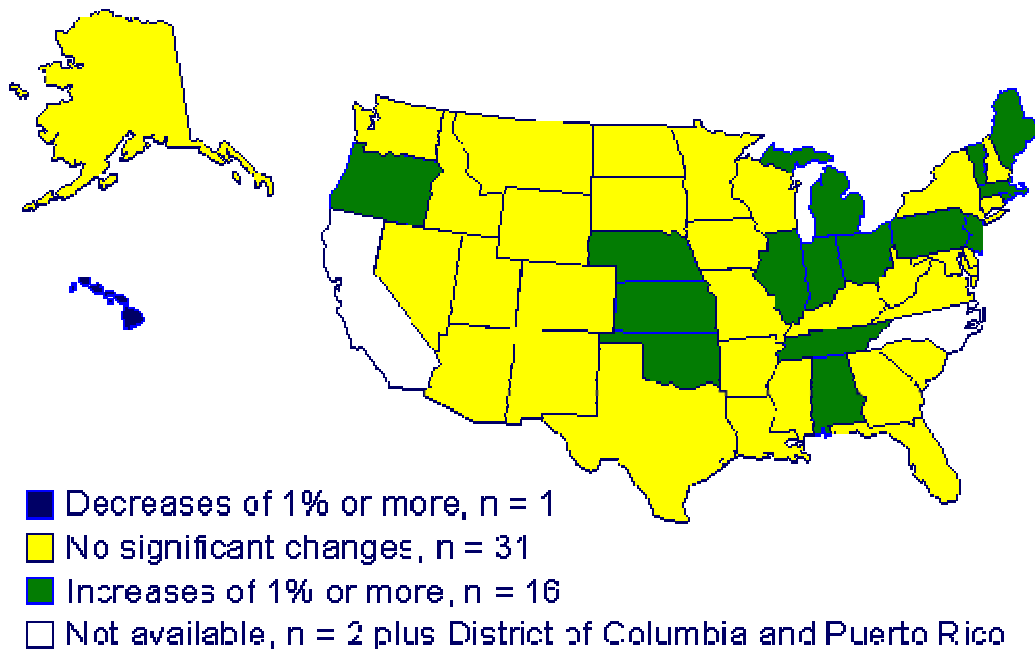


Figure 7. 2002 Net State Tax Changes as a Percentage of 2001 Tax Collections
 (Source: NCSL, October 2002)



State or Jurisdiction	November 2002 Estimate		January 2003 Estimate	
	Dollars (\$ in millions)	Percent of Gen Fund Budget	Dollars (in millions)	Percent of Gen Fund Budget
Alaska	490	21	748	30
California	6,100	8	8,500	11
New Jersey	0	0	1,100	5
Illinois	200	1	592	3
Iowa	50	1	0	0
Kansas	254	6	150	4
Minnesota	0	0	356	3
Missouri	0	0	300	5
Nebraska	161	6	174	7
South Dakota	0	0	0	0
Wisconsin	0	0	373	3
Total	17,500	3.6	25,704	5.2

N/R = no response.
Source of Data: National Conference of State Legislatures survey, January 2003.

Table 8. Estimated FY 2004 Budget Gaps (in millions of \$)

Estimated	Budget Gap	Percent of General Fund
Alaska	896	36.0
California	26,100	30.0
New Jersey	4,600	18.5
Illinois	3,500	15.8
Iowa	414	9.3
Kansas	750	16.7
Minnesota	2,367	15.0
Missouri	1,000	15.0
Nebraska	350	13.0
South Dakota	54	5.9
Wisconsin	1,999	16.0
Total	\$68,707	N/A

Note: For Nebraska and Wisconsin, the amounts shown are half of the biennial budgets.

Source of Data: National Conference of State Legislatures survey, January 2003.

As mentioned earlier, reduction in revenues and the increased payout of income tax returns are of significant concern to the states because on the aggregate they account for more than a third of state tax revenues. In Iowa, such sources contribute to 47-48% of state revenues. Table 9 presents a summary of the status of tax collection (report as of January 2003) in Iowa, its neighbors, and the comparison states. In the area of personal income tax collection, Iowa seems to be an exception (see Table 9).

Table 9
Performance of tax collection in selected categories and by states are shown below:

<u>State</u>	<u>Notes</u>
Alaska	Major tax categories are performing on target.
California	The personal income tax is down sharply. Sales taxes are down modestly. The corporate income tax is near estimate.
New Jersey	The personal income tax is down sharply, the sales tax is slightly below target, and the corporate tax is ahead of projections.
Illinois	All major tax categories are performing below projected levels.
Iowa	The personal and corporate income taxes are up by 4.5% and 10.4% through December 1, 2002.
Kansas	The personal income tax is up by 0.6% and sales and compensating use taxes are down by 1.2%.
Minnesota	The personal income tax is down substantially by 6.5% from the previous forecast in February 2002.
Missouri	General sales tax is up by 1.06%; personal income tax is down 2.5%; and corporate income tax is down 17.25%.
Nebraska	The individual income and sales taxes are ahead of estimates by 0.5% and 0.7%, respectively and the corporate income tax is behind estimates by nearly 26%.
South Dakota	The sales tax revenue is up by 2.43% and the contractor's excise tax is up 5.43%.
Wisconsin	Individual and corporate income taxes, sales taxes and excise taxes are below earlier estimates.

Source of Data: National Conference of State Legislatures survey, January 2003

Under the present circumstances, many elected officials believe that no options can be automatically ruled out or left off the table. As grim prospects of further revenue shortfalls loom in the horizon, many states are eying proposals to increase taxes in the following areas: higher income tax brackets, cigarettes, alcoholic beverages, wine producers, sales and use tax, hotel/motel/lodging room occupancy tax, gaming tax, and closing several tax loopholes (NCSL, 2003).

To provide a synoptic summary of what is going on at the economic and fiscal fronts in the states, a few newspaper clippings are presented in the following section.

C4. Excerpts from recent Reports

Since many states have a constitutional requirement to produce a balanced budget, the elected officials are forced to explore a variety of approaches. Many of these approaches such as cutting spending, increasing revenues, and using savings or rainy day funds to cover areas of need are highly contested and debated in the chambers of our legislatures. Three short excerpts are provided below to give a flavor of what is being discussed at the state level:

Coleman (2002) writing in the Sacramento Bee reports:

....California's budget deficit is too large to be closed with spending cuts alone, and lawmakers should consider a temporary tax increase, 14 economists said Wednesday. "We don't think in the long run that raising taxes is a good thing," said Alan Auerback, an economics professor at the University of California, Berkeley. But short-term tax hikes would be better than using just budget cuts to erase a deficit that could reach \$34.6 billion, he said. Cutting that much from state spending would be "a major drag on the economy," Janet Yellen, another Berkeley economics professor, added in a conference call with reporters.

....Auerbach and Yellen said lawmakers should consider raising income taxes on the wealthiest Californians, a proposal that is part of Davis' plan, or temporarily increasing sales taxes. "In choosing which taxes to raise, it's important to choose taxes that distort economic activity as little as possible," Auerback said.

....Senate President Pro Tem John Burton, D-San Francisco, questioned whether the veto of the Vehicle License Fees (VLF) bill would generate any Republican votes for Davis' tax increases. "The Republicans have made it pretty clear to me that they are not voting for any tax increases anywhere, any place, any time," he said.

Lipka and Couloumbis (2002) writing in the Philadelphia Inquirer report:

....This year, New Jersey pinned its hopes of closing a \$6 billion budget gap on the backs of smokers, businesses and property owners.

....In the current \$23.4 billion budget, meeting that obligation has meant freezing state aid to schools and municipalities - which hit many property taxpayers in their pocketbooks - and borrowing \$1.1 billion against New Jersey's share of the national tobacco settlement.

....The strategy revolves around McGreevey's insistence that there be no increase in income or sales taxes, the official said. The last time a New Jersey governor raised those taxes - Democrat Jim Florio in 1990 - was the last time that a governor served only one term.

...."When you sell off the tobacco revenues, that's a one-shot gimmick," said Donald M. Scarry, a Rutgers University professor and economist. "What Trenton

really is... is a place of one-shot gimmicks."

....Another proposal the administration is considering centers on a complex transaction with Horizon Blue Cross Blue Shield of New Jersey. It has been negotiating with state officials to obtain a for-profit status, Horizon spokesman Fred Hillmann said. Though it has yet to submit a formal application to the state, the company is seeking the conversion to be competitive with private insurers, he said. If that conversion takes place - projected initially by the company for mid-2003 - Horizon will eventually pay a state-controlled foundation an amount equal to the nonprofit's value. The payment would represent a payback of sorts for all the years the insurer received tax breaks as a not-for-profit entity, Hillmann said. Under legislation approved last year, the Horizon money would then be deposited in a fund for purposes of improving public health. But in New York, where state regulators recently approved such a conversion of Empire Blue Cross Blue Shield, the Pataki administration wants to use most of the projected \$1 billion windfall to pay for salary increases for members of a powerful union representing hospital workers. That angered consumer groups, which contended that the money was being used to plug holes in the state budget.

Finally, a press release from the Office of New York State Comptroller Alan Hevesi (2002) states that:

....President Bush's plan to stop taxing corporate dividends will cost New York State and City a total of approximately \$3.4 billion in lost tax revenues and added borrowing costs over the next four years and more than \$12 billion over ten years

....State budget officials estimate a gap of as much as \$2.5 billion for the fiscal year ending March 31 and another \$10 billion for the fiscal year starting April 1. New York City currently faces a potential gap of more than \$3 billion for its 2004 fiscal year starting July

....Not only has the President rejected proposals to provide aid to help state and local governments in this time of fiscal crisis, his tax cutting plan would add substantially to the already huge deficits we face," Hevesi said. "What's more, it's not at all clear that these particular tax cuts will provide a short-term boost to the national economy, which is what we desperately need. If the President is not going to help state and local governments, he should at least not hurt us. He should structure his dividend tax cut so that states are not injured."

Section D. Environmental Protection in a Recession

On a periodic basis, the analytical or the research arm of the National Council of State Legislatures (NCSL), National Association of State Budget Officers (NASBO), National Governors Association (NGA), Council of State Governments (CSG), CBO, OMB, EPA, USGS, NSF and the Environmental Council of the States (ECOS) have attempted to answer the many questions raised in the earlier part (Section A) of this report. With the advent of high speed communication technologies and the World Wide Web (WWW), it is now possible for any individual or an organization with an internet connection to access voluminous state-level financial information and carry out their analyses.

D1. Federal support of Environmental Protection

a. Natural Resource & Environmental Allocations – Historical Records

Several departments, agencies and units of the federal government carry out missions broadly defined as “Natural Resources and the Environment (NR&E).” Prior to World War II, a significant component (over 10%) of the federal spending was devoted to NR&E. The war years (1941-46) saw a significant increase in federal spending devoted to the military (categorized as national defense) and a concomitant decrease in NR&E outlays. The NR&E outlays as a percent of total federal outlays for the last 60⁺ years (1940-2004) are shown in Figure 8. For the last 25 years, allocation for NR&E has been slowly reduced from the peak of 2.5% in 1977 to amounts in the range of 1.3-1.5% of federal outlays in recent years.

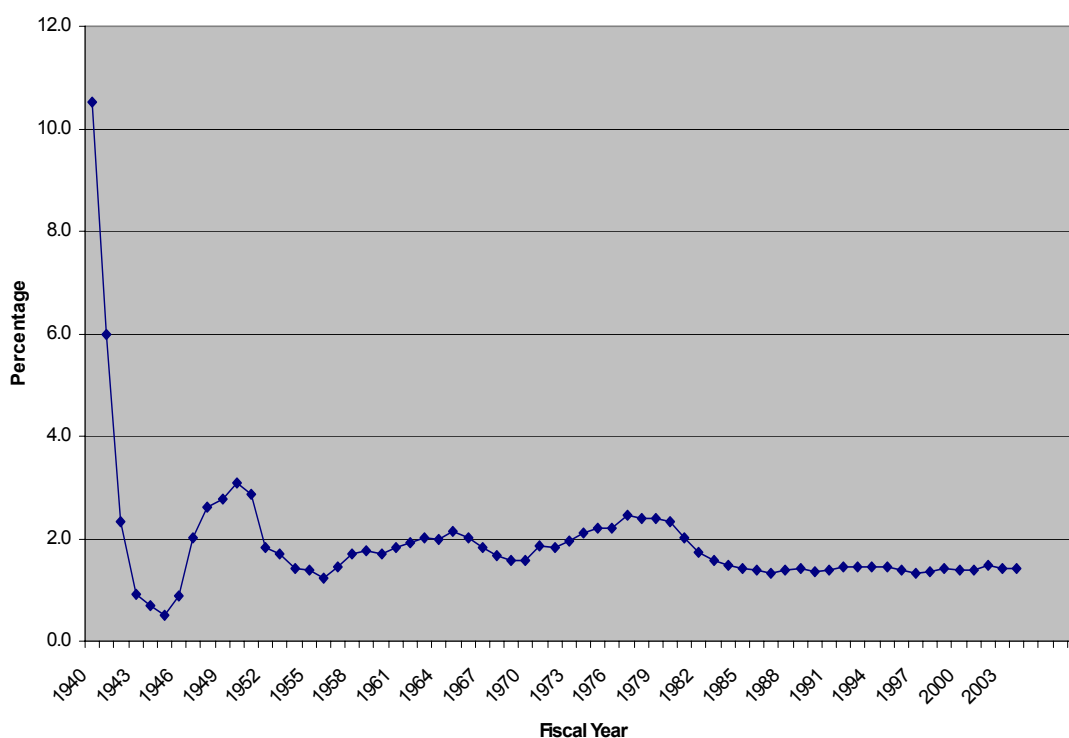
An in-depth analysis of federal allocations to the NR&E function is beyond the scope of this research. The individual components that make up this function are included under several accounts of different agencies and departments of the federal government. Some of the major agencies, departments, or other units with significant NR&E components include the Environmental Protection Agency (EPA); the departments of Agriculture, Commerce, Defense, Energy, and Interior; and the Corps of Engineers and the National Aeronautic and Space Administration (NASA).

b. Natural Resource & Environmental Allocations – Current Trends

The president’s federal spending proposal for FY 2004 is \$2.245 trillion, an estimated 19.9% of the GDP (Table 10). According to the White House, this level of spending is a 4.8 % increase over estimated 2003 levels. The federal NR&E spending in FY 2004 would be a mere 25 cents for every \$100 of the GDP (Table 10).

The proposed federal discretionary funding of \$836 billion for FY 2004 will be about 4.0% higher than the estimated FY 2003 level. About 48% of the federal discretionary dollars are assigned for defense expenditures and the remaining for all non-defense matters (Table 10). In the FY 2004 budget request, the fastest growing discretionary spending categories are homeland security (DHS) at 5.5% followed by defense at 4.2%. All other discretionary spending will grow at 3.8%. Amidst these increasing expenditures, the discretionary funding for NR&E is slated for a \$1.6 billion reduction (-5.5%) compared to FY 2002, falling from \$29.6 billion to \$27.9 billion. According to

Figure 8. Natural resources and environment outlays as a percent of Federal outlays (1940-2004)



Source of Raw Data: Office of Management and Budget, *Budget of the U.S. Government FY 2004*.

Table 10. Distribution of the FY 2002-04 Budget (outlays in billions of dollars)

	FY 2002	FY 2003	FY 2004	Change FY03-04	
	Actual	Est. 1/	Budget	Amount	Percent
GDP	10,337	10,757	11,303	546	5.1
Federal Budget (Outlays)	2,011	2,142	2,245	103	4.8
NR&E Spending	29.6	29.2	27.9	-1.3	-4.5
Fed Budget as a % of GDP	19.5	19.9	19.9		
NR&E spending (% of GDP)	0.29	0.27	0.25		
TOTAL Discretionary	734	804	836	32	4.0
Defense	349	386	401	15	3.9
Nondefense	386	418	435	17	4.1

Source of Raw Data: Office of Management and Budget, *Budget of the U.S. Government FY 2004*.

Note: The projected inflation rate between FY 2003 and FY 2004 is 1.9 percent.

1/ FY 2003 figures are based on CBO estimates reflecting final FY 2003 appropriations. Some FY 2004 figures also adjusted.

NRDC (2003), if we were to take inflation & other changing expenses into account, then the shortfall will balloon to nearly \$2.2 billion.

c. Departmental or Agency Allocations over Historical Times

The U.S. EPA was founded in 1970 and was given the responsibility to implement and enforce the provisions of a dozen major federal laws such as the Clean Air Act, the Clean Water Act, the Safe Drinking Water Act, the Resource Conservation and Recovery Act, the Superfund and others. Many of these laws and their amendments were put in place during the 1970s and 1980s and therefore it became necessary to appropriate sufficient funds for the EPA so that it can effectively implement the provisions of these laws. Some of the other NR&E missions of the federal government related to resource development, enhancement, science & technology, conservation and protection lie within the purview of major agencies such as agriculture, energy, interior, and commerce. Using OMB's historical data, Table 11 was constructed to explore patterns in federal appropriations to these agencies and the US EPA. From Table 11, it is quite clear that the US EPA has grown the least among the five members of the comparison group, whether considered over the last 5 years or 25 years.

Table 11. Growth of selected federal departments/agencies over the last 25 years

<u>Department/Agency</u>	<u>% Change in Department/Agency Budget over a period of:</u>				
	<u>25 years</u>	<u>20 years</u>	<u>15 years</u>	<u>10 years</u>	<u>5 years</u>
	<u>1977-02</u>	<u>1982-02</u>	<u>1987-02</u>	<u>1992-02</u>	<u>1997-02</u>
Agriculture	194	50	39	22	31
Commerce	164	159	150	107	40
Energy	250	52	65	14	22
Interior	202	147	93	49	44
EPA	71	47	52	25	21

Source of Raw Data: Office of Management and Budget, *Budget of the U.S. Government FY 2004*.

d. Departmental or Agency Allocations – Current Trends

To further explore the performance of selected NR&E agencies in the current economic climate, the President's FY 2004 budget proposal is briefly compared with those of FY 2003 (estimates) and FY 2002 (actual).

1. The Environmental Protection Agency

During FY 2002 and 2003, the president's budget request for EPA was increased by Congress so as to enable the EPA to carry out its missions. On closer look at the EPA's budget (Table 12), it would become clear that investments in water quality protection efforts would be reduced from \$2,659 million in FY 2002 to \$1,798 million in FY 2004 -- a loss of \$861 million, or more than 32 percent. The Clean Water State Revolving Fund (CWSRF) which loans money to states to build sewage treatment plants would decline by \$500 million, from \$1,350 million in FY 2002 to only \$850 million in FY 2004 and other water related projects would be reduced by \$361 million, from \$459 to \$98 million. Superfund would increase from \$1.30 billion in FY 2002 to \$1.39 billion in FY 2004, but many environmental groups claim that because of the failure of the administration to reinstate the "polluter pays" tax, much of the cost of cleanup would be borne by taxpayers from general revenues (Natural Resources Defense Council, 2003; Friends of the Earth, 2003). Finally, compared to FY 2003 request, the core operating programs of the EPA would increase by \$280 million to about \$4.25 billion (APWA, 2003).

Table 12. The budget of the Environmental Protection Agency (in millions of dollars)

	FY 2002	FY 2003	FY 2004	Change FY03-04

	<u>Actual</u>	<u>Est. 1/</u>	<u>Budget</u>	<u>Amount</u>	<u>Percent</u>
Science and Technology	1,788	716	731	16	2.2
Env. Progs. and Mgmt.	2,097	2,098	2,220	122	5.8
Superfund	1,330	1,265	1,390	125	9.9
State and Trbl. Asst. Grnts.	3,738	3,835	3,121	-714	-18.6
Buildings and Facilities	25	43	43	0	0.7
Leaking USTs	73	72	73	1	1.0
Oil Spill Response	15	15	16	1	4.7
Inspector General	34	36	37	1	2.9
Total EPA Appropriations	8,100	8,079	7,631	-448	-5.5

Source of Data: OMB data for R&D for FY 2004, agency budget justification, information from agency budget office, and *Budget of the United States Government FY 2004*. Discretionary budget authority only. Excludes mandatory spending and offsets.
FY 2003 figures reflect AAAS estimates of final FY 2003 appropriations.

2. The Department of Energy

In FY 2004, the department of energy is slated to receive \$23.4 billion, 5.8 percent more than what was requested for the department in the FY 2003 budget. As can be seen from Table 13, there will be a sharp increase (9.7%) for DOE defense related efforts in the area of National Nuclear Security Administration (NNSA), whereas, DOE's defense environmental services will see a reduction (-6.2%) of efforts in FY 2004. The president's FY 2004 budget requests funds for hydrogen research and places renewed emphasis on research into sequestering carbon dioxide before it can be released into the atmosphere (Whitehouse, 2003). Critic's claim that benefits of such programs won't be seen for more than a decade, while the budget underfunds proven renewable programs that offers energy independence today (Friends of the Earth, 2003). NRDC, a Washington-based legal think tank states that "The administration also recycles a request to link drilling in the Arctic National Wildlife Refuge to renewable energy funding. This is a craven attempt to justify spoiling a national treasure under the guise of renewable energy."

Commenting on another initiative of this administration, an environmental interest group claims that "The FreedomCar and FreedomFuel Initiatives are funded at a combined total of \$272 million in this budget. Although laudable in goal, Friends of the Earth fears that such concepts will be used as a smokescreen to delay tougher fuel economy standards. Finally, the FY 2004 budget requests \$591 million for the waste repository at Yucca Mountain, a \$243.7 million increase over FY2002.

3. Natural Resources (Land, water, forests, parks, fish and wildlife)

The FY 2004 budget shortchanges many programs in several resource agencies such as the Land and Water Conservation Fund's core federal land acquisition programs, the National Park Service's commitment to eliminate maintenance backlogs by 2006, land acquisition for wildlife refuges, and the Salmon recovery efforts of the Fish and Wildlife program. Finally, NOAA programs are drastically reduced from \$510 million in FY 2002 to \$411 million in FY 2004.

Table 13. Department of Energy Budget (discretionary budget authority in millions of dollars)

	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>Change FY03-04</u>	
	<u>Actual</u>	<u>Est. 1/</u>	<u>Budget</u>	<u>Amount</u>	<u>Percent</u>
DOE Defense Programs:					

Natl Nucl. Sec. Adm.	7,596	8,053	8,835	782	9.7
Defense Env. Services ¹	1,025	1,060	995	-65	-6.2
Total DOE Defense	14,688	15,632	16,597	965	6.2
Total DOE Budget	21,317	22,089	23,375	1,286	5.8

Source of Data: Department of Energy budget justification and AAAS estimates of final FY 2003 appropriations. DOE appropriations only (discretionary). Includes R&D and non-R&D components.
¹ Formerly Defense Environmental Management Privatization.

e. R&D in the Federal Budget

Over the last 34 years, the federal R&D effort as a percent of total federal discretionary outlays has increased from a mere 3.1% to the present estimate of 14% in FY 2004 (Table 14). In contrast, the federal R&D outlays as a percent of the GDP has decreased from 1.6% in FY 1970 to 1.0% in FY 2004 (Table 14). Much of the federal R&D budget, about 79% of \$117 billion in 2004, is devoted to defense and health related research (Figure 9); and relatively small amounts are devoted to environment, energy, and agriculture (2%, 1%, and 1%), respectively. The percent change in R&D request (FY 2004 to FY 2003) by the president for selected federal agencies are shown in Figure 10. It is clear, that R&D in the predominantly environment (EPA), resource (Agriculture) or technology (NOAA in Commerce) oriented agencies are slated for significant reductions, while research in defense, health, homeland security, and nuclear technology development programs are favored with significant increases (Figure 10).

Table 14. Historical Trends in R&D and Federal Outlays (in billions of dollars)

	FY 1970	FY 1980	FY 1990	FY 2000	FY 2004
	Actual	Actual	Actual	Actual	Budget
Composition of Outlays (Current \$)					
TOTAL Federal Outlays	196	591	1,253	1,789	2,245
TOTAL Fed Discr. Outlays	120	277	500	615	836
TOTAL R&D Outlays	16	32	65	79	117
Fed R&D (% of Disc Outlays)	3.1	11.5	13.0	12.8	14.0
Fed R&D as % of GDP	1.6	1.2	1.1	0.8	1.0

Source of Data: *Budget of the United States Government FY 2004, Historical Tables.*

f. Natural Resource & Environmental R&D

The R&D effort at the US EPA is slated for a 5.7% reduction (Table 15). At the Department of Energy, much of the slated 4.0% increase would go to atomic energy defense and nuclear energy development, while environmental management/remediation, and radioactive waste management will see cuts or no increase. At the Department of Agriculture a 10.3% cut is being proposed. At the Department of Commerce a cut of 11.9% is being proposed. At the Department of the Interior, BLM would see a significant increase for resource development, whereas, all the other conservation, mapping, measurement and reclamation efforts would see significant reduction or no change. Finally at the National Science Foundation much of the slated 2.8% increase in discretionary budget would go to nano and biotechnologies and atmospheric sciences, whereas, environmental, earth, and ocean sciences will see reduction in the range of 0.7 to 2.8%. Just about five months ago, the President signed into law the NSF Authorization Act of 2002 which was passed by Congress and identified a path of doubling NSF's budget in 5 years. Under such a plan, NSF's discretionary budget should have gone up by a little over 13% instead of the

proposed 2.8%. The only ray of hope is in the area of Biocomplexity in the Environment which will see a 69% increase in FY 2004 compared to the FY 2002 budget of \$59 million.

www.NCSEonline.org.

Table 15. Total R&D Outlays in selected Federal Agencies (budget authority in millions of dollars)

	FY 2002	FY 2003	FY 2004	Change FY03-04	
	Actual	Est. 1/	Budget	Amount	Percent
EPA	592	643	607	-37	-5.7
Dept. of Energy	8,078	8,205	8,535	330	4.0
Dept. of Agriculture	2,112	2,166	1,943	-223	-10.3
Dept. of Commerce	1,227	1,248	1,100	-148	-11.9
Dept. of the Interior	623	627	633	6	1.0
Natl. Science Foundation	3,526	3,927	4,035	109	2.8

Source of Data: OMB data for R&D for FY 2004, agency budget justification, information from agency budget office, and *Budget of the United States Government FY 2004*. Discretionary budget authority only. Excludes mandatory spending and offsets.

FY 2003 figures reflect AAAS estimates of final FY 2003 appropriations.

Conclusions: Prior to World War II, over 10% of the federal spending was devoted to NR&E, whereas, in the last 25 years, allocations to NR&E have been reduced to the range of 1.3-1.5% of federal outlays. It is tedious and time consuming to track down changes in NR&E expenditures because they are contained in the individual program accounts of many divisions of federal departments or agencies such as the EPA, DOE, USDA, USDI, and USDC. There is clear evidence of a major shift in federal expenditures away from NR&E protection and enhancement to resource development, use, and exploitation. Such shifts are observed both in regular allocation of funds to federal agencies as well as in their proposed R&D budgets.

Figure 9.

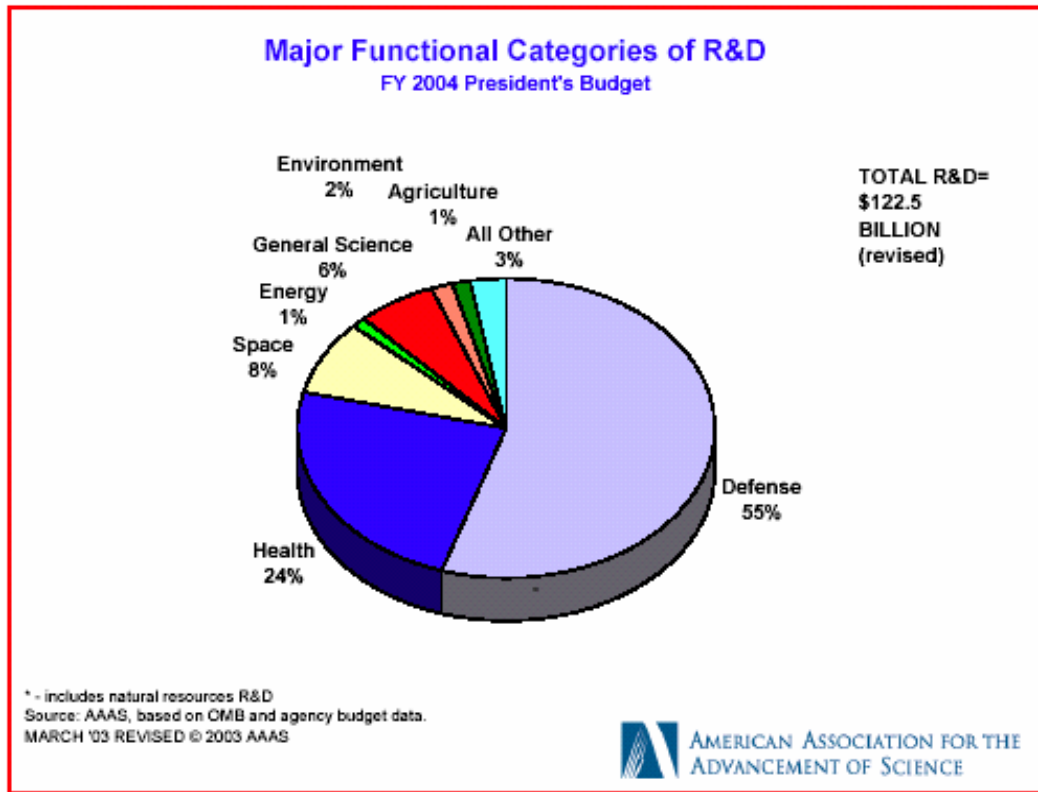
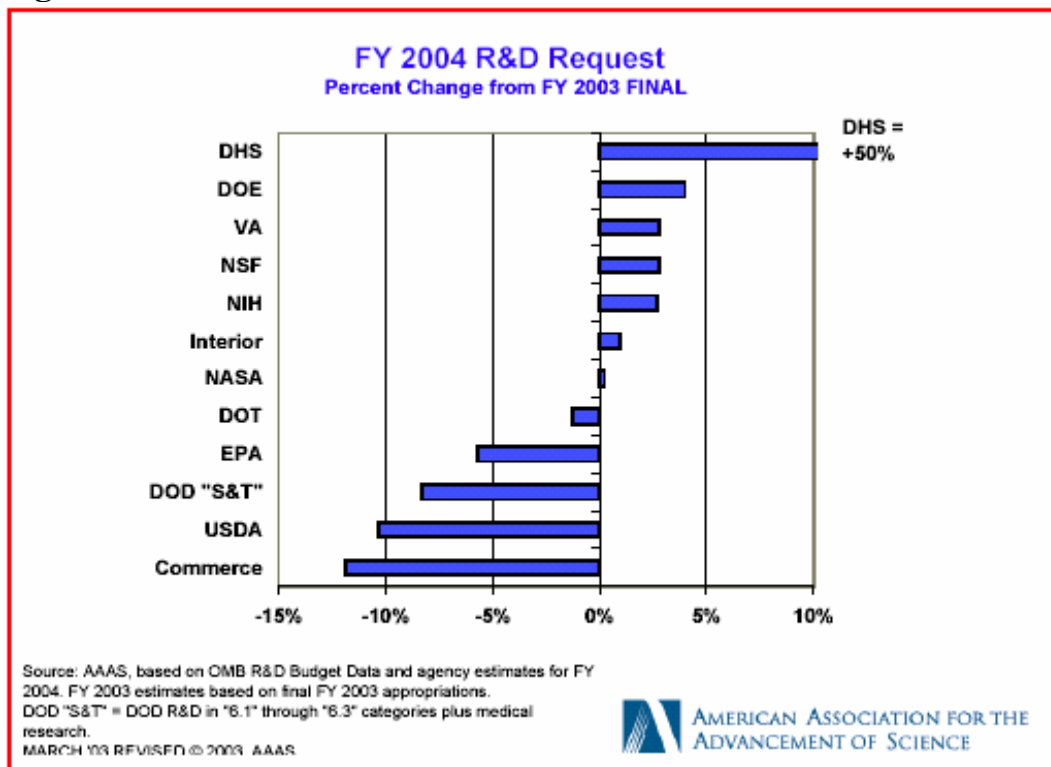


Figure 10.



D2. State support for Environmental Protection

State Environmental Budgets in the Current Climate

The ECOS founded in 1993 is a national non-profit, non-partisan association of state and territorial environmental commissioners. Its major missions are to champion the role of the states in environmental management; serve as an information clearinghouse and policy forum on environmental laws in the United States; provide for the exchange of ideas and experiences among the states in environmental management; and articulate state positions to Congress, federal agencies and the public on environmental issues. It conducts timely surveys on a variety of environmental issues and makes them available through its electronic on-line journal called the ECOSstates.

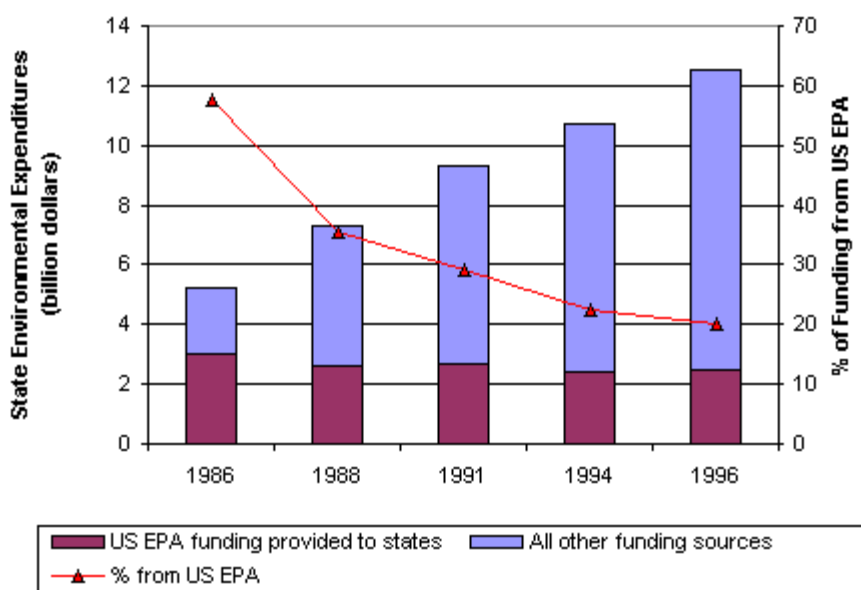
The NASBO, founded in 1945, is a self governing, non-partisan, non-profit affiliate of the National Governors Association. It contributes significantly to the development of national fiscal and executive management policies and budget practices of the NGA. It is composed of the heads of state finance departments, the states' chief budget officers, and their deputies. Its publications related to fiscal surveys and comparative analyses of budget processes in the states are timely and of much value to decision makers and researchers alike.

During 1999-2002, ECOS and NASBO published the results of several surveys of the states on environmental protection, expenditures, and innovation [Brown, 1999, 2001 & 2002; ECOS 2002; and NASBO, 2000]. A summary of the findings from these surveys follow.

In 1993, the U.S. EPA delegated to the states about 30-40% of its environmental responsibility and increased the level of such delegation to 75% by the year 1998 (Brown, 1999). As shown in Figure 11, the states share of NR&E expenses have also increased from 42% of \$5.2 billion in 1986 to 80% of \$12.5 billion in 1996 (Brown, 1988, Marshall, et al., 1999). During this period, states' share of environmental spending increased by 140 percent, while EPA's support to the states decreased by 17% (Figure 11). This reduction is mainly due to the phasing out of EPA subsidies for states' water infrastructure. To meet the increasing environmental workload, the states staffing needs also went up from 38,000 person-years in 1986 to 61,000 person-years in 1996 (Brown, 1999). Obviously such increases in responsibility and investments in environmental efforts have led to a significantly higher level of involvement by the states in enforcement, information gathering, and environmental policy-making.

For another NR&E study reported by Brown (2001), staff at ECOS collected extensive state-level data on environmental spending for the period 1986-2000 and also interviewed numerous agency and legislative staff. The study accounted for spending on 17 types of programs (air pollution, drinking water, forestry, fish and wildlife, geological survey, hazardous waste, indoor air pollution, land management, marine and coastal programs, nuclear wastes, pesticide control, soil conservation, mining reclamation, solid waste, watershed management, water quality, and water resources). For most years, the spending data was for actual amounts, except for the year 2000, when the reported data was for budgeted funds in many of the surveyed states.

Figure 11. Composition and trends in States NR&E Funding during 1986-96



Source: Brown (1999)

States also receive considerable federal funds and EPA is the single largest source of such funds. Other federal contributors include the Department of the Interior (for mining reclamation) and NOAA of the Department of Commerce (for coastal zone management).

In FY 2000, the states budgeted a little over \$13.5 billion for NR&E efforts, with about 33% of it going for water programs (water quality, water resources, marine/coastal and drinking water), 23% for land programs (forestry, land use management, soil conservation, mining reclamation, geological survey), 21% for waste and toxics programs (hazardous waste, solid waste, nuclear waste, and pesticides), 16% for fish and wildlife management, and 7% for air programs (Brown, 2001).

Table 16 shows that the total federal NR&E contributions have been in the range of 3.7 to 4.5 billion dollars during the period 1986-2000 with EPA contributing a lion's share of this total (73 to 79%). It is also clear that during this period the states' contribution as a percent of total NR&E expenditures has significantly increased from 48 to 67%, while the federal contribution has decreased from 52 to 33%. Table 17 has similar figures for "state environmental agencies" (excluding natural resource categories such as forestry, soil conservation, and fish & wildlife) for the three years of 1995, 96, and 97. This Table also breaks down the state contributions by general fund allocation and other sources (user fees and other special funds and revenues). It is clear that the bulk (over 59%) of funding for state environmental agencies come from user fees and special revenues, while the federal contribution is about 23% and the state general funds footing the remaining 18%. It is clear that the states' contribution to their NR&E expenditures have significantly increased over the last two decades compared to their federal counterparts.

Table 16. Composition of state NR&E funds during 1986-2000

	<u>1986</u>	<u>1988</u>	<u>1991</u>	<u>1994</u>	<u>1996</u>	<u>2000</u>	<u>% Change From 86 to 00</u>
All federal funds to states	4.3	3.8	4.0	3.7	3.8	4.5	4.9
EPA funds to states	3.4	2.9	3.1	2.7	2.8	3.3	-4.1
Other federal funds too states	0.9	0.9	1.0	1.0	1.0	1.2	9.0
State gen. fund & user fees	4.0	6.9	7.8	8.8	10.0	9.1	128.5
Total state env spending	8.3	10.7	11.8	12.5	13.8	13.6	64.8
% of federal support to states	52%	35	34	30	28	33	

Adapted from Brown (2001). All figures are in \$ billions adjusted to year 2000 dollars.

Table 17. Composition of state Environmental Agency funds during 1995-97

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>Totals</u>	<u>Percent</u>
All federal funds to states	1.4	1.5	1.3	4.2	22.7
State General Funds	1.1	1.2	1.0	3.3	17.9
User fees & other special revenues	3.4	4.1	3.5	11.0	59.4
Total	6.0	6.8	5.7	18.5	100.0

Adapted from Brown (2001). All figures are in billions of \$ adjusted to year 2000 dollars.

To ascertain the impact of budget cuts on "state environmental agencies" from the completed FY 2002 and the currently ongoing FY 2003, ECOS carried out a survey of such agencies in December 2001 and followed it up in May 2002. The results of these two surveys are summarized in Table 18. Major findings from these surveys are listed below:

Table 18. Estimated "State Environmental Agency" budget cuts FY 2002, N=42 respondents (states), 30 of 42 experienced cuts

	<u>Lowest</u>	<u>Average</u>	<u>Highest</u>
\$ Cut/State (in millions of \$)	0.02	6.54	89.10
% cut (usually of General Fund)	1.0	6.2	26.3
General Fund % of Total Budget	6.4	21.5	60.0
% cut from the Operating Budget	12.7	77.2	100.0

Adapted from Brown (2002) and ECOS (2002).

Definitions/Conditions: “Cuts” usually means a permanent loss of funds, while “reduction” is usually applied to the current fiscal year only. ECOS does not plan on releasing surveyed information on individual states (only statistical averages are released).

December 2001 Survey Results (estimates applicable to FY 2002)

- 30 of 42 responding states experienced cuts and the remaining 12 had not by the date of the survey in early December 2001.
- A total of \$196.4 million is being cut from the surveyed states.
- The average cut in the environmental budget of the 30 states experiencing cuts was \$6.54 million, with the lowest non-zero cut being \$18,800 and the highest being \$89.1 million (see Table 18).
- The average cut from the general fund was 6.2%, with the lowest non-zero cut being 1.0% and the highest being 26.3%. In a few states, cuts included trust or restricted funds.
- An average of 21.5% of “environmental agency” budget was from state general funds, with the lowest being 6.4% and the highest 60.0% (with 12 states reporting this information).
- General funds are often the only funds that a state agency can reallocate based on needs, and when reduced it diminishes the agency’s ability to respond flexibly.
- As expected, the operating budgets took the worst hits, absorbing on the average 77.2% of the cuts, with the lowest being 12.7% and the highest 100.0%. The remaining cuts often going to trust fund programs.

May 2002 Follow-up Survey Results (estimates applicable to FY 2003)

- 30 of 40 responding states experienced cuts and 8 of the 10 remaining had no increases in the budget.
- About \$200 million was cut from the 30 states’ budgets, slightly higher than last year’s total of \$196.4 million.
- The average cut in the environmental budget of the 30 states experiencing cuts was \$6.8 million (slightly higher than last year’s average of \$6.54 million), with the lowest non-zero cut being \$95,000 and the highest being \$70.0 million.
- General fund cuts were the source of most reductions. The average reduction of a state’s general fund was 11.2%. About 74% of the “environmental agency” cuts were taken from the general fund part of their allocation. The average general fund cut was \$5.46 million.

To cope with these “environmental agency” budget cuts of \$500 million over the last two years (projected from 40 responding states to all the 50 states), the states have adopted a variety of budget reduction techniques such as hiring/promotion freezes, travel restrictions, contract and purchase reductions, and transferring funds from one account to another and finally reducing parts of several operating programs in the areas of water, air, solid and hazardous wastes, Underground Storage Tanks, fish and wildlife, and parks. Brown (2002) observed that “Water programs were mentioned often for cuts, but no program will be spared if cuts are as deep as seems likely next fiscal year (FY 2003).” State environmental agencies have not faced such debilitating cuts since the growth years of the early 1990s and Brown (2002) notes again, “now it seems likely that “doing more with less” will return to the agendas of many ECOS members.”

ECOS surveys did not reveal that environmental agencies were either singled out or spared from budget cuts, compared to other agencies. In general, the environmental agencies' cuts were comparable to those of other divisions of state government. Similarly, the survey revealed that the impact of homeland security on environmental agency budgets were minimal.

D3. Environmental Protection in the Midwest

Since our research effort is comprehensive and not exhaustive, we decided to focus on natural resources and environment in the Midwest, especially Iowa and its neighbors to the north and south. Financial information related to natural resources and the environment for Iowa, Minnesota, and Missouri was obtained for the years 1989 to 2003. The bulk of this information was compiled from numerous government documents, websites and contact persons within the three state governments.

Data Sources

In general, natural resources and environment related spending was used to compare Iowa with Minnesota and Missouri. The metrics for this comparison were:

- Total environmental spending
- Environmental spending per capita
- Environmental spending as a percentage of total state expenditures
- Federal funds received for environmental projects/programs as a percentage of total environmental spending

For consistency in comparison, we used and counted the financial data that are expended only through the department of natural resources in each of the three states. Therefore, the term "environmental spending" in the context of this report should be interpreted to mean only the spending that has taken place through the department of natural resources in the three states. Of course, some modest additional NR&E spending also occurs through several other accounts in departments such as agriculture, transportation, and health. To identify and enumerate all these accounts is beyond the scope of this research.

Iowa Information

Information from the Iowa Comprehensive Annual Financial Report (CAFR) was used as the basis of comparison with Minnesota and Missouri. The Iowa CAFR provides:

- Total state revenues and expenditures
- Total combined expenditures for the Departments of Agriculture and Natural Resources
- Combined general fund revenues and expenditures for the Departments of Agriculture and Natural Resources

Through personal contact with the staff of Iowa Legislative Fiscal Bureau and the Iowa DNR, we were able to disaggregate the combined data provided in CAFR and obtain necessary general

fund revenue and expenditure data for the two departments (Agriculture and Land Stewardship & Natural Resources) separately.

To obtain a historical perspective of Iowa's environmental protection efforts and the level of support provided by the legislature, we also examined appropriation documents (Budget Summaries) for FY 1989 through the present. This analysis looked at the Iowa Departments of Agriculture and Natural Resources and their sources of funding. Funding was identified as either operating or capital funds, and whether it came from the general fund or from other funds. To obtain a relative perspective, funding by type at the departmental level was also compared to total appropriations at the state level.

Data for Iowa was obtained from the following four major sources.

- Iowa Comprehensive Annual Financial Report (CAFR) – FY 1989-2002
- Iowa Budget Summary – FY 1989 through 2001
- Iowa Financial Summary (IFS) – FY 2002 and 2003
- Personal contacts with staff of Iowa Legislative Fiscal Bureau and the DNR

The Iowa Budget and Financial Summaries provided much valuable financial data, both current and historical, by various agency and departmental accounts. These included summaries of data on Departments of Agriculture and Natural Resources. Such data was not used for comparative analysis with Minnesota and Missouri. Rather it was used in a historical context to examine and analyze Iowa's environmental appropriations over the period 1989-2002.

Missouri Information

Data was obtained by contacting the Missouri State Department of Natural Resources (DNR). The department provided information from 1988 through 2003. Data was categorized as:

- Total operating funds
- DNR operating funds
- Total capital improvement funds
- DNR capital improvement funds

Each category was further subdivided into general revenue funds, federal funds and other funds.

Minnesota Information

Data was obtained from the state government website (www.finance.state.mn.us/cafr). This site contains Comprehensive Annual Financial Reports (CAFR) for years 1997 through 2002. Data for earlier years were obtained through contacts at the Fiscal Analysis Department of the Minnesota House of Representatives. Minnesota CAFRs are organized into main and supplemental sections. Total government funding and spending data come from the main report, while specific environmental funding and spending information is found in the supplemental reports. The specific environmental data is included in several fund categories which are summed together for the purposes of this analysis. These funds are:

- General Fund

- Natural Resources Fund
- Minnesota Resources Fund
- Game & Fish Fund
- Environmental Fund
- Solid Waste Fund

Other Information

State population estimates were obtained from the US Census Department website (<http://eire.census.gov/popest/archives/state/st-99-3.txt>) for the years 1997 through 2001. These estimates were used in the calculation for environmental spending per capita.

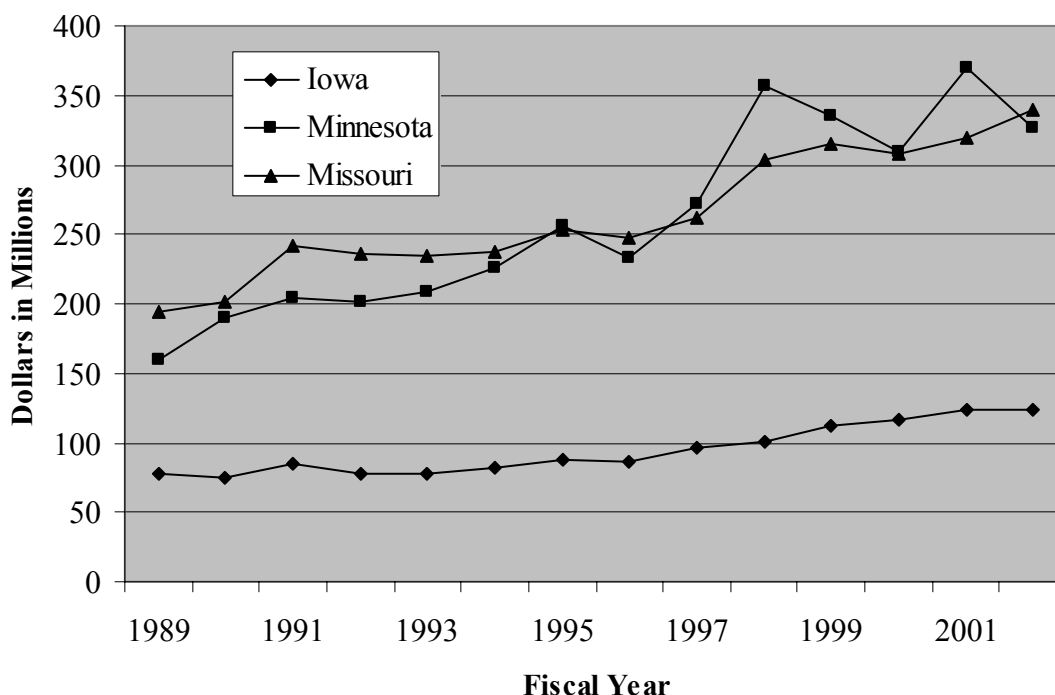
Iowa, Minnesota, and Missouri Comparisons

Much of the financial data that we collected and obtained from numerous reports, websites and contact persons within the three state governments are summarized and included in the data tables presented in Appendix 3.

Figure 12 shows the total “environmental spending” (as expended through the state DNRs) in millions of dollars for the states of Iowa, Minnesota, and Missouri for the period FY 1989-2002. As expected, Iowa being the smallest state in terms of population, gross state product, and land & water area, had the least environmental expenditure (see Figures 12-14). To enable consistent comparison across states, percent growth in environmental expenditures over time was computed and shown in Table 19. From this table, it is evident that over the long haul (13 years), the rate of growth in Iowa’s environmental expenditures have lagged behind, 59% compared to 103% and 75% in Minnesota and Missouri, respectively. When comparisons are carried out for the most recent five and eight years, the performance in the rate of growth in environmental spending in Iowa is relatively stronger. Again, the recent increased spending may be due to the initiation of new programs such as the Rebuild Iowa’s Infrastructure Fund and the Environment First Fund.

Table 19. Percent growth (decrease) in environmental expenditures in Iowa, Minnesota, and Missouri during selected periods of 1989-02			
	89-02	94-02	98-02
	<u>13 yrs.</u>	<u>8 yrs.</u>	<u>5 yrs.</u>
Iowa	59	53	22
Minnesota	103	44	(9)
Missouri	75	43	12

Figure 12. Total State Environmental Spending



Historically, environmental budgets (as measured through DNR expenditures) have stayed in the range of 1-3% in the three states of Iowa, Minnesota and Missouri. Environmental spending as a percent of total state expenditures is another indicator that can be useful in comparative analysis. Figure 15 presents such an indicator for the three states for the years 1989-2002. Historically, as measured by this indicator, Iowa has had the lowest environmental investments during this entire period except for the year 1989. In 1989, Iowa's DNR spending was at 1.8%, while Minnesota's was at 1.7%. Since then, Iowa has always lagged behind. The most recent percent investments are 1.2, 1.6, and 1.7 for Iowa, Minnesota, and Missouri respectively.

Environmental spending per capita is another indicator that can be useful in comparative analysis. Figure 16 presents such an indicator for the three states for the years 1989-2002. Historically, as measured by this indicator, Iowa has had the lowest environmental investments per capita during this entire period. In 1989, Iowa's environmental spending was \$28/person, 32% less than that of Minnesota (\$37/person), and 36% less than that of Missouri (\$38/person). By the year 2002, the gap has widened, Iowa's environmental spending was \$43/person, 51% less than that of Minnesota (\$65/person), and 42% less than that of Missouri (\$61/person).

Figure 13: Estimated Population in millions in 2001, and Gross State Product (GSP) in billions of \$ for 1999 (Morgan and Morgan, Eds., 2002).

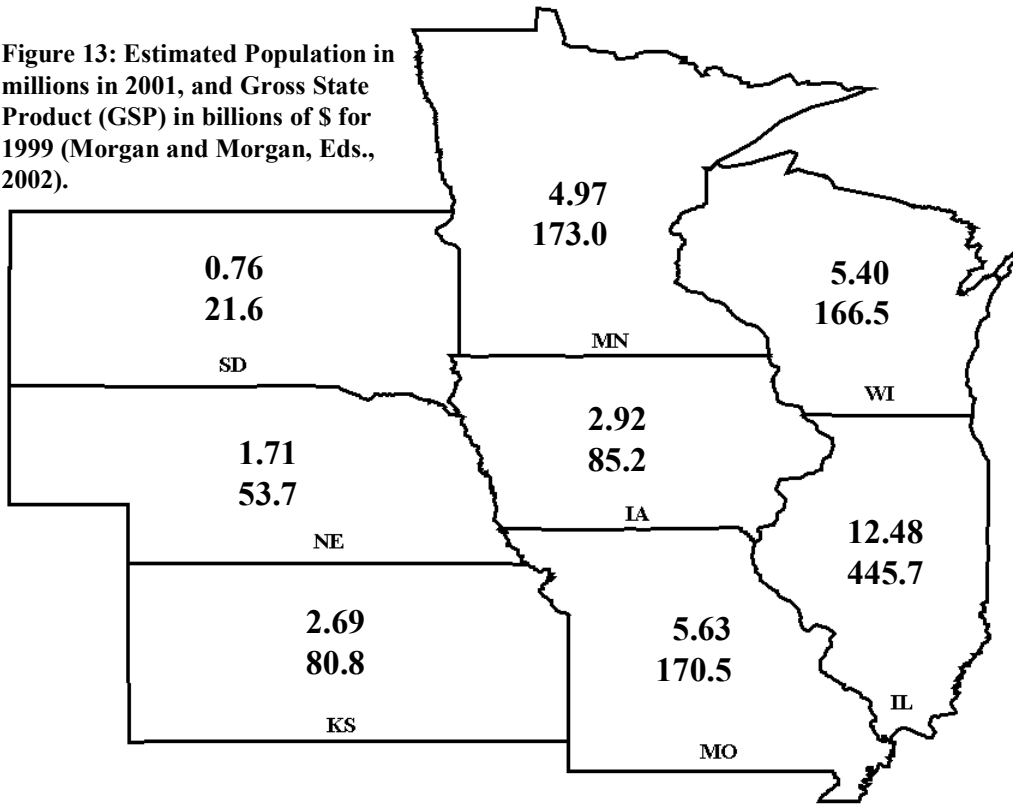


Figure 14: Estimated water and land area in square miles (Morgan and Morgan, Eds., 2002).

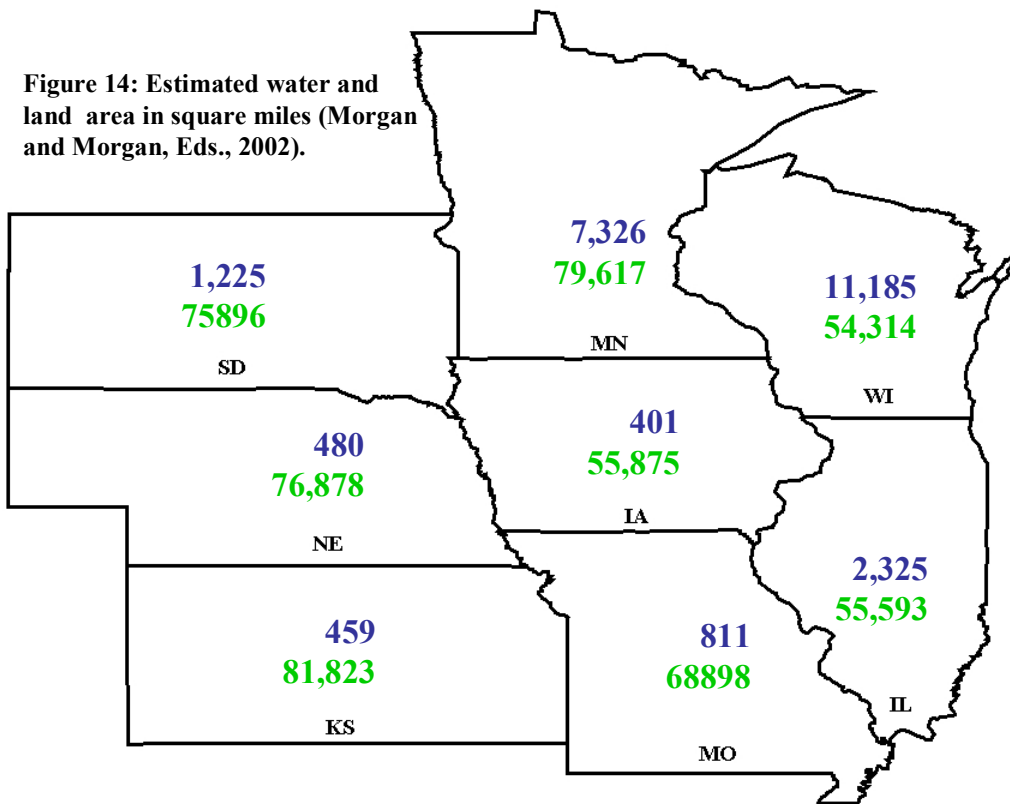


Figure 15

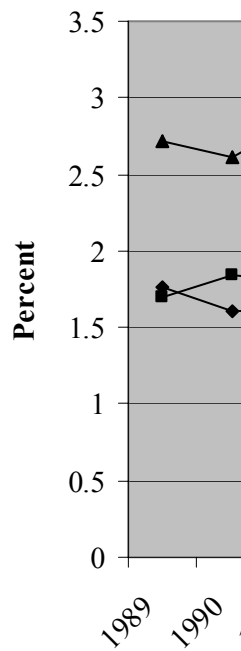
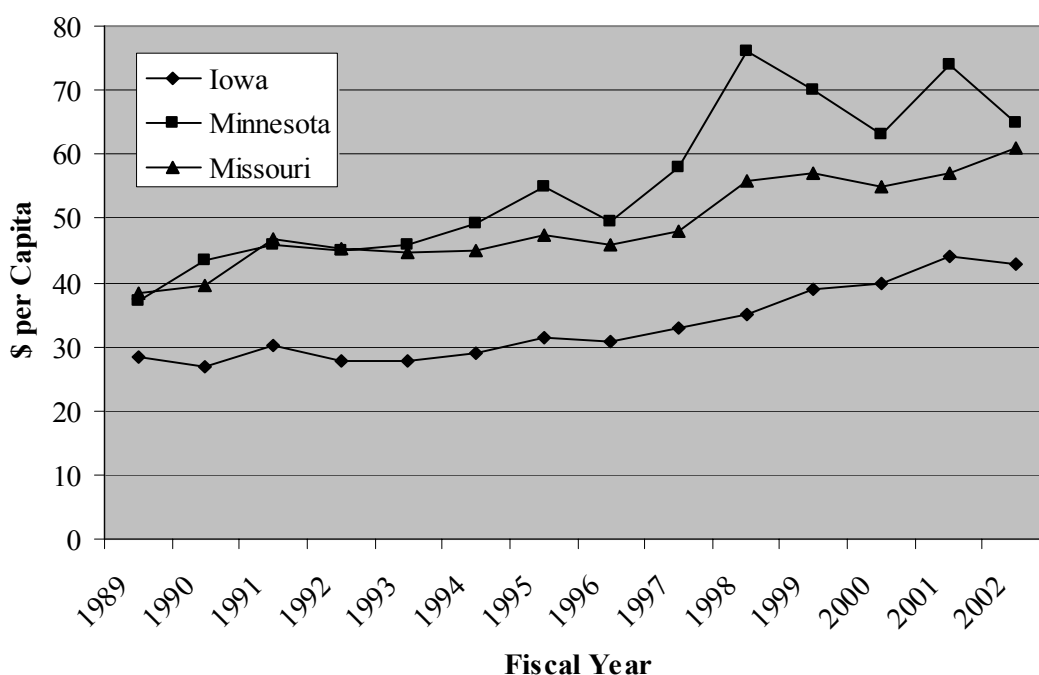


Figure 16. Environmental Spending Per Capita



The role of federal contributions to state environmental protection is yet another measure of the robustness of environmental investments in a state. Figure 17 captures such a measure, percent federal contribution to state environmental spending, for the three states during the period 1989-2002. It is interesting to note that federal contribution to Minnesota's environmental spending has stayed between 5 and 6.2% during the period, has decreased significantly from 28.4 to 10.9% in Missouri, and has increased from 15.8 to 21% in Iowa. These fluctuations indicate the timing of enactment of federal laws and subsidies offered to states for compliance, and the existence of the number and size of such facilities in different states. Again, a detailed exploration of such factors is beyond the scope of this research.

In recent years, numerous special funds have been created to support a variety of worthy causes, including environmental spending. Some of these funds have limited duration and others are contingent on resources becoming available from certain activities of society (tobacco settlement, racetrack income, riverboat gambling, oil overcharge, and so on). Figure 18 was constructed to get a perspective on the role of special funds on Iowa's environmental spending. In 1988, 61% of the state environmental spending (excluding federal contributions) came from other funds, whereas, in 2003, 79% of such funding came from other funds. It seems that environmental protection, instead of being treated as a fundamental part of Iowa's economy and health, is being dealt with through numerous ad-hoc measures and funds that are transient in nature.

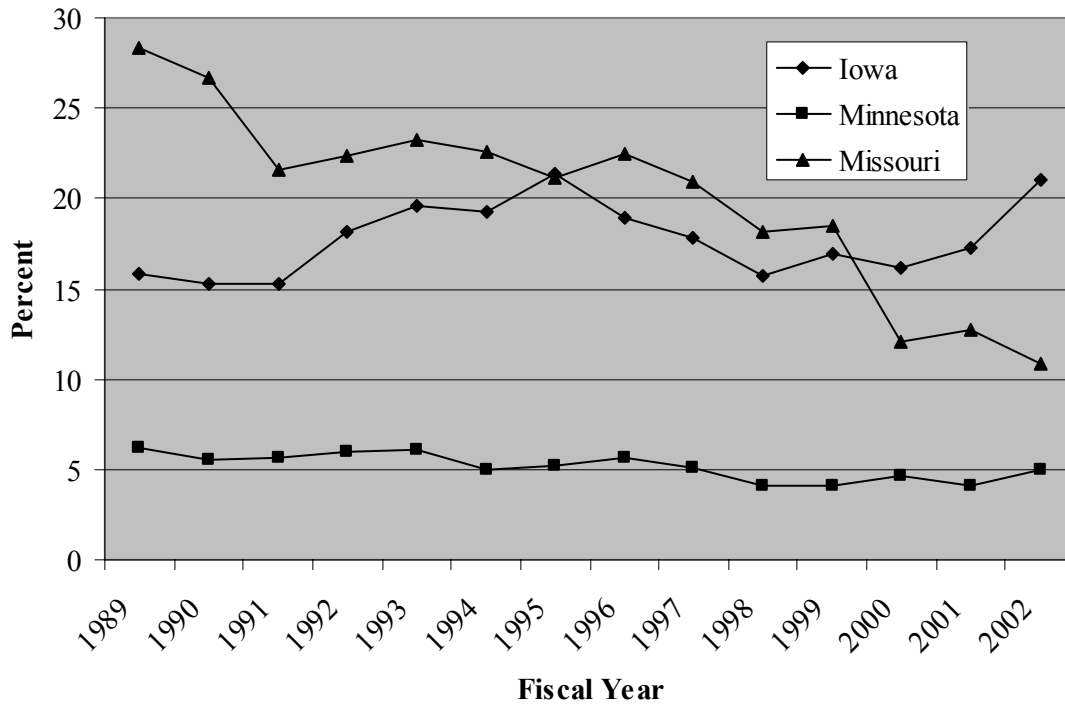
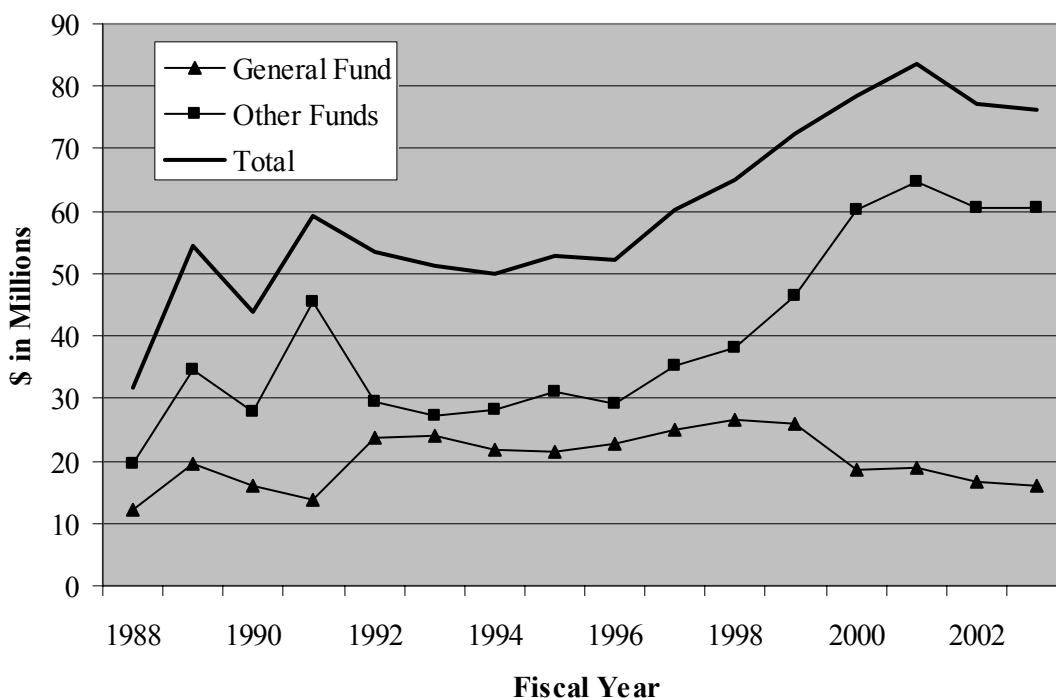
Figure 17. Federal Funds as a % of Environmental Spending

Figure 18. Appropriations to Iowa DNR



Environmental Protection in Iowa – Recent Observations

The state of Iowa, like many other states has been impacted severely by the current recessionary economy. To cope with revenue shortfalls during the last two fiscal years (2002-03), Iowa legislators have taken numerous measures such as budget cutting, depleting rainy day funds, transferring resources from certain special funds to the general fund, expediting tax collection, delaying capital programs and actions, restricting travel, and others.

The fiscal year in Iowa begins on July 1 and ends on June 30. The current fiscal year of 2003 began last July 1, 2002 and will end on June 30, 2003. The State of Iowa's General Fund budget for FY 2003 is approximately \$4.870 billion. General Fund (GF) refers to revenues accruing to the state from taxes, fees, interest earnings, and other sources which can be used for the general operation of Iowa's state government. These revenues are not specifically required in statute or in the constitution to support specific programs or agencies. In Iowa, the major contributing sources to the GF include: personal income tax 47.1%, sales tax 28.6%, corporate income tax 4.3%, and the remaining from user fees, inheritance, and insurance premium tax. To cover expenditures of the state, Iowa also receives federal funds. On the expenditure side, the largest component of Iowa's budget is education, including K-12 and the Regents institutions, followed by health and human services, and the justice system, including correctional facilities.

Iowa has an "Expenditure Limitation" law, which limits spending to 99% of revenues. Therefore, to abide by this law and to combat GF budget shortfalls in FY 2003, funds totaling \$98.1 million were transferred from other funds or sources to the General Fund.

<u>Estimated FY 03 Revenue (in millions)</u>	
School Infrastructure to the General Fund	22.0
Environment First Fund to the General Fund	18.8
RIIF to the General Fund	16.1
UST to the General Fund	10.0
Waste Tire Fund to the General Fund	1.6
Groundwater Protection Fund to the General Fund	1.0
<u>All other transfers</u>	<u>28.6</u>
<u>Total</u>	<u>98.1</u>

It is important to note that about 48.4% of the \$98.1 million transferred has come from funds that were supposed to have been expended by several agencies (including DNR) on NR&E related efforts. The transfer or reallocation of some of the major environmentally-oriented funds are shown in Box3.

Box 3. Transfers or Reversions from major environmental-oriented funds

Rebuild Iowa Infrastructure Fund (RIIF, 1995): The sources of funds for RIIF include interest earnings from the rainy day fund (the Cash Reserve and the Economic Emergency funds), and state racing and gambling receipts in excess of \$60 million (retroactive to July 1, 1995). Considerable resources from RIIF are allocated to fund the programs of Environmental First Fund (EFF), the Iowa DNR, and Loess Hills infrastructure development. The total appropriations under RIIF has been \$125, 135, 170, 165, 54, 67, 57, and 55 million during the eight years FY 1998-2004 (2003 dollars are estimated and 2004 dollars are governor's recommendation).

The Environment First Fund (EFF, 2000): The Environment First Fund was established to provide resources for the protection, conservation, enhancement, and improvement of natural resources. The General Assembly established a standing appropriation of \$35.0 million for the Fund beginning in FY 2001. Bulk of the funds are expended by the Iowa DNR and the Iowa DA&LS. The total appropriations under EEF has been \$24.9 (\$10.1 transferred or reverted), \$16.55 (\$18.45 transferred or reverted), \$35, and \$35 million during the four years FY 2001-2004 (2003 dollars are estimated and 2004 dollars are governor's recommendation).

The Resource Enhancement and Protection Program (REAP, 1989): REAP was created to protect and enhance Iowa's natural resources. REAP was to receive appropriations of up to \$20.0 million from the General Fund for each year between FY 1992 and FY 2021. During the last decade (1993-2002), the maximum allocated amount under REAP has been under \$10.5 million. In recent years, its revenues include those appropriated from the Environment First Fund. The total REAP appropriations has been \$8.5, 7.5, 7.5, 8.0, 9.0, 9.0, 9.0, 10.5, 10.5, 7.2, and 2.0 million during the eleven years FY 1993-2003 (2003 dollars are estimated). FY 02 REAP appropriation of \$10.0 million was reduced by \$2.8 million in March 2002 and FY 2003 appropriation of \$10.0 million was reduced by \$8.0 million in May 2002. The governor has proposed to restore the REAP program to \$11 million in FY 2004.

Groundwater Protection Fund (GPF, 1987): In addition to other matters, the Groundwater Protection Fund supports the activities of the Iowa Waste Reduction Center at UNI, the Center for the Health Effects of Environmental Contamination at the UI, and the Leopold Center at ISU. The Iowa General Assembly during the Second Special Session in 2002 transferred \$1.0 million from the Leopold Center to the General Fund (FY 2003 Omnibus II Appropriations Bill).

Jeff Vonk (Iowa Legislative Fiscal Bureau, 2002), the Director of IDNR states that there have been 14.0 million visitors/year to Iowa State Parks and those visitors spend \$180.0 million in Iowa communities. In addition, people that hunt and fish in Iowa spend about \$760 million in Iowa communities Iowa. Therefore, in these recessionary times, it makes sound economic policy to invest in enhancing Iowa's natural resources and the environment as opposed to undercutting or transferring the meager resources available for such purposes.

SECTION E. Conclusions and Notes on Further Research

Federal role in NR&E functions

From the high of 2.5% in 1977, NR&E outlays have been reduced to 1.3-1.5% of the total in recent years. The federal NR&E spending of \$27.9 billion in FY 2004 would translate to about 25 cents for every \$100 of the GDP. In the proposed FY 2004 budget, discretionary spending is slated to grow at 3.8% or higher, whereas, spending for NR&E is slated for a \$1.6 billion reduction (-5.5%) compared to FY 2002 spending. These reductions will come from the budgets of EPA and other NR&E oriented agencies. The federal R&D outlays as a percent of the GDP has decreased from 1.6% in FY 1970 to 1.0% in FY 2004. Much of the federal R&D, about 79% of \$117 billion in 2004, will be devoted to defense and health related research; and relatively small amounts of 2%, 1%, and 1% are slated for the environment, energy, and agriculture, respectively. Again, much of R&D for NR&E missions would see a reduction.

Federal subsidies to the States for NR&E functions

Over the last two decades, states have assumed increasing responsibility for almost all of NR&E functions. The total federal NR&E contributions to the states have been in the range of 3.7 to 4.5 billion dollars during the period 1986-2000 with EPA contributing a lion's share of this total (73 to 79%). During this period the states' contribution as a percent of total NR&E expenditures has significantly increased from 48 to 67%, while the federal contribution has decreased from 52 to 33%. Over 59% of funding for state environmental agencies is derived from user fees and special revenues, while the federal contribution is about 23% and the state general funds footing the remaining 18%.

A December 2001 survey showed that a total of \$196.4 million was being cut from the FY 2002 budget of 30 state "environmental agencies" and a follow-up survey in May 2002 indicated that a total of \$200 million was being cut from the FY 2003 budgets. The surveys did not reveal that "environmental agencies" were either singled out or spared from budget cuts, compared to other agencies. In general, the cuts of environmental agencies were comparable to those of other units of state government. Similarly, the surveys revealed that the impact of homeland security on environmental agency budgets were minimal.

Iowa, Minnesota, and Missouri Comparisons

Among the three states of Iowa, Minnesota, and Missouri, the "environmental spending" (DNR spending) in Iowa was the smallest over the entire period FY 1989-2002. The percent growth in environmental spending over the 13 years showed that Iowa lagged behind, 59% compared to 103% and 75% in Minnesota and Missouri, respectively. When comparisons are carried out for shorter durations of five and eight years, Iowa's performance improves, indicating the initiation of new programs such as the Rebuild Iowa's Infrastructure Fund and the Environment First Fund. To keep this pace active, Iowa should invest in these funds as opposed to transferring funds out of them. When "environmental spending" is measured as a percent of state spending, Iowa has always lagged behind, except for the year 1989. The most recent (2002) percent investments are 1.2, 1.6, and 1.7 for Iowa, Minnesota, and Missouri respectively. On a per capita basis, Iowa again had the lowest figures. In 1989, Iowa's environmental spending was \$28/person, 32% less than that of Minnesota (\$37/person), and 36% less than that of Missouri (\$38/person). By the year 2002, the gap has widened, Iowa's environmental spending was

\$43/person, 51% less than that of Minnesota (\$65/person), and 42% less than that of Missouri (\$61/person). It is interesting to note that federal contribution to Minnesota's environmental spending has stayed between 5 and 6.2% during the period, has decreased significantly from 28.4 to 10.9% in Missouri, and has increased from 15.8 to 21% in Iowa. These fluctuations indicate the influence of timing of enactment of federal laws, subsidies covered under such enactments, and the NR&E demographics of the states that enable them to qualify for such subsidies.

State role in setting their own NR&E priorities

Looking ahead to FY 2004, the fiscal outlook is grim. The aggregate FY 2004 gap is \$68.7 billion for the 36 states facing budget problems. To meet budget shortfalls due to a recessionary economy, many states have rainy day funds. Iowa has a general fund reserve account consisting of two funds: the Cash Reserve Fund (CRF) and the Economic Emergency Fund (EEF), with a maximum balance of 7 ½ percent of estimated general fund revenues in CRF and 2 ½ percent in EEF, respectively (a total of 10% combined). The combined balance in these funds has been depleted from the highs of 9-10% during FY 1996-2001 to under 3% (\$141 million) in the year 2003. Recent research shows that retaining rainy day funds while cutting budgets often is not the best use of resources, preserving such funds for the future is tantamount to not having a rainy day fund at all, and using much of the rainy day funds in FY 2003 and FY 2004 would be most appropriate. The governor and our elected officials should seriously consider revitalizing the states NR&E functions by using part of the rainy day funds for such a cause. In FY 2003, about 48.4% of the \$98.1 million transferred to cover budget shortfalls has come from funds that were supposed to have been expended on NR&E related efforts. It would be sound fiscal and environmental policy to replace some of those funds during FY 2003 and/or FY 2004 with funds from Iowa's general fund reserve account.

In 1988, 61% of the state environmental spending (excluding federal contributions) came from other funds, whereas in 2003, 79% of such funding came from other funds. It seems that environmental protection, instead of being treated as a fundamental part of Iowa's economy and health, is being dealt with through numerous ad-hoc measures and funds that are litigious and transient in nature. It would be prudent environmental policy to underwrite a major part of the DNR's budget based on a sound mechanism of permanent funding as opposed to linking NR&E funding to a series of ad-hoc piecemeal programs.

Mr. Vonk, the Director of IDNR states that there have been 14.0 million visitors/year to Iowa State Parks and those visitors spend \$180.0 million in Iowa communities (Iowa Legislative Fiscal Bureau, 2002). In addition, people that hunt and fish in Iowa spend about \$760 million in Iowa communities. Therefore, in these recessionary times, it makes sound economic policy to invest in enhancing Iowa's natural resources and the environment as opposed to undercutting or transferring the meager resources available for such purposes into the general fund.

SECTION F. Glossary of terms

Glossary of Budget Terms

All the following terms and phrases are either directly excerpted, adapted, or modified from the three sources identified at the end of this section.

Across-The-Board Reduction. Section 8.31, Code of Iowa, authorizes the Governor to reduce quarterly allotments of appropriations in amounts sufficient to avoid an overdraft or deficit. The Governor, through Executive Order, has the authority to enact across-the-board reductions in order to restrict spending. While the actual appropriation amount will remain unchanged, the reduction in allotments will reduce spending and will increase reversions. The statute specifically exempts the Legislative Branch and the Judicial Branch from across-the-board reductions made by the Governor under Executive Order. The Governor cannot exempt any appropriations from across-the-board reductions; the reduction must be applied across-the-board uniformly and prorated between all departments, agencies, and establishments upon the basis of their respective appropriation. Attorney General opinions in 1980 and 1989 stated that the Governor may not make selective mandatory reductions in appropriations through the practice of “targeted reversions.” Governor Ray issued two of these Orders, Governor Branstad issued four, and Governor Vilsack issued a 4.3% (\$203 million) spending reduction in Executive Order Number 24 on November 1, 2001.

Appropriation. A legislative allocation of money for a specific purpose and use by departments of state government.

Base. The base is the component of a budget request or recommendation which reflects previous fiscal year appropriations. It may include inflation for an agency’s ongoing programs.

75.0% Base Budgeting. A form of modified base budgeting used by the State in which agency managers assume for budgeting purposes that 75.0% of the current appropriation becomes the base for the next fiscal year's budget.

Bond Rating. A judgment of credit quality based on detailed analysis of specific data given to a state by a rating agency such as Moody’s Investors Service, Standard and Poor’s Corporation, and Fitch’s Investors Service. Factors that are evaluated in determining bond ratings include a state’s ability to raise taxes, sovereignty, and the relative size and diversity of a state’s economic base.

Budget. A budget is a plan for the expenditure of funds to support an agency, program, or project.

The **budget process** is the process by which a state determines public priorities by allocating financial resources among competing claims.

Budget Unit. A predetermined grouping of one or more organizations that indicates an individual entity within a department. There may be one or more budget units within a department. A budget unit generally equals an appropriation made by the General Assembly.

Budgeting for Results. A form of budgeting which ties the appropriation of resources to the outcomes or results expected from a program. A results-oriented performance budget is developed by defining desired program results and determining how many units of the desired outcomes can be achieved with the requested level of funding. Resources are then allocated based on the performance expected. Progress toward meeting the outcomes is tracked and analyzed, and department directors are held accountable for the performance.

Budget stabilization or contingency funds, also referred to as **rainy day funds**, allow states to maintain spending during recessions without having to raise taxes. Simply stated, the rainy day funds act as a state saving account, allowing the state to save money when the economy is healthy, for use during an economic downturn. While stabilization funds are rarely able to meet the costs associated with an economic downturn; they serve as a cushion in the short term while larger structural reforms can be debated and implemented.

The **capital budget** is the budget associated with acquisition or construction of major capital items, including land, buildings, structures, and equipment. Funds for these projects are usually appropriated from surpluses, earmarked revenues, or from bond sales.

Capital Appropriation. An appropriation for long-term additions to or betterment of State property such as land, buildings, or equipment.

Code of Iowa. The official compilation and publication of all Iowa laws of a permanent nature issued by the Code Editor following the legislative session in each even-numbered year.

Conference Committee. Committee composed of appointed members of both chambers to resolve differences between the two chambers on a legislative proposal.

Constitution. A written instrument embodying the fundamental principles of the State, outlining the powers and duties of the government and guaranteeing certain rights to the people.

Constitutional Majority. Majority of the membership in the Iowa General Assembly: in the Senate, 26; in the House of Representatives, 51 votes.

Contingency Fund. A fund set apart to provide for unforeseen expenditures or for anticipated purposes of uncertain amounts.

Deappropriation. A decrease in the amount of an appropriation for a current fiscal year.

Debt Management. Negotiate and manage issuance of bonds and refunding.

Decision Package. An individual request for funding made by a department for personnel, services, equipment, capitals, or other items. Decision packages are either requests to return the budget to 100.0% of the previous year's appropriation from the 75.0% base budget, or new requests for funding, over and above the previous year's appropriation. Decision packages are normally listed in priority order for each budget unit.

Earmarked Revenues. Earmarked revenues are the designation of certain sources of revenue for support of specific programs or agencies by statutory or constitutional provision. For example, earmarking tobacco funds for public health programs, pesticide surcharge to water pollution control efforts, and so on.

Estimated Revenues. A projection compiled by the Revenue Estimating Conference (REC) for General Fund receipts.

Expenditures. Disbursements and payables for services rendered and goods received including authorized encumbrances for a specific period.

Estimated Expenditures. A projection compiled according to legislative action, adjusted for salary, cost-of-living, and merit increases.

Executive Budget. Suggested allocation of state moneys presented annually by the Governor for consideration by the Legislature.

Fiscal Note. A memorandum attached to a bill or amendment that states the financial effect on the revenue or expenditures of legislation.

Federal Fiscal Year (FFY). The 12-month financial period used for record keeping, budgeting, appropriating, revenue collecting, and other aspects of fiscal management for the federal government. The fiscal year of the federal government is October 1 through September 30.

FY/Fiscal Year. The 12-month financial period used for recordkeeping, budgeting, appropriating, revenue collecting and other aspects of fiscal management. FY refers to the state fiscal year and the number following FY is the year the fiscal year ends. For example, FY '03 of the State of Iowa is July 1, 2002 to June 30, 2003.

General Fund. General fund refers to revenues accruing to the state from taxes, fees, interest earnings, and other sources which can be used for the general operation of state government. General fund revenues are not specifically required in statute or in the constitution to support particular programs or agencies.

A **general obligation bond** pledges to the lender the full faith and credit of the state as security, that is all government funds are available to repay the debt, and if necessary, taxes would be raised to repay the debt.

Generally Accepted Accounting Principles (GAAP). A method of accounting approved by the Governmental Accounting Standards Board.

Incremental Budgeting. An approach to budgeting that requires that only additions or deletions to current budgeted expenditures be explained and justified. Funding decisions are made on the margin, based on the justification for the increased costs of operating agencies or programs. This process can be used in conjunction with either line-item budgeting and/or program budgeting.

The **item veto** is a provision that allows the governor to reject particular items in a piece of legislation such as a sentence, paragraph, or part of a sentence (syntax).

Line-Item. A term to describe funds requested and/or appropriated on a detailed or itemized basis (personal services, travel, equipment, or other items).

The **line item veto** is a provision that allows a governor to veto components of the legislative budget on a line-by-line basis.

Lump Sum Appropriations. Made for a state purpose, or for a named department, without specifying further the amounts that may be spent for particular objects of expenditure. An example is an appropriation for the corrections department that does not specify the amounts to be spent for salaries and wages, travel, equipment, and so forth.

Mandate. A law, policy, program or provision that is passed by one level of government but applies to another. i.e. federal standards for state and local ozone levels.

Nonrecurring/One-Time Appropriation. An appropriation made for onetime items or projects. Examples include capital or major equipment purchases, special studies, and information technology upgrades.

Ongoing Appropriation. This type of appropriation is made for ongoing programs for which future appropriations will have to be made.

Operating Budget. The budget established for operation of a state agency or program, typically based on legislative appropriation.

Performance Budgeting. Performance budgeting is similar to program budgeting. Performance budgets are constructed by program but focus on program goals and objectives; measured by short-term outputs, projected longer term outcomes, and cost/benefits analysis. Appropriations are not only linked with programs, but also with expected results specified by the set performance criteria.

Program Budget. Program budgeting refers to budgets that are formulated and appropriations that are made on the basis of expected results of services to be carried out by programs. The focus on outcomes is usually over multiple years. The budget material is arranged in such a way as to aid the executive and legislature in understanding the broader policy implications of their decisions.

Program Evaluation. Preparation of reports with detailed analytical back up to determine to what degree programs are effective and are accomplishing their objectives. Emphasis is on analyzing proposed activities.

For a **revenue bond**, the lender is promised repayment on a particular revenue source. Inherently, the revenue bond involves a bit more risk, since if the revenue source may, in the future, become insufficient to repay the lender.

Revenue Estimating. The process used by a state to project available revenues for the support of operating costs and capital outlays in the current and future fiscal years.

Reversion. Following the close of a fiscal year, all unencumbered or unobligated balances revert to the State treasury and to the credit of the fund from which the appropriation was made.

Revolving Fund. A fiscal entity that has a designated revenue source and specific expenditure purpose, with stipulated State agency access to the fund as required. All balances in a revolving fund typically remain in the fund at the close of the fiscal year for expenditure in the future.

Standing Limited Appropriation. An appropriation of a specific dollar amount established by the Code of Iowa. An example is the Indian Settlement Officer, Section 331.660, Code of Iowa: "There is appropriated annually from the General Fund of the State to the County of Tama the sum of three-thousand, three-hundred, and sixty-five dollars to be used by the County only for the payment . . ."

Standing Unlimited Appropriation. An appropriation of an unspecific dollar amount established by the Code of Iowa. An example reads as follows: "There is hereby appropriated out of any funds in the State treasury not otherwise appropriated a sum sufficient to pay for . . ."

Statute. A permanent or general act approved by the Legislature.

Structural Deficit. Structural deficits occur when growth in spending needed to maintain current services and growth in revenues from current taxes and other revenue sources are inconsistent.

Supplemental Appropriation. Additional funds appropriated for the current fiscal year in addition to the original appropriation to cover unforeseen events, projected over- expenditures, or to replace revenue shortfalls.

Trust Funds. Amounts received or appropriated and held in trust in accordance with an agreement or legislative act which may be expended only in accordance with the terms of such trusts or act.

Veto. An action taken by the Governor to prevent the enactment of an entire bill.

Zero Base Budgeting. Zero based budgeting subjects all programs, activities and expenditures to justification (in contrast to incremental budgeting). Funding requests, recommendations and allocations for existing and new programs are usually ranked in priority order on the basis of alternative service levels, which are lower, equal to and higher than current levels. This process can be used in conjunction with either line-item budgeting and/or program budgeting.

Sources:

1. Appendix C: staffweb.legis.state.ia.us/lfb/miscpubs/ladar_fy2003.pdf
2. Reference: 76-1:
www.legis.state.ia.us/GA/76GA/LSB/LegHandbook/References/Glossary.html
3. Budget Process in the States. Published by the National Association of State Budget Officers, January 2002, Washington, D. C.

G. Appendices

Appendix G1. Selected Organizations and Publications of Interest

Much of the description provided below are either excerpted or adapted from the web sites of the respective organizations.

The Hall of the States and State Services Organization (SSO)

The State Services Organization (SSO), founded in 1976, is a joint venture of the National Governor's Association (NGA), the Council of State Governments (CSG), and the National Council of State Legislatures (NCSL). It has a premier facility of 225,000 square feet in Washington D.C. called the Hall of the States located near the U. S. Capitol and the Union Station. It has a full service library, conference rooms, a print shop, internet access, a mailroom, desktop publishing, and state-of-the-art telecommunication services. These facilities are made available to more than 90 affiliates of SSO's member organizations. Source:

<http://www.sso.org/>

The National Governors Association (NGA)

The National Governors Association (NGA), founded in 1908, represents the nation's governors by providing a collective voice on Capitol Hill and before the Administration on key federal issues affecting the states. It also develops and disseminates insights on innovative state programs to state government executives. Its center for "Best Practices" focuses on state innovations on issues that range from education and health to technology, welfare reform, and the environment. It provides management and technical assistance to both new and incumbent governors. Each year the NGA elects a chairman and vice chairman of different parties from the nine-member executive committee that runs the organization. There are three standing committees -- on Economic Development and Commerce, Human Resources, and Natural Resources -- that provide a venue for governors to examine and develop policy positions on key state and national issues. Source: <http://www.nga.org/>

The National Association of State Budget Officers (NASBO)

Founded in 1945, NASBO is a self governing, non-partisan, non-profit affiliate of the National Governors Association. It contributes significantly to the development of national fiscal and executive management policies and budget practices of the NGA. It is composed of the heads of state finance departments, the states' chief budget officers, and their deputies. The major functions of the organization consist of research, policy development, education, training, and technical assistance. These are achieved primarily through NASBO's publications, membership meetings, and training sessions. NASBO publications related to fiscal surveys and comparative analyses of budget processes in the states are timely and of much value to decision makers and researchers alike. The Association's revenue is derived primarily from dues paid by states and territories.

Source: <http://www.nasbo.org/>

The Council of State Governments (CSG)

CSG is a nonpartisan, nonprofit organization that seeks to foster excellence in state government. Founded in 1933, it serves the executive, judicial and legislative branches of state government through leadership education, research and information services. It assist states with multi-state and regional solutions, it maintains offices throughout the country that staff regional associations of legislative and executive elected officials. It helps states increase efficiency by identifying the new and creative approaches to significant state problems and produces information products with useful and practical policy solutions. It promotes the sovereignty of the states and their role in the American federal system. In addition, CSG draws upon experts in the states, and marshals them as consultants to help sister states in need of services. CSG is funded through its entrepreneurial efforts which include: Publication Sales, Conference Revenue, CSG Associates, Contributions, and Investment Income (29%), Grants 28%, and State Appropriations 43%. CSG's national headquarters is in Lexington, KY. Source: <http://www.csg.org/>

The National Conference of State Legislatures (NCSL)

The National Conference of State Legislatures, founded in 1975, is a bipartisan organization dedicated to serving the lawmakers and staffs of the nation's 50 states, commonwealths, and territories. With a focus on service, it contributes to improving the quality and effectiveness of state legislatures, promoting policy innovation and communication among state legislatures, and ensuring the state legislatures a strong, cohesive voice in the federal system. NCSL publications related to surveys of fiscal status and comparative analyses of state strategies to manage budget shortfalls are timely and of much value to decision makers and researchers. NCSL also publishes, 10 issues per year, national magazine called "*State Legislatures*" devoted to governmental policies covering a wide variety of topics. Source: <http://www.ncsl.org>

The Environmental Council of the States (ECOS)

Founded in 1993, the Environmental Council of the States (ECOS) is a national non-profit, non-partisan association of state and territorial environmental commissioners. Its major missions are to champion the role of the states in environmental management; serve as information clearinghouse and policy forum on environmental laws in the United States; provide for the exchange of ideas and experiences among the states in environmental management; and articulate state positions to Congress, federal agencies and the public on environmental issues. It conducts timely surveys on a variety of environmental issues and makes them available through its electronic on-line journal called the ECOSates. Source: <http://www.sso.org/ecos/>

The American Society of Public Administration (ASPA)

Established in 1939, ASPA is a professional organization that serves its membership through the collection, compilation, and dissemination of information on matters relating to public administration and thus advances the science, processes and art of public administration. It publishes the journal "Public Administration Review" six times of the year. Articles I the journal identify and analyze current trends, provide a factual basis for decision making, stimulate discussion, and make other related literature available in an easily accessible format. <http://www.aspanet.org>

Governing

Governing is an excellent monthly magazine published by the Congressional Quarterly, Inc., a subsidiary of the Times Publishing Co. of St. Petersburg, Florida. Its primary audience is state

and local government officials: governors, legislators, mayors, city managers, council members and other elected, appointed and career officials. The magazine has a circulation of over 85,000. Besides public officials, its readers include journalists, academics, concerned citizens with interest in governance, and providers of products and services to government. Source: <http://governing.com/>

The Iowa Legislative Service Bureau (LFB)

The LFB is one of the four central non-partisan agencies of the Iowa General Assembly. The principal tasks of the LFB are to provide timely and useful analysis and evaluation of expenditures, revenues and operations of state government, and to evaluate the potential impact of legislative proposals on state and local government. Source: www.staffweb.legis.state.ia.us/lfb/

The Iowa Department of Management (DM)

The Iowa Department of Management works closely with the Governor's Office and other state agencies to determine how state resources are best allocated to serve the needs of Iowans. It is divided into two teams: the Budget and Finance team (B&F) and the Strategic Planning and Accountability team (SP&A). The Budget and Finance Team is the financial center of state government and manages more than \$8 billion in resources annually. The B&F team members' assist the Governor in developing policy, prepare and track budgets, and follow proposals through the legislative process serving as a resource for legislators, the media and others wanting information on specific bills. Revenue estimating is another responsibility of the Budget and Finance Team. The "Revenue Estimating Commission" in Iowa is comprised of the director of the Department of Management, the director of the Legislative Fiscal Bureau and a third agreed upon person. It's their job to estimate how much revenue the state will take in each quarter. This process is assisted by the B&F team which tracks state revenue on a monthly basis and also keeps close tabs on economic indicators such as unemployment, the impact of new tax laws and changes in spending behavior. The SP&A team is concerned with the performance of state government and it does this by using a variety of approaches such as: Strategic planning, public polling and surveys, issue scanning, and budgeting for results. Source: <http://www.state.ia.us/government/dom/>

The Iowa Department of Revenue and Finance

In addition to its tax collection responsibilities, the Iowa Department of Revenue and Finance also publishes several valuable and timely reports on monthly, yearly, and ad-hoc basis. In particular, the Department's Annual Reports, the Citizen's Report, and the Iowa Comprehensive Annual Financial Report (CAFR) are of much value to citizens, professionals, and researchers alike. With the advent of the modern Worldwide Web, the reports for several years, including the latest are readily available on the department's web site. Source: <http://www.state.ia.us/tax/comptrol/finreport.html>

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