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February 2, 2009

Congressional Research Service

Report RL33154

*The Impact of Hurricane Katrina on the State Budgets of
Alabama, Louisiana, and Mississippi*

Steven Maguire, Government and Finance Division

November 15, 2005

Abstract. After major disasters, affected state and local governments face the dual challenge of responding to the crisis and absorbing the economic losses associated with the disaster. Typically, tax revenue collections, both state and local, decline immediately following a disaster. The severity and range of the destruction determine when and to what level tax revenue will rebound. For states, the revenue loss is inopportune given both the cost of repairing government infrastructure and providing assistance to affected local governments and individuals. Most states have emergency funds to tap into when disaster strikes. For catastrophic disasters on the scale of Hurricane Katrina, however, the emergency fund may be insufficient. In cases where the scale of the disaster overwhelms the fiscal capacity of state governments, the states may borrow to finance emergency spending. Each of the states most severely affected by Hurricane Katrina - Alabama, Louisiana, and Mississippi - could be forced to address budget shortfalls with increased borrowing. This report outlines the budget issues facing each of these states. The last section of the report provides a rough approximation of the potential state tax revenue loss in the month (September 2005) following Hurricane Katrina. CRS estimates that if the disaster region lost about half of its economic activity in September 2005, then the state of Alabama would have lost \$38.0 million in revenue, Louisiana \$179.6 million, and Mississippi \$108.0 million.



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The Impact of Hurricane Katrina on the State Budgets of Alabama, Louisiana, and Mississippi

November 15, 2005

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The Impact of Hurricane Katrina on the State Budgets of Alabama, Louisiana, and Mississippi

Summary

After major disasters, affected state and local governments face the dual challenge of responding to the crisis and absorbing the economic losses associated with the disaster. Typically, tax revenue collections, both state and local, decline immediately following a disaster. The severity and range of the destruction determine when and to what level tax revenue will rebound. For states, the revenue loss is inopportune given both the cost of repairing government infrastructure and providing assistance to affected local governments and individuals.

Most states have emergency funds to tap into when disaster strikes. For catastrophic disasters on the scale of Hurricane Katrina, however, the emergency fund may be insufficient. In cases where the scale of the disaster overwhelms the fiscal capacity of state governments, the states may borrow to finance emergency spending. Each of the states most severely affected by Hurricane Katrina — Alabama, Louisiana, and Mississippi — could be forced to address budget shortfalls with increased borrowing. This report outlines the budget issues facing each of these states.

The last section of the report provides a rough approximation of the potential state tax revenue loss in the month (September 2005) following Hurricane Katrina. CRS estimates that if the disaster region lost about half of its economic activity in September 2005, then the state of Alabama would have lost \$38.0 million in revenue, Louisiana \$179.6 million, and Mississippi \$108.0 million.

This report will be updated as legislative events warrant.

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The Impact of Hurricane Katrina on the State Budgets of Alabama, Louisiana, and Mississippi

Introduction and Overview

The gulf coast region has endured significant disruptions in economic activity in the aftermath of Hurricane Katrina. State and local governments in the affected region, along with their citizens, will face considerable financial obstacles during the recovery period. In the short run, the expected drop in economic activity likely will be accompanied not only by an increase in public spending on wages of public employees working overtime, but also the accompanying costs of providing benefits to the unemployed and sick. In addition, repairing public infrastructure will strain state budgets. The combination of lower revenues and increased spending will likely create substantial short term budget problems for state and local jurisdictions. The anticipated budget problems will be exacerbated by state and local balanced budget rules which prohibit these entities from funding current expenditures with debt.

Historically, the federal government has provided assistance to state and local governments following national crises arising from economic downturns, natural disasters, and large scale terrorist attacks. Most recently, Congress provided states with \$20 billion in fiscal assistance in 2003 and 2004.¹ And, throughout the 1970s and 1980s, Congress provided state and local governments with direct aid through a general revenue sharing program. Congress is currently studying the amount and format of alternative federal response proposals to the Katrina disaster.²

Each county (or parish) in the federally declared disaster area contributes tax revenue to its state government. Tax revenue may disappear completely in some jurisdictions; in others, tax payments may be delayed or significantly reduced. Because the swath of destruction wrought by Hurricane Katrina is so broad — and in the case of New Orleans, Louisiana has continued for such an extended period — tax revenue loss to the state may be particularly dramatic.

Displaced economic activity that remains in each state, however, *reduces* the potential revenue loss arising from dislocated state sales taxes. The economic activity would still generate revenue for the state, although it would shift from one part of the state to another. The loss in personal income taxes may be significant as many workers in the coastal region may not have jobs to return to and will elect to

¹ See P.L. 108-27, *The Jobs and Growth Tax Relief Reconciliation Act of 2003*.

² See CRS Report RL33134, *Supplemental Appropriations: Trends and Budgetary Impacts Since 1981*, by Thomas L. Hungerford.

migrate out of the gulf region. The relative size of potential state corporate income tax revenue losses is unclear as corporate profits, the base of state corporate income taxes, are typically not allocated to individual counties.

Table 1 below reports the relative reliance of each Katrina affected state on major taxes including sales, personal income, and corporate income taxes. Note that these three revenue sources represent the majority of total tax revenue in each state.

Table 1. Tax Source Reliance of the States Affected by Hurricane Katrina, FY2003

Tax	Alabama	Louisiana	Mississippi
Total Tax Revenue (in 000s)	\$6,416,351	\$7,447,533	\$4,947,396
— Sales & Gross Receipts	52.21%	58.74%	65.75%
— Corporation License/Franchise	1.17%	2.58%	1.40%
— Individual Income	31.72%	25.07%	20.62%
— Corporation Net Income	3.78%	2.67%	5.84%
— Documentary & Stock Transfer	0.71%	n/a	n/a
— Severance	1.63%	6.48%	0.95%
Subtotal Percentage	92.77%	96.58%	96.07%

Source: U.S. Bureau of Census, State Government Tax Collections.

The remainder of this report is divided into sections designated by the affected state. A budget overview of each affected state is provided; Louisiana is addressed first because that state was the most broadly affected by Hurricane Katrina. Mississippi and Alabama are analyzed separately. The report concludes with a rough estimate of the potential lost revenue arising from the devastation in the gulf area.

Louisiana

Arguably, Hurricane Katrina hit Louisiana the hardest financially. All parishes in Louisiana were designated disaster areas by the Federal Emergency Management Agency (FEMA), and residents were declared eligible for individual and public assistance in 31 parishes (counties). These 31 hardest-hit parishes constitute a significant portion of state economic activity and, thus, tax revenue. **Table 2** presents the amount of personal income and retail sales that can be attributed to the 31 parishes declared disaster areas by FEMA and whose residents are eligible for individual and public assistance. Almost three-quarters of state personal income and retail sales (72.8% and 72.2%, respectively) are generated in the declared disaster parishes.³

³ For this report, the counties whose residents are eligible for individual *and* public assistance comprise the “disaster area.” For this reason, no Florida counties are included (continued...)

Table 2. Louisiana Parishes Affected by Hurricane Katrina, Personal Income and Retail Sales, 2002

Parish	Personal income (\$000s)	Percent of LA total	Retail sales (\$000s)	Percent of LA total
Louisiana Total	114,457,452	100.00%	41,885,192	100.00%
Louisiana Disaster	83,367,605	72.84%	30,226,453	72.17%
Acadia	1,261,480	1.10%	381,589	0.91%
Ascension	2,130,057	1.86%	691,599	1.65%
Assumption	592,911	0.52%	87,762	0.21%
Calcasieu	4,721,704	4.13%	2,032,091	4.85%
Cameron	176,060	0.15%	30,960	0.07%
East Baton Rouge	11,902,674	10.40%	5,031,137	12.01%
East Feliciana	449,919	0.39%	49,620	0.12%
Iberia	1,689,733	1.48%	728,376	1.74%
Iberville	694,247	0.61%	210,531	0.50%
Jefferson*	13,862,559	12.11%	6,523,229	15.57%
Jefferson Davis	586,378	0.51%	250,115	0.60%
Lafayette	5,668,821	4.95%	2,666,644	6.37%
Lafourche	2,372,178	2.07%	656,241	1.57%
Livingston	2,156,896	1.88%	462,012	1.10%
Orleans*	13,627,645	11.91%	3,158,341	7.54%
Plaquemines*	642,862	0.56%	94,776	0.23%
Pointe Coupee	499,357	0.44%	149,597	0.36%
St. Bernard*	1,594,549	1.39%	457,970	1.09%
St. Charles*	1,257,957	1.10%	251,750	0.60%
St. Helena	201,110	0.18%	37,596	0.09%
St. James	439,888	0.38%	93,681	0.22%
St. John the Baptist*	967,314	0.85%	274,090	0.65%
St. Martin	936,310	0.82%	241,243	0.58%
St. Mary	1,281,194	1.12%	415,176	0.99%
St. Tammany*	6,257,678	5.47%	2,155,481	5.15%
Tangipahoa	2,180,612	1.91%	1,057,339	2.52%
Terrebonne	2,467,752	2.16%	1,176,348	2.81%
Vermilion	1,100,951	0.96%	370,330	0.88%
Washington	864,655	0.76%	291,967	0.70%
West Baton Rouge	522,336	0.46%	151,913	0.36%
West Feliciana	259,818	0.23%	46,949	0.11%

Source: CRS calculations based on U.S. Census Bureau data for retail sales [<http://www.census.gov/econ/census02/guide/geosumm.htm>], and Bureau of Economic Analysis data for [<http://bea.gov/bea/regional/reis/>] personal income.

Note: Parishes listed are designated by FEMA as eligible for individual and public assistance.
*Represents parishes in the New Orleans metropolitan statistical area (MSA).

³ (...continued)
in the report.

The parishes of Orleans and Jefferson alone account for almost one-quarter of personal income and retail sales for the entire state of Louisiana. The city of New Orleans is in Orleans parish, and Jefferson parish borders Orleans parish to the west. More broadly, the seven parishes in the U.S. Census defined New Orleans-Metairie-Kenner metropolitan statistical area (MSA), indicated with an asterisk in **Table 2**, represent about one-third of personal income and a little less than one-third of retail sales.

Budget Issues

The Louisiana budget will be strained by the unexpected jump in expenditures and fall in revenues arising from the destruction of Hurricane Katrina. One news report has the cost of environmental cleanup alone tagged at \$61.5 billion which includes "... \$35 billion ... to restore wastewater treatment facilities and \$25 billion to clean up hazardous waste."⁴ Before Katrina, the Louisiana budget was in deficit, with a FY2004 operating shortfall of \$11 million.⁵ Clearly, the drop in revenues and anticipated cost of rebuilding public infrastructure will create a serious strain on the Louisiana State budget.

The budget process, balanced budget rules, expenditure limitations, and state budget stabilization funds, will all be critical elements in the state's response to the Katrina disaster. Following is a brief review of these elements in Louisiana.

Budget Process. Louisiana employs an annual budget cycle that begins on July 1. In September, the governor sends budget guidelines to each agency. Agencies then submit requests to the governor in November. The governor submits the budget to the legislature in February or March, and the legislature adopts the budget in June. The timing of Hurricane Katrina will very likely alter that budget schedule.

When the legislature is not in session, the Louisiana Interim Emergency Board (IEB) may appropriate up to 0.1% of total state revenue from the previous fiscal year. According to the Louisiana Executive Budget for FY2006, total general fund revenue in FY2005 was \$6.8 billion.⁶ The cost to the state of the response and recovery effort will substantially exceed the IEB appropriation amount. Consequently, the State Legislature will likely hold a special session to address the spending needs related to post-Katrina recovery.

State Balanced Budget Rules and Debt Limits. All states except Vermont are required to balance the budget for each budget cycle either by state constitution or by statute. In Louisiana, the rule is both statutory and constitutional. States like Louisiana have two options to finance spending beyond current revenues:

⁴ Dolores W. Gregory, Susanne Pagano, Maybelle Cagle, and Sherry Jones, "Katrina's Impact on Gulf State Revenues Still Being Assessed, As IRS, States Offer Relief to Taxpayers Affected by Hurricane," *Daily Tax Report*, no. 182, Sept. 21, 2005, p. J-1.

⁵ State of Louisiana Annual Report, FY2004.

⁶ State of Louisiana, Executive Budget for FY2006.

additional debt or higher taxes. The latter option, higher taxes, would seem the less viable following a major disaster after which economic activity has declined and the state tax base narrowed.

Borrowing to finance response and recovery spending seems the more likely option for Louisiana. Without legislative action, however, additional borrowing to finance an operating budget shortfall could violate state balanced budget rules. In addition, like many states, Louisiana imposes a debt limit that could be constraining given the magnitude of the Katrina disaster. In Louisiana, for example, the constitution requires that the debt service cost general obligation debt be no more than 6% of total revenue (taxes, licenses, and fees) of the same fiscal year.⁷ Total revenue (by this definition) in Louisiana for FY2004 was just over \$8 billion and the debt service cost was \$152 million, or just 1.88%.⁸ The latest available Louisiana Treasurer report projected that:

... in addition to the State being able to issue \$425,000,000 in the 2004-2005 Fiscal Year, the State can issue \$425,000,000 each year thereafter and remain within the State Debt Limit based on the Projection Model.⁹

The restrictions would likely prevent Louisiana from financing reconstruction on state-backed debt alone. The federal government would be likely more to augment rather than replace state finance of recovery and reconstruction. What is unclear, however, is what portion of reconstruction should (and could) be the responsibility of the federal government.

Budget Stabilization or “Rainy Day” Fund. States typically maintain a fund to access during unanticipated budget shocks such as natural disasters. In Louisiana, at the close of fiscal 2004, the “budget stabilization fund” had \$239.3 million.¹⁰ According to the National Association of State Budget Officers (NASBO), in Louisiana, up to one-third of the fund can be used with legislative approval.¹¹ The fund will likely provide temporary liquidity for the state to meet some immediate spending needs, though the balance is likely insufficient to address the potential long-term cost of post-Katrina repair and recovery.

⁷ National Association of State Budget Officers, *Budget Processes in the States*, November 2002, p. 38. (Hereafter cited as NASBO, *Budget Processes in the States*.)

⁸ John Neely Kennedy, Louisiana State Treasurer, Chair State Bond Commission, *Status Report: Net State Tax Supported Debt*, May 20, 2004. (Hereafter cited as Kennedy, *Status Report*.)

⁹ *Ibid.*, p. 3.

¹⁰ National Governor’s Association, National Association of State Budget Officers (NASBO), *Fiscal Survey of States*, June 2005, Table A-1, p. 18. (Hereafter cited as NSABO, *Fiscal Survey of States*.)

¹¹ NASBO, *Budget Processes in the States*, p. 59.

State Fiscal Response

Louisiana will likely use a combination of stabilization fund revenues and the issuance of additional debt to finance relief and recovery spending. In FY2004, Louisiana debt was rated “A+” by the rating firms Fitch and Standard and Poor’s.¹² The bond rating, though strong, indicates that Louisiana may not be able to withstand economic shocks as well as higher rated issuers. A news story reported that the debt for many projects in the gulf coast area are under a “credit watch.”¹³ Issuers and bonds under a credit watch are thought to be at an elevated risk for default.

Mississippi

Mississippi was almost as hard hit as Louisiana in terms of economic activity affected by Hurricane Katrina as measured by portion of personal income in the disaster region. The gulf area most severely affected by the hurricane accounts for over two-thirds of the personal income and retail sales in the state, (see **Table 3**). The cities of Biloxi, Jackson, Hattiesburg, Pascagoula, and Gulfport are all included in the most severely affected disaster designated counties. The counties comprising the Gulfport-Biloxi and Jackson MSAs represent over one-third of total retail sales in Mississippi.

Table 3. Mississippi Counties Affected by Hurricane Katrina, Personal Income and Retail Sales, 2002

County	Personal income (\$000s)	Percent of MS total	Retail sales (\$000s)	Percent of MS total
Mississippi Total	64,552,413	100.00%	25,017,531	100.00%
Mississippi Disaster	44,534,407	68.99%	16,980,276	67.87%
Adams	755,771	1.17%	39,300	0.16%
Amite	256,701	0.40%	27,972	0.11%
Attala	435,498	0.67%	167,792	0.67%
Choctaw	150,571	0.23%	40,404	0.16%
Claiborne	191,109	0.30%	32,441	0.13%
Clarke	344,348	0.53%	38,766	0.15%
Copiah*	533,198	0.83%	123,445	0.49%
Covington	350,902	0.54%	104,639	0.42%
Forrest	1,782,334	2.76%	916,832	3.66%

¹² Louisiana Department of Treasury, *Annual Report: Fiscal Year 2004*, p. 16. An “A+” rating indicates that an issuer “... has a strong capacity to meet its financial commitments but is somewhat more susceptible the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.” The highest rating would be “AAA.”

¹³ Leslie Wayne, “Tax Bases Shattered, Gulf Region Faces Debt Crises,” *New York Times*, Sept. 19, 2005, p. C1.

County	Personal income (\$000s)	Percent of MS total	Retail sales (\$000s)	Percent of MS total
Franklin	142,673	0.22%	14,651	0.06%
George	381,405	0.59%	131,859	0.53%
Greene	198,541	0.31%	29,050	0.12%
Hancock**	1,038,914	1.61%	300,432	1.20%
Harrison**	4,869,046	7.54%	2,139,214	8.55%
Hinds*	6,654,634	10.31%	3,023,634	12.09%
Jackson	3,164,499	4.90%	937,404	3.75%
Jasper	334,391	0.52%	54,775	0.22%
Jefferson	127,538	0.20%	14,186	0.06%
Jefferson Davis	227,680	0.35%	46,357	0.19%
Jones	1,501,195	2.33%	559,991	2.24%
Kemper	183,891	0.28%	39,610	0.16%
Lamar	948,351	1.47%	457,599	1.83%
Lauderdale	1,887,668	2.92%	1,028,426	4.11%
Lawrence	277,394	0.43%	37,551	0.15%
Leake	426,269	0.66%	120,672	0.48%
Lincoln	707,958	1.10%	361,527	1.45%
Lowndes	1,359,756	2.11%	678,102	2.71%
Madison*	2,602,104	4.03%	901,868	3.60%
Marion	482,974	0.75%	175,384	0.70%
Neshoba	709,183	1.10%	245,376	0.98%
Newton	460,730	0.71%	119,152	0.48%
Noxubee	209,611	0.32%	55,951	0.22%
Oktibbeha	913,369	1.41%	339,423	1.36%
Pearl River	948,430	1.47%	342,976	1.37%
Perry	202,018	0.31%	39,507	0.16%
Pike	771,829	1.20%	397,956	1.59%
Rankin*	3,288,703	5.09%	1,392,855	5.57%
Scott	529,317	0.82%	159,834	0.64%
Simpson*	563,407	0.87%	182,869	0.73%
Smith	327,847	0.51%	41,894	0.17%
Stone**	293,792	0.46%	93,222	0.37%
Walthall	251,145	0.39%	64,677	0.26%
Warren	1,331,898	2.06%	478,729	1.91%
Wayne	382,782	0.59%	137,440	0.55%
Wilkinson	161,637	0.25%	41,268	0.16%
Winston	362,033	0.56%	111,245	0.44%
Yazoo	509,363	0.79%	192,019	0.77%

Source: CRS calculations based on U.S. Census Bureau data for retail sales [<http://www.census.gov/econ/census02/guide/geosumm.htm>], and Bureau of Economic Analysis data for [<http://bea.gov/bea/regional/reis/>] personal income.

Note: Counties listed are designated by FEMA as eligible for individual and public assistance.

* Counties in the Jackson MSA.

** counties in the Gulfport-Biloxi MSA.

Budget Issues

The budget of Mississippi before Hurricane Katrina was relatively sound with a FY2004 surplus of \$3 million.¹⁴ According to the Mississippi Department of Finance and Administration, for FY2005, sales tax revenue was anticipated to grow 4.4%; income tax revenue 3.6%; and corporate income tax revenue 8.0%.¹⁵ These three revenue sources comprise approximately 90% of total tax revenue for Mississippi (see **Table 1**).

Budget Process. Mississippi employs an annual budget cycle that begins July 1. Agencies submit requests for the next fiscal year in August and, the governor submits the budget to the legislature before January. The legislature typically adopts the budget in March or April. Requests for additional funding for recovery will likely be included in the 2007 budget, which begins July 1, 2006.

State Balanced Budget Rules and Debt Limits. Mississippi, like 48 other states, has a balanced budget rule.¹⁶ In Mississippi, the balanced budget rule is statutory rather than constitutional. In contrast, the debt limits in Mississippi are constitutional. Thus, exceeding the debt limits in Mississippi would entail amending the state constitution.

The debt limits in Mississippi are applied to general obligation (GO) debt and short-term debt. For GO debt, the limit is 1.5 times total revenue. This type of limit, based on the relationship between the outstanding debt and total revenue, is unlike the Louisiana method, which is based on debt servicing costs, not the amount outstanding. When interest rates are relatively low, the volume based limit is more constraining than the Louisiana method. Short-term debt in Mississippi is limited to 5% of general fund appropriations.

According to the Mississippi Department of Finance and Administration, total GO debt outstanding in FY2004 was \$2,997,341,000 and the "... State had established a constitutional debt limit of \$8,429,055,000."¹⁷ Thus, it appears there is some flexibility for Mississippi to borrow without amending the state constitution. Nevertheless, using debt to finance current operating expenditures may require statutory changes.

¹⁴ NASBO, *Fiscal Survey of States*, p. 18.

¹⁵ Mississippi Department of Finance and Administration, *Comprehensive Annual Financial Report 2004*, June 30, 2004, p. 27. The report is available on line at [<http://www.dfa.state.ms.us/resources.html>].

¹⁶ Vermont is the exception.

¹⁷ Mississippi Department of Finance and Administration, *Comprehensive Annual Financial Report 2004*, June 30, 2004, p. 27. The report is available on line at [<http://www.dfa.state.ms.us/resources.html>].

Budget Stabilization or “Rainy Day” Fund. Mississippi maintains a budget stabilization fund that had a balance of \$38 million in FY2004. The fund was established by statute and the funds can be used to:

- (1) meet cash flow needs (borrowed funds must be repaid within the same fiscal year); (2) cover deficits (up to \$50 million in any one fiscal year); and (3) provide funds for disaster assistance.¹⁸

In the present circumstance, the stabilization fund is likely insufficient to fully finance the repair and recovery spending needs in the most severely affected part of Mississippi.

State Fiscal Response

Some observers believe the utilization of existing bond capacity will be the likely response to Katrina recovery financing in Mississippi. The state’s bond rating in FY2004 was a relatively strong “AA,” implying that the interest rate on state debt should be somewhat reasonable.¹⁹ Bond investors, however, may be less willing to lend to Mississippi if the economic infrastructure is judged permanently impaired. The increased risk associated with Mississippi debt may, in turn, increase debt servicing costs. On the other hand, the increased economic activity associated with rebuilding and recovery could compensate, at least in part, for the likely increase in debt servicing costs.

Alabama

Of the three hardest hit states, Alabama escaped with the least adverse economic impact. Nevertheless, Hurricane Katrina inflicted significant damage in the gulf region of Alabama. Approximately one-sixth of personal income and retail sales in Alabama is generated in the hardest hit counties (see **Table 4**). Three counties in the disaster region, Baldwin, Mobile, and Tuscaloosa, comprise a large portion of the economic activity in the state (15.3% of state personal income).

¹⁸ National Conference of State Legislatures, Appendix A. Rainy Day Funds, p.4.

¹⁹ According to Standard and Poor’s, a “AA” rating indicates an issuer “... has a very strong capacity to meet its financial commitments.”

Table 4. Alabama Counties Affected by Hurricane Katrina, Personal Income and Retail Sales, 2002

County	Personal income (\$000s)	Percent of AL total	Retail sales (\$000s)	Percent of AL total
Alabama Total	114,692,872	100.00%	43,784,342	100.00%
Alabama Disaster	19,973,455	17.84%	8,019,374	19.57%
Baldwin	4,044,702	3.53%	1,820,932	4.16%
Choctaw	326,503	0.28%	63,054	0.14%
Clarke	600,210	0.52%	262,080	0.60%
Greene	188,015	0.16%	33,021	0.08%
Hale	320,007	0.28%	67,453	0.15%
Marengo	523,430	0.46%	164,079	0.37%
Mobile	9,070,058	7.91%	4,073,954	9.30%
Pickens	408,731	0.36%	94,127	0.21%
Sumter	260,169	0.23%	61,224	0.14%
Tuscaloosa	4,422,969	3.86%	1,875,902	4.28%
Washington	332,091	0.29%	53,985	0.12%

Source: CRS calculations based on U.S. Census Bureau data for retail sales [<http://www.census.gov/econ/census02/guide/geosumm.htm>], and Bureau of Economic Analysis data for [<http://bea.gov/bea/regional/reis/>] personal income.

Note: Counties listed are designated by FEMA as eligible for individual and public assistance.

Budget Issues

The Alabama budget situation before Hurricane Katrina was improving, with a reported FY2004 ending balance of \$141 million.²⁰ According to a recent bond rating update prepared by Moody's investor services, the State of Alabama financial status has improved, noting that in Alabama a "[f]inancial recovery is underway, with revenues exceeding estimates and [a] declining reliance on non-recurring [revenue] measures."²¹

Budget Process. Alabama's annual budget cycle employs a fiscal year that begins in October. For FY2007 — beginning October 1, 2006 — agency budget requests were due on November 1, 2005 and the governor would be required to present the budget(s) to the legislature on February 4, 2006 under normal circumstances. This schedule may be altered in light of the Katrina disaster.

State Balanced Budget Rules and Debt Limits. Alabama, like 48 other states, has a balanced budget rule. The Alabama constitution requires that the

²⁰ Bob Riley, *State of Alabama Executive Budget: 2005-2006*, p. iii.

²¹ Moody's Investor Services, "Moody's Upgrades Alabama General Obligation Debt to Aa2 from Aa3," Aug. 26, 2005. (Hereafter cited as *Moody's*.)

Governor submit a balanced budget. The balanced budget rule is reinforced by a statutory requirement that the legislature pass a balanced budget.

The Alabama constitution does not impose a general obligation debt limit, though short-term debt is limited by the constitution to \$300,000.²² General obligation bond issues, however, must pass a public referendum (simple majority) and the legislature must approve the debt by a three-fifths majority. The public and legislative approval requirements may constrain borrowing in Alabama. According to the Moody's report, "[N]et tax-supported debt amounts to 2.0% of personal income (compared with a national median of 2.4%), and \$523 per capita (compared with a national median of \$703).²³ Alabama, thus, has relatively less debt than other states.

Budget Stabilization or "Rainy Day" Fund. Alabama maintains a budget stabilization fund that had a balance of \$104 million in FY2004 and was estimated to rise to \$140 million for FY2005.²⁴ The stabilization fund in Alabama has two parts: the state general fund and the education fund. The stabilization fund is structured to preserve the integrity of the education fund, the largest operating fund.

State Fiscal Response

In connection with the recent hurricanes, Alabama does not appear to face a serious financial crisis, particularly in comparison with Louisiana and Mississippi. The ability of Alabama to issue debt seems reasonably strong, though the state balanced budget rules would likely require revisiting if debt were used to cover operating expenditures. The Alabama bond rating from Moody's of "Aa2" is roughly equivalent to a "AA" rating from Standard and Poor's or Fitch rating services. Note that Mississippi also holds a "AA" rating. Again, the constraint for Alabama, as with the other states, is how to use debt to finance current operating expenditures without violating state balanced budget rules.

Estimated Revenue Loss by State

If affected states must borrow, a critical first step is determining how much to borrow. The description of state budgets and the data detailing the relative economic impact form the basis for the following estimate of the potential revenue loss arising from Hurricane Katrina. The general assumption is that the hardest hit counties and parishes will generate significantly less tax revenue from the dislocated economic activity occurring after Hurricane Katrina. More specifically, the estimates are based on the revenue that would have been raised in September 2005. The estimate will overstate the long-term sales tax revenue loss for the following reasons: (1) some portion of retail sales and accompanying sales tax will shift to another part of the

²² NASBO, *Budget Processes in the States*, p. 36.

²³ *Moody's* (2005).

²⁴ National Governor's Association, National Association of State Budget Officers, *Fiscal Survey of States*, June 2005, Table A-1, p. 18.

state; (2) some retail sales will be delayed, not eliminated; and (3) some parishes and counties on the outer ring of the affected area may actually realize an increase in retail sales as relief workers and recovery efforts stimulate economic activity and thus increase tax revenue.

State personal income tax collections will also decline, although — as with retail sales — it's unclear if the loss in tax revenue would be as permanent. Larger employers could retain employees and continue to make scheduled payroll deposits, although the tax payments would likely be delayed. The states have granted employers extensions through January 3, 2006, to comply with individual and corporate income tax payments. The state will likely receive a significant rise in tax payments, both personal and corporate, in late 2005 and early 2006, as postponed tax payments are made before the extension expires. Other taxes, such as the Louisiana severance tax, though not tied directly to personal income or retail sales, will likely decline in the short run, but will rise considerably as natural resource extraction activities rebound.

A recent Congressional Budget Office (CBO) publication estimated the revenue loss of the state of Louisiana at \$3 billion to \$6 billion. Local governments in the affected region of Louisiana generate about \$3.1 billion in sales and property taxes; in Mississippi local governments in the affected region generate about \$2.25 billion to \$2.3 billion in sales and property taxes; and in Alabama local governments in the region generate approximately \$510 million in sales and property tax revenue.²⁵ The CBO report did not provide estimates for state revenue losses in Alabama or Mississippi.

Estimation Methodology

As noted above, the estimates in **Table 5** are based on the assumption that after Hurricane Katrina, economic activity will slow and tax revenue decline. The amount of lost sales tax revenue is estimated using the amount of retail sales that occurred in the affected counties (parishes) relative to the rest of the state. The percentage of retail sales was then multiplied by the amount of sales and use tax revenue generated in the entire state in September of 2003 (2004 for Alabama). This approximation does not adjust for the likely increase in prices and corresponding rise retail sales amounts since 2003.

The bottom three rows provide estimates of the revenue loss under three different assumptions on the percentage of lost economic activity. In the most extreme scenarios, all revenue for the month of September is lost. Though likely in some areas, it's unlikely that all of the counties and parishes designated as eligible for individual and public assistance would lose 100% of state tax collections. Nevertheless, the amount does provide an upper limit to the potential revenue loss. The two other scenarios, 50% and 25% loss, would seem more likely. Because a smaller portion of Alabama was affected, it is probable that economic activity shifted

²⁵ U.S. Congressional Budget Office, *The Macroeconomic and Budgetary Effects of Hurricanes Katrina and Rita: An Update*, Sept. 29, 2005.

to other parts of the state. The result is the state of Alabama would likely be on the low end of the estimated tax loss assumption.

In the short term, using the 50% loss assumption, Louisiana and Mississippi could have lost approximately \$170.6 million and \$108.0 million of tax revenue in September 2005. Using the 25% loss estimate, Alabama could have lost just over \$18 million of tax revenue in September 2005. The revenue loss in October 2005 will likely decline for many of the disaster designated counties.

The long term prospects for tax revenue loss are exceedingly difficult to assess given the nature of the disaster and the long term prospects for returning economic activity to pre-hurricane levels. In addition, the degree to which economic activity increases as rebuilding begins may actually increase tax revenue above pre-Katrina levels.

Table 5. Estimated Tax Revenue Loss in September 2005 Following Hurricane Katrina

Revenue source	Alabama	Louisiana	Mississippi
<i>September Tax Revenues</i>	FY2004 ^a	FY2003 ^b	FY2003 ^c
— Sales and Use	\$155,257,777	\$180,574,138	\$133,487,312
— Personal Income	183,894,822	186,315,631	111,978,655
— Corporate Income	48,319,455	50,703,855	54,600,025
— Corporate Franchise*	1,718,706	12,906,445	15,181,300
— Severance Tax**	629,811	32,149,105	0
<i>Estimated September Loss by Tax Source</i>			
— Sales	\$30,388,256	\$130,311,345	\$90,602,522
— Personal Income	32,810,446	135,707,092	77,253,549
— Corporate Income	8,621,139	36,931,269	37,668,301
— Corporate Franchise	306,651	9,400,693	10,473,508
— Severance Tax	314,906	28,934,195	0
<i>Total Estimated Loss</i>			
— 100% Loss	\$72,441,399	\$341,284,593	\$215,997,880
— 50% Loss	36,220,699	170,642,297	107,998,940
— 25% Loss	18,110,350	85,321,148	53,999,470

Sources: a) Alabama Department of Revenue, Revenue Abstract, Month of September 2004, available at [<http://www.revenue.alabama.gov/stat.html>]. b) Louisiana Department of Treasury, *61st Annual Report: Fiscal Year 2004*, p. 39. c) Mississippi State Tax Commission, Summary of Transfers, September 2003.

* In Mississippi, the “corporate franchise” source is actually “gambling fees and taxes.”

** Alabama severance tax revenue is from coal and forest products. Louisiana severance tax is from petroleum, timber, and mineral products