The State of the States: Governors Consider the Long View

By Katherine Willoughby

Governors did seem to concentrate heavily on their education budgets this year, and then on the budgets of other activities that are primary to the mission of state government. Yet threaded through these addresses is a stronger consideration of a multi-pronged and multi-year view of government operations—understanding state education services on a continuum from pre-kindergarten to work force retraining, for instance. Governors are aware of the federal government's slowing financial support as well as its poor reaction to Katrina and what this means for state coffers.

Governors have spent the last few years lamenting the poor fiscal climate that settled across the United States, explaining the necessity of pulling state governments back to their primary missions, especially education. This year, however, while state chief executives find themselves in a different fiscal environment, their budget and policy agendas vary marginally from those they have been relaying to citizens in the recent past. That is, revenues are flowing more freely into state coffers; state governments are realizing surpluses.

While revenue growth fuels a common gubernatorial mantra to cut taxes, it has not necessarily opened the floodgates to different spending initiatives. Today's governors seem to have learned from periods of fiscal stringency. In fact, many are calling for measured approaches to budget making—emphasizing long-range planning, balance and good management to pursue the work of the states.[1]

The Politics

Governors seemed to take a calculated approach in their State of the State addresses, most likely because 2006 is an election year. The Republican stronghold at the national and state levels is under fire. In the 28 states with Republican governors, 22 will hold gubernatorial elections this year. The governors in Arkansas, Colorado, Florida, Nevada and Ohio cannot run again. Three more Republican governors—in Idaho, Massachusetts and New York—have said they will not run again. In the 22 states with Democratic governors (New Jersey elected Democrat John Corzine as governor in 2005), 14 will hold elections for the chief executive spot in 2006. Of these 14 governors, only one, Tom Vilsack of Iowa, has said he will not seek reelection.[2] Quite a few of these state-level chief executives are actively seeking the nation's top spot, or at least are being considered as likely presidential candidates. Vilsack, Philip Bredesen of Tennessee, Mike Easley of North Carolina, Mark Warner of Virginia (2002–2006), and Bill Richardson of New Mexico are some of the Democratic governors considering or mentioned as possible candidates for president. Haley Barbour of Mississippi, Mike Huckabee of Arkansas, Bill Owens of Colorado, George Pataki of New York and Mitt Romney of Massachusetts, are some of the Republican governors who also have been mentioned as possible presidential candidates.[3]

With the upcoming elections, governors understand the need for strategic political maneuvering to hold onto or gain political power in their states. The party advantage in state legislatures just slightly favors Republicans. The GOP controls both houses in 20 states, while Democrats control both houses in 19 states. Legislatures in 10 states are split between the two parties, while Nebraska's legislature is unicameral and nonpartisan. Therefore, it is expected that elected officials are tempering discussions of their budget and policy agendas. This year, governors want to focus attention on the taxing and spending interests of constituents, but they seem more cognizant of the difficulties experienced when unable to deliver on promises made.

California Gov. Arnold Schwarzenegger's mea culpa is just one example of a more considered approach to policymaking and problem-solving:

> "Now what a difference a year makes—a year ago USC and I were #1—what happened? … I've thought a lot about the last year and the mistakes I made and the lessons I've learned. Now it's true that I was in too much of a hurry. I didn't hear the majority of Californians when they were telling me they didn't like the special election. I barreled ahead anyway when I should have listened. I have absorbed my defeat and I have learned my lesson. And the people, who always have the last word, sent a clear message—cut the warfare, cool the rhetoric, find common ground and fix the problems together. So to my fellow Californians, I say—message received."

This year, Schwarzenegger suggested using "bonding capacity more wisely … to attract other resources—like federal funding, more local funding and more private investment." Yet, he does call on legislators, civil servants and citizens to come forward with their ideas and innovations, to help come up with ways to solve the state's problems.

Revenues, Expenditures and Balance

Governors and legislators are surely breathing a sigh of relief that the revenue picture is brighter. Nonetheless, this picture is just slightly off-center. Revenue actions in the states in 2006 realized a net increase of $2.5 billion in state treasuries; this is the lowest positive change to revenues in the last three years.[4] These revenue actions garnered increases in all taxes and fees noted below in Table A.[5] However, cuts to state personal income taxes led to the decrease in this revenue tax source by $739 million.

Table A: Net Increase from 2006 State Revenue Actions (In millions of dollars)

Revenue source	*Net increase*
Cigarette/tobacco	$1,249
Sales	995
Fees	686
Other taxes	142
Corporate income	120
Motor fuel	81
Alcohol	36

Source: NASBO, *The Fiscal Survey of the States*, 2005.

On the other hand, because of the upturn in the economy, collections from sales taxes and personal and corporate income taxes are expected to increase in 2006 when compared to the previous fiscal year. States have been able to continue shoring up resources as evidenced by examining budget stabilization funds—states with these funds realized $12.1 billion in 2004, $14.9 billion in 2005, and $16.3 billion by 2006.

In real terms, state spending grew by 3.2 percent in 2005 and is expected to rise about the same (by 3 percent) in 2006.[6] The rosier budget picture is further evidenced when considering that by 2005, just six states had to go back and cut the budget as passed, whereas three quarters of states made such cuts in 2002 and 2003. Also, in spite of federal reductions in support, states illustrate continued commitment to human welfare enhancement—while a few states increased cash assistance levels to families, "no state will decrease benefit levels."[7] On the other hand, states are falling short in terms of getting a handle on Medicaid spending. In spite of attempts to contain costs, more than half (26) the states expect their Medicaid spending to exceed their 2005 budgets.[8]

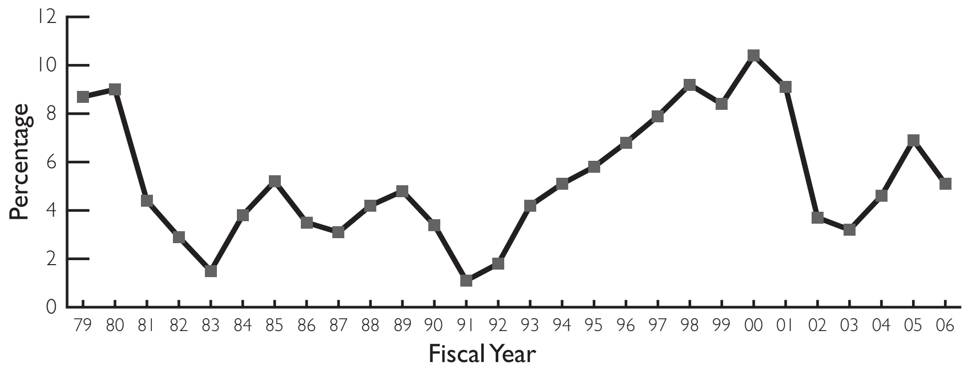
A clearer indication of the budget trend in the states is evidenced by looking at total balances as a percent of expenditures. While these balances rebounded by 2005, they quickly deflated by 2006. In fiscal 2000, total balances swelled to $48.8 billion (10.4 percent of expenditures). By 2006, total balances as a percent of expenditures are expected to be 4.6. Figure A illustrates the trend in end of year balances of states for the last 25 years. Note that the increase in total balances in 2005 is not expected to be sustained in 2006. The soaring costs associated with activities like Medicaid will continue to swallow much of any new and increased revenues flowing into states.

What's on the Agenda?

An assessment of the content of the 40 State of the State addresses this year yields interesting results. Table B illustrates different topics addressed and the number and proportion of governors mentioning such topics in their 2006 speech. Clearly, governors are keeping conversations to the primary expenditures of state government. Virtually every governor providing an address this year discussed his or her agenda regarding education. Yet, a multiyear approach to education is often evidenced. Illinois's chief executive, Rod Blagojevich, believes the new revenue environment will support his kindergarten to college initiative. Similarly, Oregon Gov. Ted Kulongoski describes this continuum as the "Education Enterprise" that moves "Oregonians seamlessly from pre-K/Head Start to K through 12, to post-secondary institutions, to workforce training—and retraining." Kulongoski asked for "big changes" in managing and funding education that involves guaranteed percentage increases in future funding, and for the creation of a "stability fund" as a safety measure when the revenue flow slows.

The focus of health care initiatives swirls around Medicaid reforms, prescription drug plans, avian flu and even personal responsibility. For example, Idaho Gov. Dirk Kempthorne talks of a proactive approach to modernizing the [Medicaid] system that focuses on results and outcomes. "My common sense plan will simplify the system, reduce costs, and turn our attention to prevention, wellness and personal responsibil-

Figure A: State Total Balances as a Percent of Total Expenditures, 1979–2006



Source: NASBO, 2005. *The Fiscal Survey of the States*, Table 9, page 14.

ity," said Kempthorne. Indiana Gov. Mitch Daniels and Tennessee Gov. Phil Bredesen also harp on basic wellness programs as a means to lasso health care costs. Blagojevich, who boasts that Illinois is the only one that "guarantees access to affordable, comprehensive health care for every single child," seeks to extend access to comprehensive health care to veterans. He suggested better coordination with the federal prescription drug plan to help contain health care costs.

Several chief executives also allotted time to a possible avian flu pandemic and plans are underway to prepare for such a calamity. Utah Gov. Jon Huntsman Jr., for example, explained the state is "better prepared than ever before for any such catastrophic event. I have already spoken with Health and Human Services Secretary Mike Leavitt about hosting, in collaboration with our Department of Health, a Governor's Summit in March to prepare for any possible avian flu pandemic. On this important issue, we in Utah will lead out, rather than stand back and react." Interpretations of government response to Katrina undoubtedly influenced many of the governors' statements about state response to possible health or other crises.

Aside from taxes, the governors addressed other important topics, including natural resources—particularly discussions of energy costs, sources and relief. Hawaii Gov. Linda Lingle was most graphic in her request for approval of the state's Department of Land and Natural Resources budget, one "that is unprecedented in scope and scale. Residents and visitors alike expect and deserve better than broken or filthy restrooms." Vilsack asked legislators and citizens in Iowa to "dedicate our work this year to making E85 and soy diesel the future fuel for Iowa and for all of America." South Dakota Gov. Mike Rounds talked of power plants, pollution control and renewable energy. And Gov. Don Carcieri of Rhode Island discussed a multi-pronged approach to energy policy including conservation, increasing LNG

Table B: Issues Considered in 2006 State of the State Addresses (n=40)

Issues	*Number of governors mentioning topic*	*Percent of addresses where topic is mentioned*
Education	40	100%
Health/medicaid	39	98
Taxes	37	93
Natural resources/energy	33	83
Economic development	31	78
Corrections	26	65
National guard/military	26	65
Transportation	24	60
Terrorism/security	19	48
Methamphetamine	18	45
Rainy day fund	12	30
Pensions	7	18
Illegal immigrants	5	13

Source: Content analysis of 2006 State of State Addresses, Katherine Willoughby.

supplies without building in populated areas, support to the most vulnerable, pursuit of renewable energy sources, and reform of "the unfair electricity pricing system in New England."

Discussions about transportation fed into talk of economic development. Good roads support efficiency of work, both within and across states. Stem cell research, technology investment, collaboration between industry and agriculture in other countries, and regional cooperation agreements were all mentioned as avenues toward increasing job creation and productivity. Several governors also linked work force training and other education services and programs to economic development programs in their states.

Most governors also thanked their military personnel and National Guard members for work in and out of the United States. While fewer than half the governors mentioned the war in Iraq or security specifically, many did recognize the crises of Katrina and/or Iraq when discussing state work in the last year. Few governors, however, waded into the quagmire of immigration in the United States—a topic of debate in many state legislatures as well as in Congress. Finally, the conversations about corrections focused primarily on generating deterrents to methamphetamine use—mentioned specifically by 18 governors—as well as building more prisons and locking up sexual predators.

The relatively few governors who brought up rainy day funds and/or pensions were pointed in their comments. Lingle, of Hawaii, seeks to double her state's rainy day fund to shore up resources for lean times. West Virginia Gov. Joe Manchin also asked to increase the state's rainy day fund. He kept the state's pension woes front and center by discussing a new long view of state finances. "For the very first time in West Virginia's history, I am providing the legislature with a five-year forecast of our revenues and expenditures. Never before has this been done, but if, as I've pledged, we're going to run this state like a business, then this is a vitally important component of that effort. Our state's traditional shortsightedness has to end. We must ensure that the decisions we make today are right for tomorrow as well, and this five-year forecast gives us the tools we all need to do just that," he said.

Pennsylvania Gov. Ed Rendell said, "In the near future, the state budget and local taxpayers will be expected to increase school funding annually simply to meet growing pension obligations. This could impair our ability to fund the cost of educating our students. We must work together to address the growing pension obligations of our school districts."

Where is the Money?

As expected, the current swell of revenues has encouraged governors to continue whittling away at tax structures, whether these structures are reasonably balanced or not. The Government Performance Project examined states' abilities to balance ongoing revenues with expenditures. Of the eight states scoring well on "structural balance," only Minnesota Gov. Tim Pawlenty did not give a State of the State address this year. The tax changes considered by some of the others are interesting.[9] For example, Vermont Gov. James Douglas is going after that state's significant property tax. Vermont has one of the highest tax burdens in the country (9.2 percent compared to the national average of 6.8 percent as measured by total taxes as a percent of personal income).[10] Though sales taxes are the primary tax source in this state (approximately 35 percent of total tax sources come from general and selective sales taxes in Vermont), it also receives considerable revenues from property and individual income taxes (these make up approximately 27 and 25 percent of total tax sources in the state). Douglas explains while property tax revenues have multiplied to keep up with state spending, he believes the burden of the tax is unsustainable. In his speech, Douglas called for a significant restructuring of the property tax. With an eye toward the long-term effects of such reform, however, he emphasized that to avert added stress to the education budget from reduced revenues, instead of adding "more pre-kindergarten grades to the already stressed K–12 education system and putting taxpayers on the hook to fund it. … We need to find ways to assist our private pre-school providers."

Delaware's tax burden is also high compared to most states at 8.5 percent, though its tax structure has been termed "recession proof" given its ability to sustain the state fiscally through rough waters.[11] Gov. Ruth Ann Minner proposed to "modernize Delaware's bank franchise tax" to hold on to present business and further grow the banking industry. On the other hand, Pennsylvania's Gov. Edward Rendell called for property tax relief in his 2006 budget address—asking the Pennsylvania legislature to honor a compact that originally linked property tax relief with gaming funds. In his budget address, Rendell proposed:

- Accelerating phase out of capital stock and franchise tax;
- Increasing tax credit for research and development;
- Uncapping net operating losses (NOLs)—and, "should future revenues permit us to continue to uncap these losses, it is my intention to propose

each year additional increases in the NOL cap until the limit is completely removed";
- Lowering the rate and also closing loopholes of the corporate income tax; and
- Adopting a single sales factor.

Pennsylvania's tax burden ranks closer to the bottom than the top—total taxes as a percent of personal income is 6.4 percent, just under the state average of 6.8 percent.[12]

Virginia's tax burden is lower than Pennsylvania's at 5.7 percent. Virginia also underwent significant tax code reforms under Gov. Mark Warner to achieve stronger structural balance. So it is not surprising that the state's new governor, Timothy Kaine, urged a calculated approach to any tax changes—"we shouldn't race to the bottom in taxes and jeopardize our ability to fund the critical services that our citizens demand. … But, we must always examine the way we tax and watch for opportunities to make our tax code fairer." He focused attention on the property tax—by not passing unfunded mandates to local governments that would necessitate property tax increases, by providing taxpayers with more information about tax assessments and rates, and through creation of a homestead exemption.

Governors in states not scoring as well on structural balance by the GPP also had many ideas regarding taxes. Wisconsin has a higher than average tax burden (7.5 percent) and the state's weakest component of money management as scored by the GPP was structural balance.[13] In his address, Wisconsin Gov. Jim Doyle said "no to higher sales taxes, no to higher income taxes, no to higher excise taxes. … And, in fact we've cut taxes for veterans, for businesses, for manufacturers … repealed automatic increases in gas taxes, expanded middle class tax deductions for health care, for college. And next year, the tax on Social Security benefits will be history." Hawaii has the highest tax burden in the country (10.1 percent) if measured by total taxes as a percent of personal income. The state also maintains a strong dependence on federal dollars that weakens its ability to weather economic downturns. Lingle outlined her tax relief package, including:
- Raising the standard deduction to 75 percent of the federal level;
- Widening income tax brackets;
- Allowing a $100 per person tax credit to households earning $50,000 or less a year; and
- Imposing a one-time tax refund of $150 per exemption for all but the highest income residents.

Alabama's strict earmarking of revenues to education means that it constantly grapples with fueling most other activities in the general fund. Gov. Bob Riley called for a "historic tax reduction package" in his 2006 address, despite the state's weak score in structural balance by the GPP and the low tax burden (total taxes make up 5.9 percent of personal income) compared to the rest of the country. His effort to provide for a more equitable tax structure crashed in 2003. Now he wants every citizen who pays income taxes to get a tax cut. "Over the next five years, taxpayers will keep more than $200 million to meet the needs of their families," Riley said. The plan includes an increase to the tax deduction for dependents; an increase in the personal tax exemption, and an increase in the threshold where income is taxed. Riley also asked for a state sales tax holiday.

In the past, Michigan's strong dependence on one-time revenues has hampered budget balancing in that state. The state had a weak grade on structural balance by the GPP, and has a high tax burden of 7.7 percent. Gov. Jennifer Granholm called attention to a $600 million tax-cut package recently passed by the legislature "that will fight the outsourcing of our existing jobs and encourage the insourcing of new ones." She said she "signed 51 tax cuts into law, both for individuals and to help businesses create jobs, without leaving gaping holes in our budget. I've also made it clear that I will not support business tax breaks that would shift the burden to everyday citizens or force cuts to education and health care." On the other hand, in New Hampshire, a tough anti-tax ethos has weakened the structural balance yet resulted in the state's position as having the lowest tax burden in the country—total taxes comprise just 4.4 percent of personal income. New Hampshire depends heavily on the property tax for revenue (approximately 26 percent of total tax collections are from the state property tax; selective sales taxes comprise 32 percent of tax collections while corporate income taxes comprise about 20 percent of these collections). In 2006, Gov. John Lynch seeks to eliminate the statewide property tax "once and for all."

Conclusion

Governors did seem to concentrate heavily on their education budgets this year, and then on the budgets of other activities that are primary to the mission of state government. Yet threaded through these addresses is a stronger consideration of a multi-pronged and multi-year view of government operations—understanding state education services on a continuum from pre-kindergarten to work force retraining, for instance. Governors are aware of the federal government's slowing financial support as well as its poor reaction to Katrina and what this means for state coffers. And, the U.S. Supreme Court's consideration of the tax credit and exemption package by the State of Ohio to DaimlerChrysler has governors alert to the ramifications on state governments' ability to use tax concessions as economic development. Most importantly, perhaps, the last year has generated interest in examining the balance between state revenues and expenditures. Case in point, Wyoming Gov. Dave Freudenthal talked about creating a budget that is structurally sound, of limiting ongoing obligations, and spending one-time revenues more logically.

Finally, it is interesting that governors seem more determined to place advancing responsibility for state operations with citizens, albeit indirectly. Ultimately, control of government spending lies with citizens, although control can be approached several ways. David Walker, the comptroller general of the United States, noted recently that citizens must be more active and vocal in holding elected officials accountable to spending prudently and responsibly. "In our republic, ultimate accountability for government rests with each of us," he said. "It's no accident that our Constitution begins with the words, 'We the people.'"[14] On the other hand, governors are calling on individuals to take active responsibility for solving problems themselves and in turn, reducing state responsibility (costs). Tennessee's governor extolled a "matter of values"—the personal responsibility required of parents to teach their children the values of education, hard work and respect and that required of every individual regarding personal health and fitness. "Government can't solve every problem, but government can and should be a partner to help our citizens solve more problems themselves," Bredesen said.

Notes

[1] Chief executives of state governments report annually or biennially to their legislatures regarding the fiscal condition of their state, commonwealth or territory. Governors often use their address to lay out their policy and budget agendas for their upcoming or continuing administration. The 2006 state of the state addresses were accessed from January through March 1, 2006 at *www.stateline.org*, *www.nga.org*, or at the state government homepage. This research considers those 40 states with transcripts available at these sites as of March 1, 2006. Although both Virginia's outgoing and newly elected governors gave state speeches, only that of the newly elected Gov. Timothy Kaine (D) is assessed here. Speeches not available by March 1, 2006 included those from Florida, Louisiana, Massachusetts and Minnesota. Also in 2006 in six states, governors did not give state of state addresses, including: Arkansas, Montana, Nevada, North Carolina, North Dakota and Texas. All quotes and data presented here are from the addresses accessed at these Web sites, unless otherwise noted.

[2] A summary of 2006 gubernatorial elections is available at *www.nga.org* and accessing the "Governors" link at the top of this Web site.

[3] Linda Feldmann, "Governors Line Up for Oval Office," *The Christian Science Monitor*, (March 1, 2005) at: *http://www.cbsnews.com/stories/2005/03/01/politics/main677300.shtml*.

[4] NASBO, *The Fiscal Survey of the States*, The National Governors Association, December 2005, Table 6, page 8.

[5] NASBO, *The Fiscal Survey of the States*, The National Governors Association, December 2005, Table 7, page 9.

[6] NASBO, 2005, Table 2, p. 3.

[7] NASBO, 2005, p. ix.

[8] Ibid.

[9] The Government Performance Project (GPP) is a periodic survey conducted of state government management practices in the areas of human resources, budget and finance, infrastructure and information. The project is sponsored by The Pew Charitable Trusts and involves both academic and journalist partners. Results from the most recent survey are available at *www.results.gpponline.org*. The eight states indicating strong structural balance in the 2005 survey include: Delaware, Kansas, Minnesota, Pennsylvania, South Dakota, Utah, Vermont and Virginia. Scores for structural balance required examination of state revenue structures, use of one-time or windfall revenues, cash and risk management activities as well as use of counter-cyclical or contingency planning, particularly in periods of economic decline.

[10] Federation of Tax Administrators, 2004. State Tax Collections, 2004 State Revenues Per Capita and as Percent of Personal Income accessed February 22, 2006 at *http://www.taxadmin.org/fta/rate/burden.html*.

[11] See Delaware's scores for Money and Structural Balance at *www.results.gpponline.org*.

[12] Federation of Tax Administrators, 2004.

[13] See Wisconsin's scores for Money and Structural Balance at *www.results.gpponline.org*.

[14] David Walker, Comptroller General of the United States Government Accountability Office, Lecturer at Getzen Lecture Series on Government Accountability at the University of Georgia, Athens, Georgia, on February 8, 2006.

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Katherine Willoughby is professor of Public Administration and Urban Studies in the Andrew Young School of Policy Studies at Georgia State University in Atlanta. Her research concentrates on state and local government budgeting and financial management, public policy development and public organization theory. She has conducted extensive research in the area of state budgeting practices, with a concentration on performance measurement applicability at this level of government in the United States.