Fiscal Condition of Tenth District States

by Mark Drabenstott, Marvin Duncan, and Anne O'Mara McDonley

State governments have come under increasing budget pressures in recent years. Many of the problems can be attributed to the economic recession and its effect on revenue and expenditures. Other factors, such as cutbacks in federal grants-in-aid, the high cost of issuing bonds, changing demographics, and voter resistance to tax increases also have contributed to a deterioration in state budgets.

States of the Tenth Federal Reserve District — Colorado, Kansas, Missouri, Nebraska, New Mexico, Oklahoma, and Wyoming — have had additional problems. While energy and agriculture had been countercyclical sources of strength to the district economy in the past, both of these important sectors have suffered a recession along with the rest of the economy since 1981. As a result, revenue pressures have increased in these seven states.

This article reviews the fiscal status of Tenth District states from 1973 through 1982 and discusses both changes in state finances and probable reasons for the changes. The first section discusses differences in the state and federal budget processes. The second section examines the growth of revenue and expenditures in district states and discusses some recent factors shaping the state budget environment. The third section analyzes the budget pressures that have resulted from the economic recession. The fourth section considers some of the challenges district states may have to face in effectively managing their budgets in the future.

State and federal budget systems

There are substantial differences between the states and the federal government in budget-making procedures and fiscal policies. Moreover, state procedures and policies sometimes contribute to the fiscal problems they are now experiencing. This section reviews these differences, compares the way states and the federal government incur debt, and summarizes the growth in state and federal debt.

The use by state governments of separate capital budgets is one marked difference from the federal government's budget process. The federal government's budget accounting makes no distinction between payments based on the useful life of purchases or transfer payments. All budget items are fully expensed in the year purchased. When the federal govern-

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TABLE 1
State limitations on deficits in general operating budgets

	Number of States with Limitations that are:		
United States			
Type of provision	Prohibitive	Constraining only	Total
Constitutional	33	6	40
Statutory	6	2	8
None	-	-	2
Total	39	8	50
Tenth District			
Type of provision	Prohibitive	Constraining only	Total
Constitutional	5	1	6
Statutory	1	0	1
Total	6	1	7

Note: Ten states cited both constitutional and statutory provisions.
Source: The National Association of State Budget Officers, *Limitations on State Deficits,* The Council of State Governments, Lexington, Kentucky, April 1976. This publication has not been updated, but a phone survey validated the table above.

ment buys a dam, a highway, or a jet aircraft, the accounting system handles that expenditure the same way it handles purchases of office supplies — as though the useful life of the goods or services purchased did not extend past the fiscal year they were bought. States, however, typically separate their capital-improvement and operating budgets, thus taking into account differences in the useful life of purchases.

That difference explains why states ordinarily are perceived to balance their budgets every year. Actually, what states balance is their general operating budgets. All but two of the 50 states — Vermont and Connecticut — have constitutional or statutory limits on their ability to run deficits in their general operating budgets (Table 1).

States do incur debt, however, to make capital investments. Investments such as roads, buildings, waterways, and dams often are funded with borrowed capital repaid over the expected useful life of the asset — a practice not much different from that in the private sector. Most states finance these big-ticket items through capital market bond issues or, in the case of highways and other transportation-related investments, by transfer payments from the federal government. Funds to repay bonded indebtedness are generated by special tax levies, usually voted in by the taxpayers, and by receipts from special federal and state taxes or trust funds, such as federal and state gasoline taxes.

An important distinction between federal and state capital spending programs is that the states, unlike the federal government, establish the sources of repayment funds before the capital expenditures are made.

Although Congress sets federal debt ceilings, three general constitutional and statutory restraints limit the ability of states to incur debt. One restricts the total debt level. Outstanding debt may be limited, for example, to a percentage of the assessed property value in the state. Another requires that general operating budgets be in balance. The third outlines procedures for managing budget deficits, whether impending or incurred. Procedures may require, for example, that state expenditures be cut or taxes be raised enough to cover the previous year's deficit.

States, therefore, operate under much tighter budget restraints than the federal government. Decisions to incur debt in state government typically require direct legislative action or a vote of the people.

States, nevertheless, have incurred substantial debt. Demands for infrastructure have grown along with population and industry, and the rapid inflation of the past decade added substantially to the cost of such projects. So, despite legal restraints on the ability of state governments to incur debt and despite the reluctance of taxpayers to vote for higher taxes, state government debt has increased markedly in the past decade (Chart 1). Between 1973 and 1982, debt for all 50 states increased 259 percent, compared to a 245 percent increase in federal debt. Since 1980, however, growth in federal debt has outstripped that of the states. Debt outstanding for Tenth District states grew more rapidly than for the 50 states, increasing 374 percent between 1973 and 1982.

The state budget environment: 1973-82

Changes over the past ten years have put increasing stress on the budgets of Tenth District states. After more than a decade of strong economic growth before 1973, the states entered the 1973-82 period with healthy fiscal surpluses, low unemployment rates, and moderate growth in expenditures. With rapid inflation and energy price shocks beginning about 1973, all that changed.

Changing revenue and expenditure patterns

General revenue for district states grew strongly over the 1973-82 period, reflecting fairly rapid economic growth. General revenue increased more than 10 percent a year in every year except 1974 (Chart 2). For the period as a whole, revenue increased at an average annual rate of 11.7 percent. By 1982, general revenue for the seven state governments totaled more than $19.5 billion.

District state revenue generally grew more rapidly than for the nation as a whole. Revenues for all 50 states increased at an average annual rate of 10.4 percent, 1.3 percentage points less than for the district states (Table 2). Of the district states, energy-producing Wyoming, New Mexico, and Oklahoma had the fastest growth in revenues.

At the same time that total revenue grew, the composition of revenue sources changed. More than 86 percent of district states' general revenue in 1973 came from intergovernmental transfers — overwhelmingly federal grants-in-aid — and from sales taxes and from individual and corporate income taxes. Charges for state services and income from other sources accounted for only slightly more than 13 percent of all revenues. By 1982, federal budget austerity, recession, and taxpayer revolt had trimmed the share of revenue provided by transfers and taxes to less than 80 percent, leaving states to rely more heavily on other revenue sources (Chart 3). Miscellaneous revenues from such sources as interest earnings, rents, and sale of properties grew 38 percent a year after 1978.

For most of the 1973-82 period, spending in district states increased faster than revenues. For the entire period, expenditures grew an average of 11.7 percent a year, the same rate as for revenue. Until 1982, however, growth

CHART 1
Total long-term debt

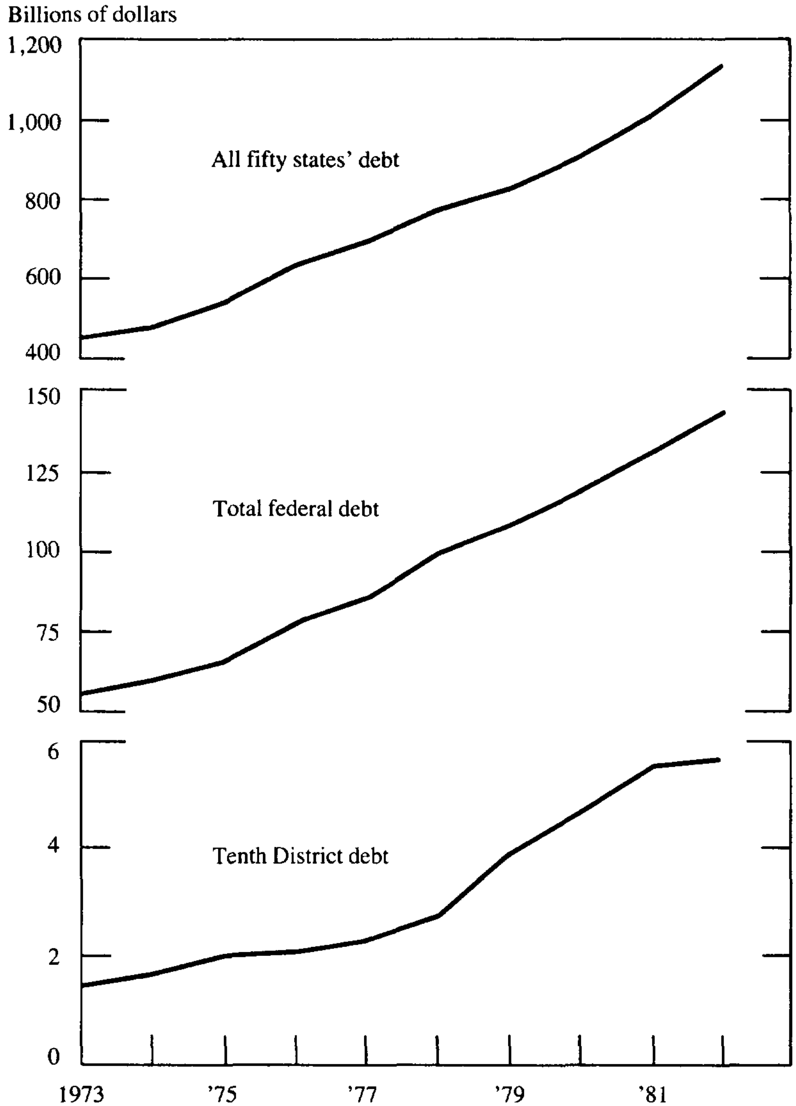
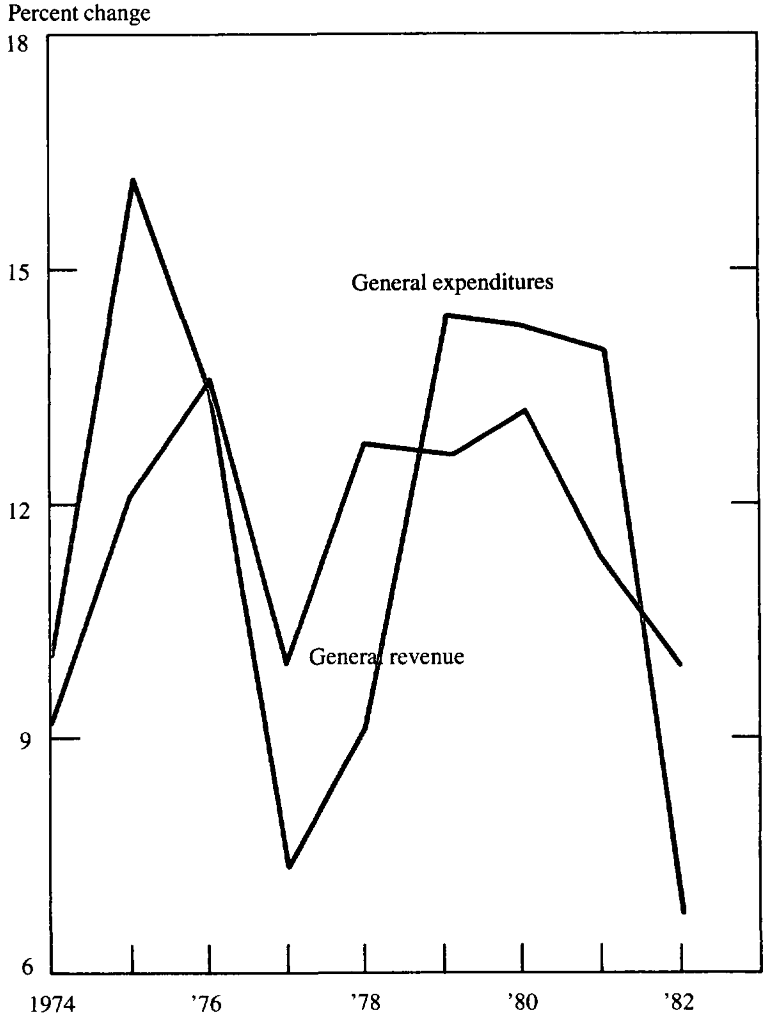


CHART 2
Growth in general revenue and expenditures
Tenth District states



in expenditures outstripped growth in revenues by a significant margin (Chart 2). Expenditure growth slowed dramatically in 1982 as states responded to increased fiscal strain in 1980 and 1981. The rapid growth in expenditures before 1982 reflected growing demand for state public services resulting from increases in population and economic activity. Recent cutbacks in federal social programs also caused states to spend more for some affected programs. Spending by district states also increased faster than the average for all states

TABLE 2
Growth in general revenue
(percent)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1974-82 Average
Colorado	12.8	13.9	13.3	7.0	11.9	14.0	9.3	4.0	9.3	10.6
Kansas	7.9	12.2	14.1	9.9	7.9	13.3	10.2	9.8	2.3	9.7
Missouri	7.2	6.6	11.6	9.3	11.8	11.9	11.5	3.4	5.5	8.8
Nebraska	9.4	9.6	17.8	12.1	11.8	8.3	12.3	4.9	4.9	10.1
New Mexico	11.0	20.9	11.3	8.6	22.1	13.1	18.2	24.8	12.0	15.8
Oklahoma	8.6	11.8	12.5	13.2	12.3	12.9	17.2	19.2	13.4	13.5
Wyoming	9.0	26.1	27.4	13.9	17.9	16.4	19.6	26.0	35.2	21.3
Tenth District	9.2	12.1	13.6	10.0	12.8	12.7	13.3	11.4	10.0	11.7
50 States	8.1	10.0	13.0	11.7	11.3	10.0	12.3	10.5	6.6	10.4

Source: State Government Finances, U.S. Bureau of the Census.

during the decade. State expenditures in the nation increased an average of 10.8 percent a year, 1 percentage point less than the average increase for district states (Table 3).

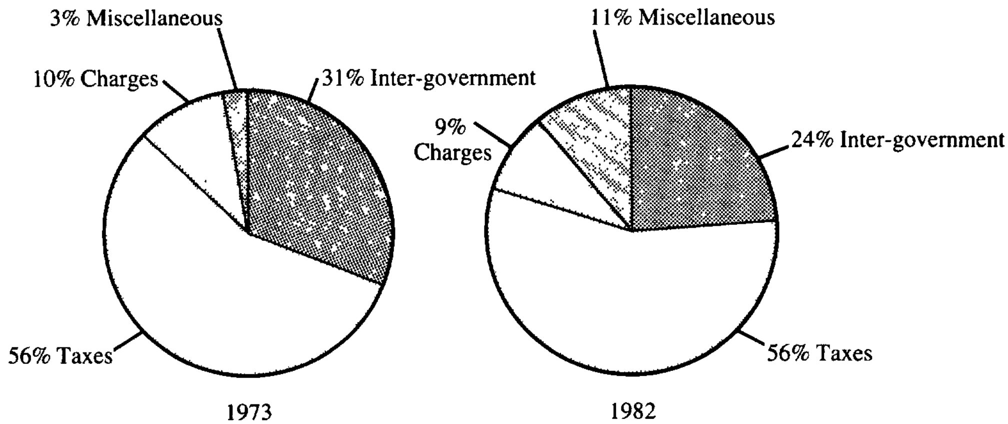
The overall mix of expenditures in district states remained fairly stable throughout the period. Education was the biggest expense, accounting for more than 40 percent of total spending every year (Chart 4). Public welfare assistance and transportation, mostly highway construction and maintenance, were other major expense items. Together, education, public welfare, and transportation accounted for nearly three-fourths of total general expenditures. In dollar terms, all three functions grew significantly from 1973 to 1982. But spending on health programs and hospitals grew faster than any other type of state spending. Reflecting the rapid increase in health care-costs and the strong demand for public health programs, health expenditures increased nearly 15 percent a year.

Fiscal surplus and deficit

The fiscal status of district states has deteriorated since 1973. With expenditures increasing faster than revenues in most years, most district states have come under growing budget stress. Some states even faced budget deficits in 1981 and 1982.

Fiscal surplus may be defined as the difference between general revenue and general expenditures in a given year. General expenditures include both operating budget items and amortized capital investment expenditures. As a deficit indicates that a state's general revenues cannot cover its general expenditures, this negative balance must be offset by expenditure cuts, tax increases, or a carryover surplus from previous years. States can reduce the strain on general revenue by issuing bonds to cover specific capital expenditures, thus removing such amortized items from the general budget. The surplus or deficit in any particular year, therefore, reflects the extent of strain on a budget resulting from the balance of general revenue and expenditure. The particular budget balance discussed here does not take into account carryover surpluses from previous years or subsequent actions to offset deficits. And, because of restraints on their

CHART 3
General revenue by sources
Tenth District states



Source: State Government Finances, Bureau of the Census

ability to run operating budget deficits, states almost certainly used carryover surpluses, raised taxes, or reduced expenditures to offset their deficits.

Taken together, district states maintained a budget surplus for the entire 1973-82 period (Chart 5). Except for 1982, the surplus declined during the two recession periods, 1974-75 and 1980-81, and increased during business expansions. In 1982, the surplus actually increased as district states cut back sharply on expenditures while recession further slowed revenue growth. The fiscal surplus for district states did not erode as sharply during either recession as the surplus of all states. The relatively resilient district economy provided stronger growth in state revenue during economic downturns than for the nation as a whole (Chart 5). The district's healthy positive fiscal balance in 1981 and 1982 masks some sharp distinctions among states, however. In 1981, for example, Colorado, Kansas, Missouri, and Nebraska all had budget deficits. For the district as a whole, these deficits were more than offset by large surpluses in Oklahoma, New Mexico, and, to less extent, Wyoming (Table 4).

Recent factors affecting state budgets

Several factors other than general economic activity are now shaping the budgets of district states. These factors include greater austerity in federal grants to states, the high cost of issuing debt, and changes in demographics.

Growth in federal transfers to district states has slowed sharply in the past two years. Before 1973, district states came to rely on federal dollars to make up about 30 percent of their total revenue. Between 1973 and 1980, total annual grants to district states about doubled, exceeding $4.3 billion in 1980. Since then, however, cutbacks in federal spending have slowed the increase in grants to states to

TABLE 3
Growth in general expenditures
(percent)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1974-82 Average
Colorado	13.8	21.7	12.0	8.2	6.6	11.1	11.2	15.5	7.9	12.0
Kansas	11.7	17.1	17.3	10.4	2.5	16.5	10.7	13.0	1.1	11.1
Missouri	10.7	15.7	8.1	2.8	11.3	12.4	17.2	10.8	(1.0)	9.8
Nebraska	13.2	21.5	10.4	10.5	10.6	10.0	10.3	11.5	5.5	11.5
New Mexico	10.8	13.4	15.5	7.2	18.4	20.0	10.2	16.4	17.4	14.4
Oklahoma	4.3	9.1	15.0	11.2	7.6	15.1	17.8	15.8	11.3	11.9
Wyoming	4.6	22.3	38.0	(3.0)	13.3	24.5	26.8	20.2	15.8	18.1
Tenth District	10.1	16.2	13.4	7.4	9.1	14.4	14.3	14.0	6.8	11.7
50 States	10.9	15.4	11.1	8.0	8.8	11.5	13.8	11.1	6.2	10.8

Source: State Government Finances, U.S. Bureau of the Census.

1.9 percent a year, compared with 12 percent from 1973 to 1980 (Chart 6). As a result, federal transfers amounted to 24 percent of total district revenue in 1982.

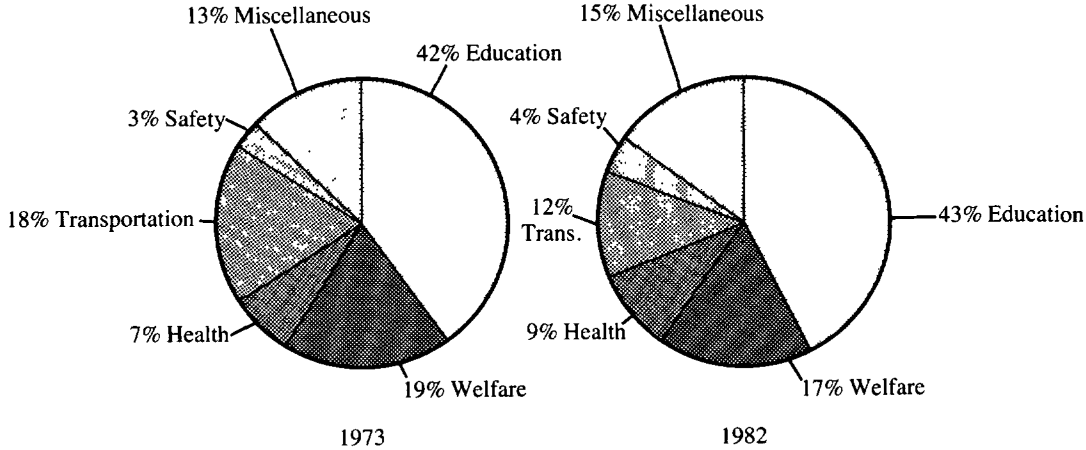
The recent slow growth in federal transfers has left district states with the need to provide for more revenue. That has proven particularly difficult during a recession and at a time when demands on states were increasing rapidly. Consequently, the cutbacks have forced states to raise taxes or fund more capital expenses by issuing debt. Because the prospect of large federal deficits is likely to limit increases in federal transfers, district states may have to adjust to a permanently lower growth rate in federal revenue support.

District states have responded to growing budget pressures by funding more capital expenditures through debt issuance rather than increases in general revenues. Between 1973 and 1982, total long-term debt more than tripled — an average annual growth rate of more than 16 percent. Debt issuance peaked in 1979, when district states placed more than $1 billion in bonds. Although debt is one way of funding some capital expenditures, high interest rates on new bonds have tended to discourage states from undertaking even more debt. Municipal bond rates, after remaining fairly stable at 5-6 percent until 1979, increased sharply thereafter and averaged almost 11 percent in 1982. With interest rates about twice what they had been in the 1970s, district states found bond issues for capital outlays increasingly costly at the very time their fiscal positions were deteriorating, and in some states were becoming deficits.

Although municipal bond rates are now below their 1982 peaks, large federal budget deficits have kept market rates well above the levels enjoyed throughout much of the 1970s. The cost of new debt, therefore, is continuing to complicate the funding decisions of district states.

In addition to slowing federal aid and higher interest rates, population growth also significantly affected state budgets during the 1973-82 period. The population of district states has increased an average of 1.4 percent a year since 1973. According to preliminary data, the district's population totaled 17.0 million at mid-1982, compared with 15.2 million in 1973. Rates of growth varied from state to state. The fastest growth was in Colorado and

CHART 4
General expenditures by function
Tenth District states



Source: State Government Finances, Bureau of the Census

Wyoming. Missouri, Nebraska, and Kansas had very low rates of growth, with population declines some years. States with rapidly increasing populations generally had significant increases in expenditures, but they also had a growing revenue base. States with little change in population saw a slight slowing in the expenditure growth but a noticeable decline in their revenue base.

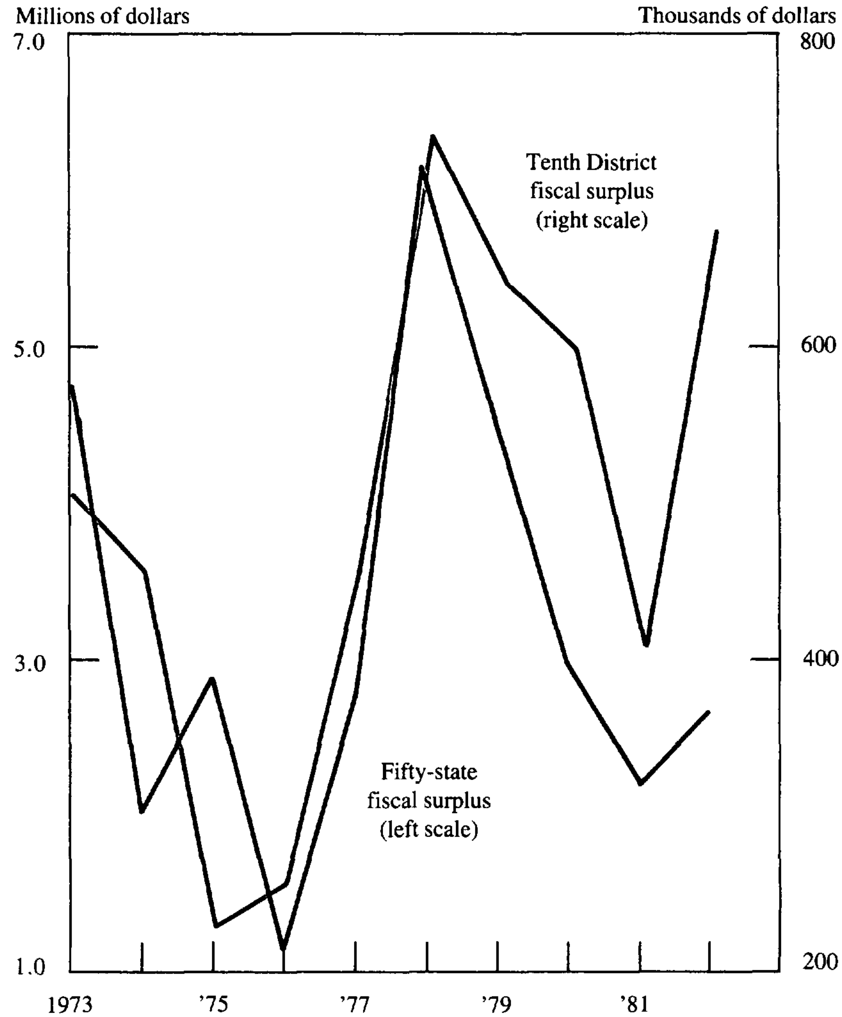
Changes in the age distribution in district states also affected state budgets. Two population trends were evident over the past ten years. First, the postwar baby-boom generation matured into its early working years: The proportion of district population between the ages of 17 and 44 increased from 36.7 percent in 1973 to 42.2 percent in 1982. This change provided a growing base for state tax revenues (Chart 7). Second, the proportion of elderly people increased, though only slowly, from 11.1 percent in 1973 to 11.8 percent in 1982. Although the shift was less pronounced than in other parts of the country, an increase in the proportion of elderly people creates budget pressures for states. People in this age group usually are retired and receive more state-funded services than they pay in taxes or other revenue. Thus, with the aging of the population, states have felt additional budget pressures.

In brief, district state budgets have come under increasing pressure as expenditures usually have grown faster than revenue. Meanwhile, the budget-making environment also has changed. Slowing growth in federal grants, high rates on municipal bonds, and changing demographics have all made balancing state budgets more difficult than a few years ago.

Budget performance in recession

While several factors have influenced state budgets over the past ten years, economic

CHART 5
Tenth District fiscal surplus
(1972 dollars)



recession has been the dominant one. The two most severe recessions in the postwar period came during the past ten years,in 1974-75 and 1981-82. This section analyzes the effects of these recessions on state budgets.

The latest recession cut deep into the revenue of district states. The growth in personal income over the district slowed to only slightly more than 6 percent in 1982, compared with annual gains averaging more than 11.7 percent from 1973 to 1980 (Chart 8). Growth in personal income for the nation

TABLE 4
State fiscal surplus (deficit)
(millions of dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Colorado	118	121	34	60	42	153	234	211	(77)	(42)
Kansas	117	91	50	18	13	100	61	58	(3)	25
Missouri	156	106	(61)	9	166	198	207	53	(212)	37
Nebraska	64	47	(28)	28	46	63	49	79	(6)	(15)
New Mexico	67	75	147	129	153	226	169	321	541	501
Oklahoma	15	74	121	97	144	254	240	267	416	541
Wyoming	10	21	36	14	86	120	103	82	145	364
Tenth District	546	537	300	354	650	1,114	1,063	1,072	803	1,410
50 States	5,038	2,436	(3,693)	(1,572)	3,871	9,297	7,524	5,369	4,505	6,146

Source: State Government Finances, U.S. Bureau of the Census.

slowed from 11.1 percent to 6 percent. The slowdown in the region's economy translated into slow growth in general revenues in 1981 and 1982 (Chart 2).

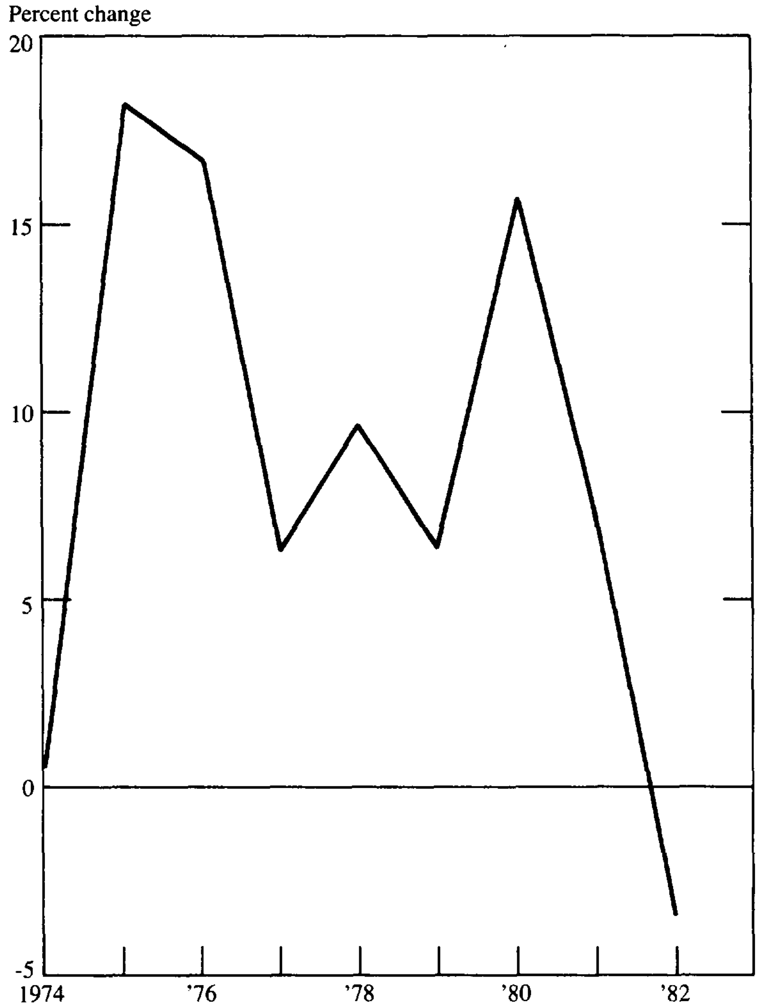
The effect of the recession on general revenues was especially severe because of coincident weakness in nearly all sectors of the region's economy. Countercyclical strength in agriculture and energy served in previous recessions to help offset declines in manufacturing and retailing. But from 1980 through 1982, agriculture and energy were undergoing recession along with other sectors of the district's economy. Numerous problems — weak export markets, abundant grain supplies, and a weak national economy — have kept agriculture in recession since 1979. Energy production, accounting for 5.7 percent of district income in 1982, has fallen sharply because of declining energy prices and weak demand in world markets. With the effects of the recession broadly felt in all district states, growth in state revenue slowed.

The recent recession also affected state budgets by creating more need for public assistance programs. Rising unemployment, combined with weakened incomes, caused many public assistance programs to swell. Unemployment rates increased sharply over the district during the past two years. After a decade of fairly stable unemployment rates of between 4.0 and 5.5 percent, the district unemployment rate climbed to 7.5 percent in 1982. Only in 1975 had the district's unemployment rate risen above 6 percent. As unemployment increased, expenditures for public welfare programs expanded 19 percent in 1981, and then rose 6.6 percent in 1982 as states cut back because of fiscal strain.

The dual effects of recession — reduced revenue and increased expenditures — created budget pressures that many district states had not known before. Only two states, Missouri and Nebraska, had deficits in the 1974-75 recession, and they came only in 1975. In 1981, these states along with Colorado and Kansas had deficits. In 1982, sharp expenditure cutbacks left deficits in only two states, Colorado and Nebraska. Thus, while both recessions had noticeable effects on state budgets, the recent downturn left a more lasting imprint on budget positions in the district.

Several measures suggest that the recent recession had a more severe effect on state

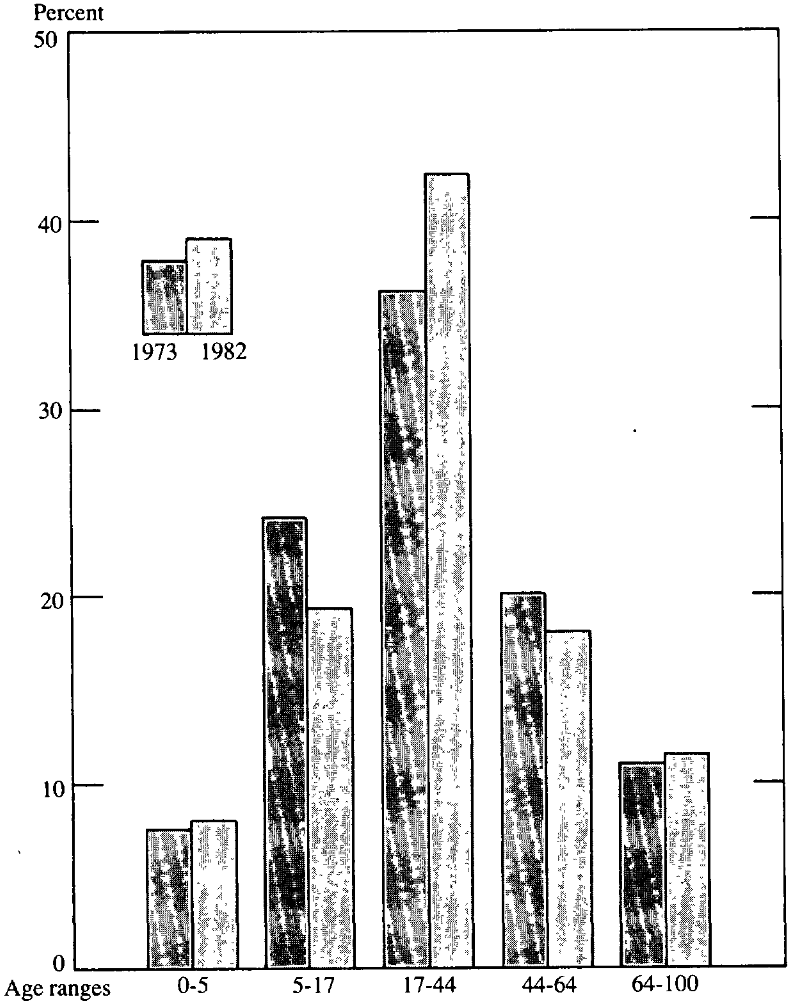
CHART 6
Growth in federal transfers,
Tenth District states



Source: State Government Finances, Bureau of the Census

economic performance — and hence on budgets — than the 1974-75 recession. Though personal income continued to grow during both recessions, the growth rate dipped to 6.4 percent in 1982, compared with 8.8 percent in 1974. The district's unemployment rate peaked at 8.3 percent in the fourth quarter of 1982, while in the previous recession it peaked at 6.6 percent. Moreover, employment growth in district states continued in 1974 and 1975, but total district employment declined in 1982.

CHART 7
Age distribution of Tenth District population

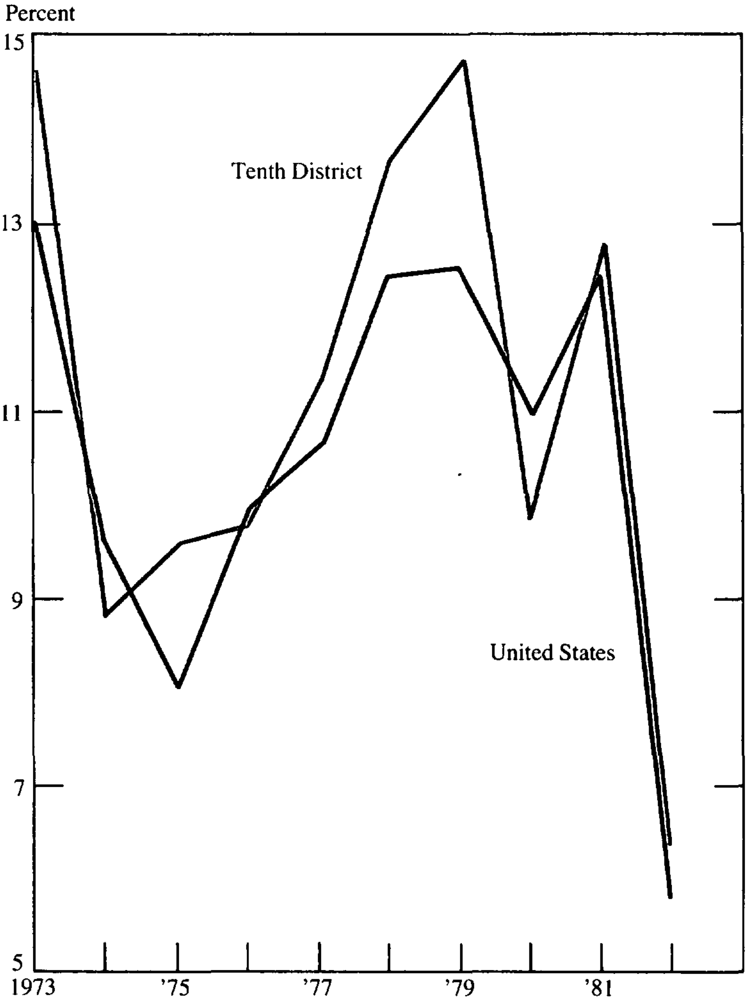


Source: Bureau of the Census

Budget challenges of the future

As district states look to the future they find themselves in a more complex budget-making situation than in the past. Lingering effects of the sharp recession in 1981-82, declining revenue support from the federal government, high interest rates on bonded indebtedness, changing demographics — these and other factors pose problems for the states.

CHART 8
Personal income growth
(annual change)



Source: Bureau of Economic Analysis, Department of Commerce

Future revenue growth

The strength of the district's economy will be a primary determinant of state revenue growth. The traditional source of district strength — its diversity — did not prevent the states from feeling the effects of the sharp recession in 1981-82, mainly because the two most important countercyclical industries, energy and agriculture, also were suffering. And, as energy and agriculture have seen their fortunes interwoven with national and world economic activity, growth for the region's economy may no longer be as insulated from national business cycles as in the past. As a result, the future of the district economy seems to be more closely tied to a sustained recovery of the U.S. economy and the economies of U.S. trading partners.

Moderate growth in state revenue can be expected on the basis of economic growth. The strong recovery now underway in most of the district is likely to slow somewhat by 1984. Over the longer run, the regional economy will continue to grow, though probably slower than the rapid pace of the 1960s and early 1970s. Strength will be found in an expanding high technology sector and continued dependence on the district's rich reserves of natural resources — oil, gas, coal, and farmland. On the other hand, a fairly stable population and delays in replacing needed public infrastructure may be two sources of regional economic weakness.

The public's willingness to support more taxes also will influence revenue growth. Effects of the 1978 taxpayer revolt still reverberate through district states. But while states have had difficulty in raising taxes to ease the fiscal strain of recent years, a consensus supporting higher taxes likely will build as the public realizes government services increasingly are unmet. Concerns over declines in public education, for example, may foreshadow increasing willingness to fund higher levels of educational services. Necessary additional taxes, however, may increasingly take the form of user fees and consumption taxes, such as sales taxes.

The ability of state governments to fund capital outlays through bond issues also will affect growth in available revenues. District states responded to high interest rates by increasing their long-term debt only 1.8 percent in 1982, compared with 20 percent in 1981. Although nominal interest rates may remain below their 1981 peaks, real interest rates — the inflation-adjusted cost of carrying debt — is likely to remain higher than in the 1970s for the next year or two because of large prospective federal deficits and strong private sector credit demand. As long as interest rates remain high by historical standards, district states probably will continue to refrain from rapid debt issuance. As a result, more capital expenditures may be funded through general revenue.

Future expenditure growth

Changing demographics will continue to heavily influence district state budgets and the services states provide. The population is expected to continue aging for the next two decades as the baby-boom generation further matures and the average life span increases. While education services for the children of baby-boom parents will be needed, conflicting public demands on state revenue may make providing this service more difficult so that new ways of funding education may be needed. Public health services will be in greater demand as the proportion of older people in the population increases. These demands will present a significant challenge to district states, especially if health-care costs continue rising faster than inflation overall.

Prospective cutbacks in federal public programs also may increase demand for state-funded programs. Cutbacks in such federal programs as food stamps, public housing, and certain specialized public assistance programs already have created more demand for state expenditures. Federal programs are likely to remain austere as projected large federal deficits force reductions in federal spending. Therefore, states may have to assume larger roles in these programs, provided the public continues to support government assistance at some jurisdiction.

Public infrastructure expenditures are likely to increase rapidly, especially compared with recent growth. High interest rates and fiscal strain prevented many district states from undertaking the capital expenditures needed in recent years. Capital outlays increased little in 1981 and 1982. As a percentage of total state expenditures, capital expenditures fell markedly in both years. Infrastructure needs likely will be high for two reasons. First, the expenditures needed to update existing infrastructure will be great. Many states have used up old investments without making capital improvements to offset deterioration. As a result, many public structures are now in a state of disrepair and large outlays will be needed to bring existing structures to acceptable standards. Second, needs for infrastructure as a foundation for future economic growth also will be great. District states will need to put in place public goods to encourage business and economic growth. Public investment in such things as industrial parks, improved transportation, and cooperative ventures in education, research, and development could be significant.

On balance, expenditures in district states are likely to continue increasing faster than spending by the federal government. Demands for public services will remain high, cutbacks in federal programs will shift some spending to the states, and infrastructure expenditures will be great throughout the 1980s.

Future for budget balancing

With the outlook for moderate growth in revenues and rapid increases in expenditures, the overall outlook for district states depends on their ability to generate revenue that meets spending needs. The fiscal strain district states felt in 1981 and 1982 therefore, may, foreshadow stress for the rest of the 1980s. District states can probably expect the prospect of deficits to shape their actions.

Economic recovery will reduce the strain. A period of sustained regional economic growth could correct many of the fiscal problems district states now face. State fiscal stress always results from cyclical downturns in the economy. District states, therefore, stand to benefit from economic policy that fosters long-term growth in both the national and regional economies. Economic recovery, however, will not solve all the states' fiscal problems. Reduced federal aid to states, prospects for continued high municipal bond rates, aging populations, and urgent infrastructure needs may place stress on state budgets that recovery alone will not relieve. Even if the recovery endures, district states may have to raise taxes or increase other revenues.

District state budgets already may reflect discretionary corrective steps to relieve fiscal strain. In 1982, a year of steep recession across the district, all states except Nebraska and New Mexico increased their fiscal surpluses. State budgets improved because states cut expenditure growth by more than half while raising taxes in some cases. States in the district, therefore, appear willing to address their difficult budget situations by reducing expenditure growth as well as by raising taxes.

As district states look to the future, raising taxes is an obvious possibility in maintaining fiscal balance. The success states have in raising taxes depends not only on the willingness of the public but also on the ability of a state's economy to generate additional tax revenues. The latter factor, which might be termed "tax capacity," is difficult to evaluate.

The Advisory Commission on Intergovernmental Relations (ACIR) has developed a broad index that estimates how much revenue each state could generate if it taxed all of its tax bases at national average rates. As a measure of fiscal capacity, the index measures the multiple resources claimable by state governments through a variety of taxes.[1] A tax capacity greater than 100 indicates the state has more fiscal capacity than the 50 states as a whole.

Based on this index, Tenth District states appear to have considerable fiscal capacity. All district states except Missouri and Nebraska had index values greater than 100 in 1981, the last year for which estimates are available (Table 5). This means, for example, that Colorado, with an index of 113, had 13 percent more tax capacity than the rest of the nation. Missouri, on the other hand, with an index of 92, had 8 percent less tax capacity than the rest of the United States. Wyoming, with an index of 216, was second only to Alaska in tax capacity. The high number assigned to Wyoming reflected that state's rich mineral wealth. Overall, the Tenth District appears to have a strong tax base to support increased expenditures.

The tax capacity of most district states has increased in recent years. Only Missouri and Nebraska had deterioration in tax capacities between 1967 and 1979. The tax capacity of the other district states increased steadily over the same period. Indeed, New Mexico, Oklahoma, and Wyoming showed stronger growth in tax capacity than much of the rest of the nation. The region's growing economy and rich supply of natural resources were largely responsible for the general growth in tax capacity.

The ability to raise additional taxes also depends on how much of a state's tax capacity has already been used. The ACIR generates an index of tax effort that measures a state's total tax collections relative to its total tax capacity. A tax effort greater than 100 indicates that the state is taxing its overall base at higher than average rates.

The Tenth District appears to have substantial capacity for generating additional revenue. All seven states had tax effort index numbers less than 100 in 1981, suggesting that tax collections in the district were running well below the national average (Table 5). Only Nebraska even approached the average tax effort in 1981. Index numbers over the 1967-81 period show that, except for Nebraska, district states actually had reduced tax collections relative to the national average over time. Thus, the relatively high tax capacity of district states coupled with relatively low tax collections suggest that considerable additional tax revenues could be raised. Whether these additional revenues are realized depends, of course, on the voters in the various states.

States will continue to use income taxes as a revenue mechanism, but other taxes may be proposed. Additional severance taxes may be important in energy-rich states. States also will turn increasingly to user charges for state services and consumption-type taxes, such as sales taxes. Fiscal strain has made district states more aware of their costs, increasing the likelihood that they will respond to revenue shortfalls more quickly in the future. Although demand for expenditures will be great, new and old spending programs are likely to be scrutinized carefully. Capital expenditures also are likely to be undertaken only after careful consideration of short- and long-run objectives.

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[1] Advisory Commission On Intergovernmental Relations, *Tax Capacity of the Fifty States: Methodology and Estimates*, Report No. M-134, Washington, D.C., March 1982. The ACIR was created by Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. It is a permanent, national, bipartisan body representing the executive and legislative branches of federal, state, and local government and the public.

TABLE 5
Tax capacity and tax effort in Tenth District states

	Tax Capacity				Tax Effort			
	1967	1977	1979	1981	1967	1977	1979	1981
Colorado	104	107	110	113	106	95	96	84
Kansas	105	109	109	109	96	89	87	87
Missouri	97	96	97	92	86	80	82	81
Nebraska	110	101	100	97	78	98	98	95
New Mexico	94	98	103	114	92	77	85	89
Oklahoma	102	101	108	127	80	72	74	73
Wyoming	141	154	173	216	79	82	83	73
United States	100	100	100	100	100	100	100	100

Source: Advisory Commission on Intergovernmental Relations, 1981 *Tax Capacity of the Fifty States*, Report No. A-93, Washington, D.C., September 1983.

Summary

Tenth District states, like other states in the nation, have had declining state budget balances over the past decade, and in some cases budget deficits. The problems have been particularly severe in states that rely heavily on manufacturing, energy, or agriculture as engines of economic activity. The stress has increased in recent years as a result of recession, cutbacks in federal assistance programs, and an aging infrastructure and population base.

Economic recovery will solve many state budget problems, as it has in past recoveries. Overall, district states can expect reasonably strong economic growth to support adequate tax revenues. Most district states may be able to carry fiscal surpluses. Many of the factors that have placed budgets under stress, however, will necessitate prudent and careful budget planning. That planning may result in additional actions to cut budgets and to raise revenues. Since most district states tax their citizens less than other states, most of the states have the potential tax revenue to solve budget problems that may arise — provided revenue increases meet voter approval.