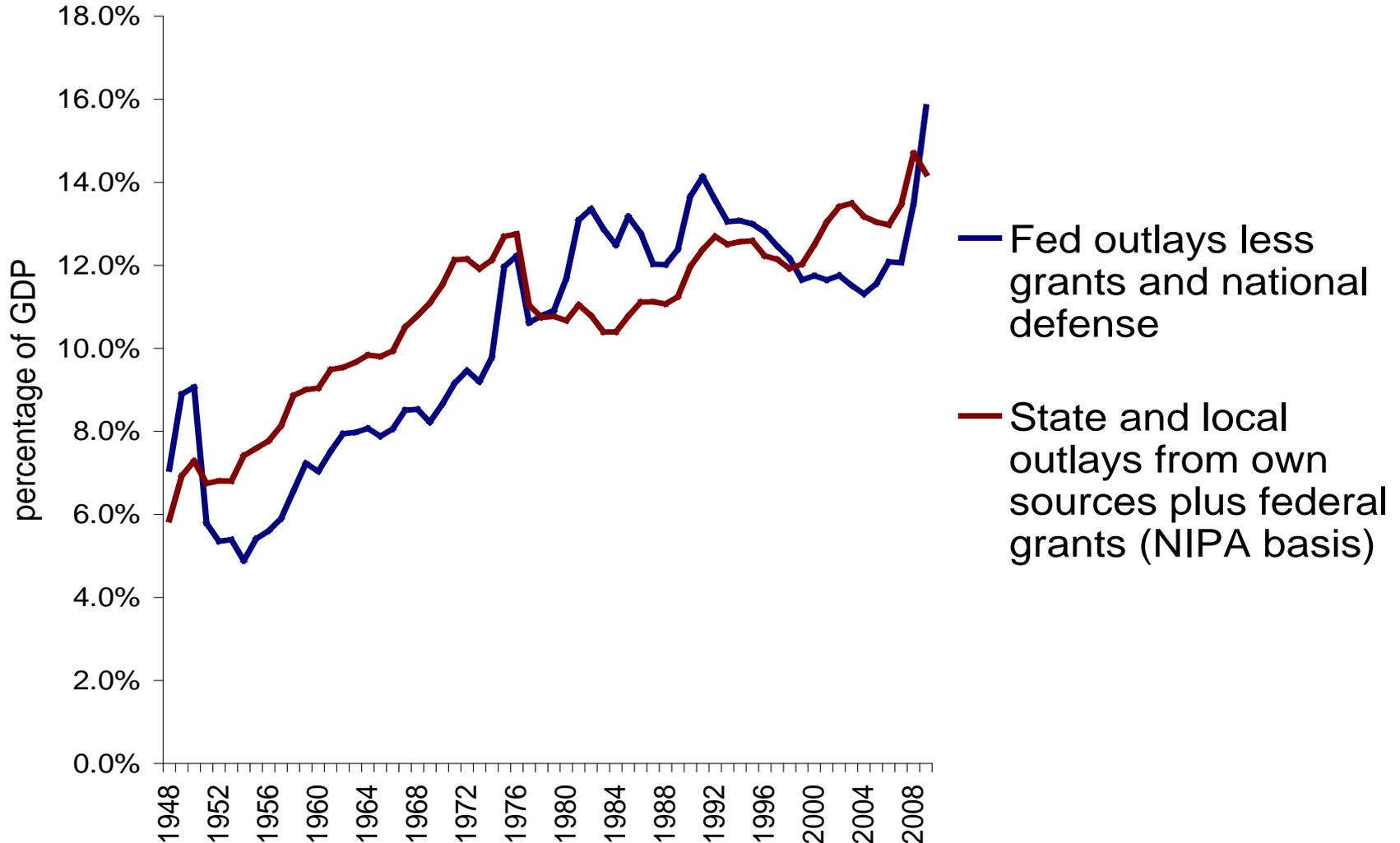


Fiscal Realities: Facing State Budget Tradeoffs

Tracy Gordon
University of Maryland, College Park and
Brookings Institution

*Prepared for “State Budgets under Stress: Paths to
Sustainability” Federal Reserve Bank of Chicago
June 24, 2011*

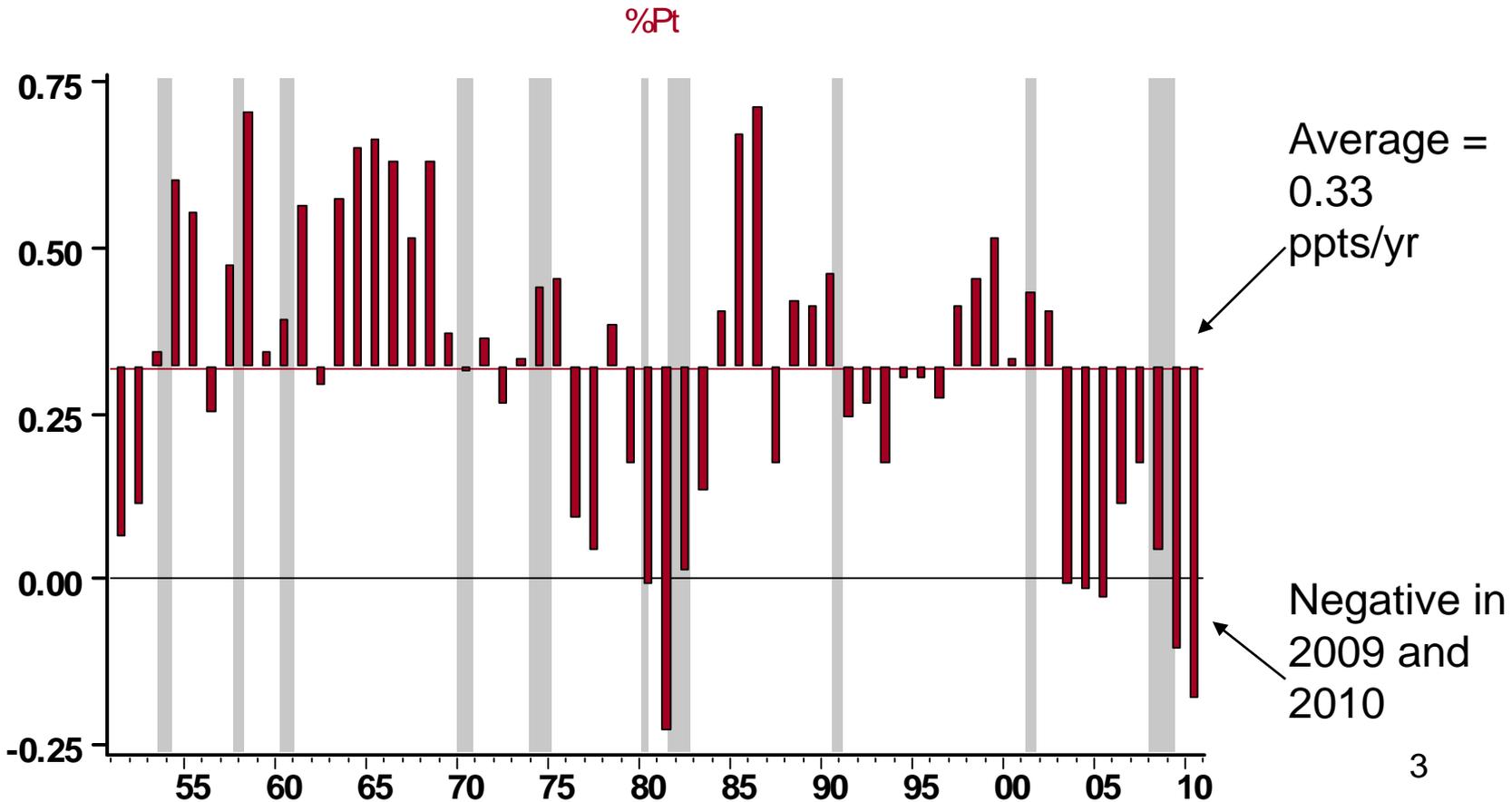
State and Local Governments Are Dominant Service Providers



Source: Office of Management and Budget, 2011.

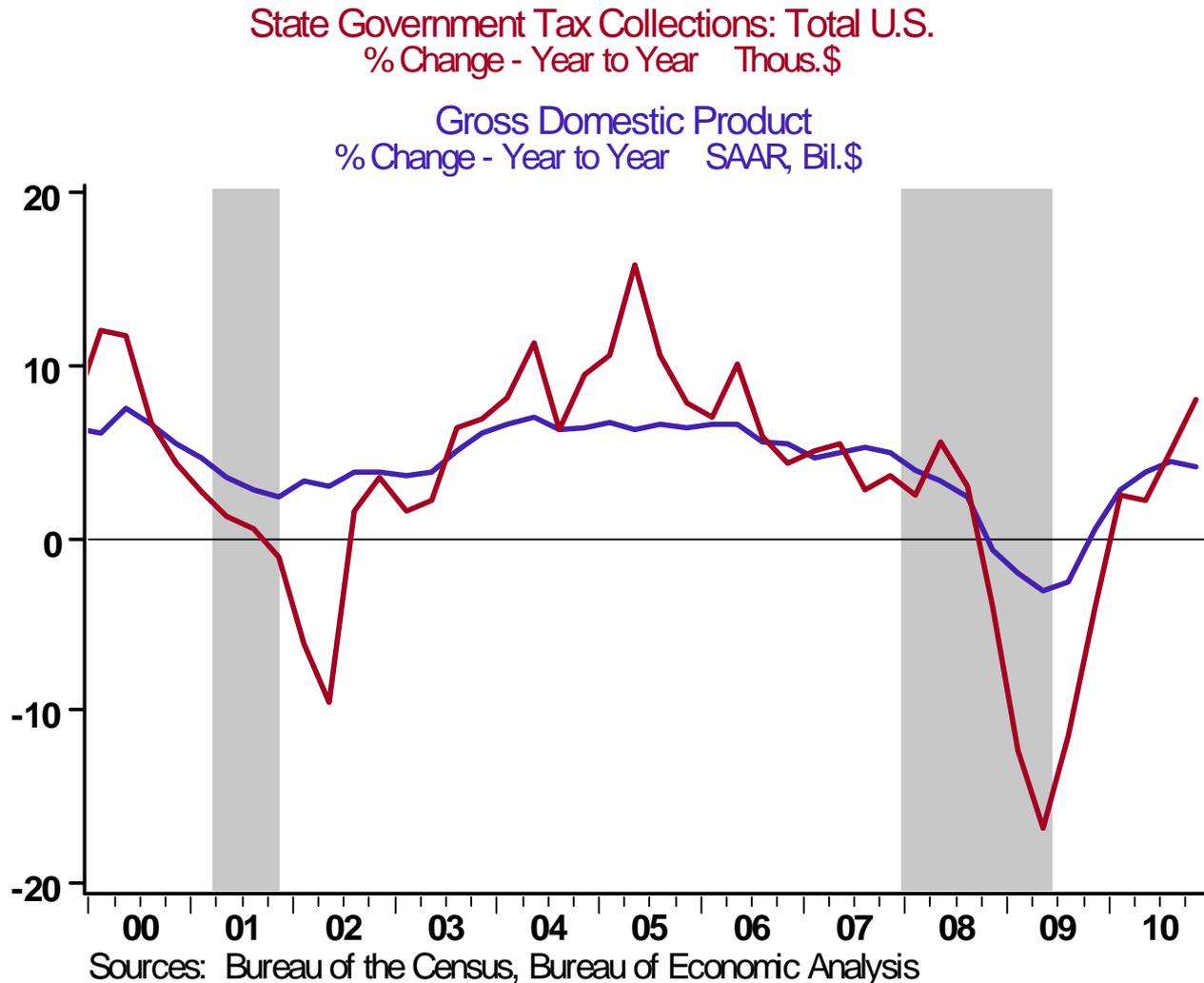
They Usually Contribute to U.S. Economic Growth

State & Local Govt Consumption/Investment: Contrib to Real GDP % Chg

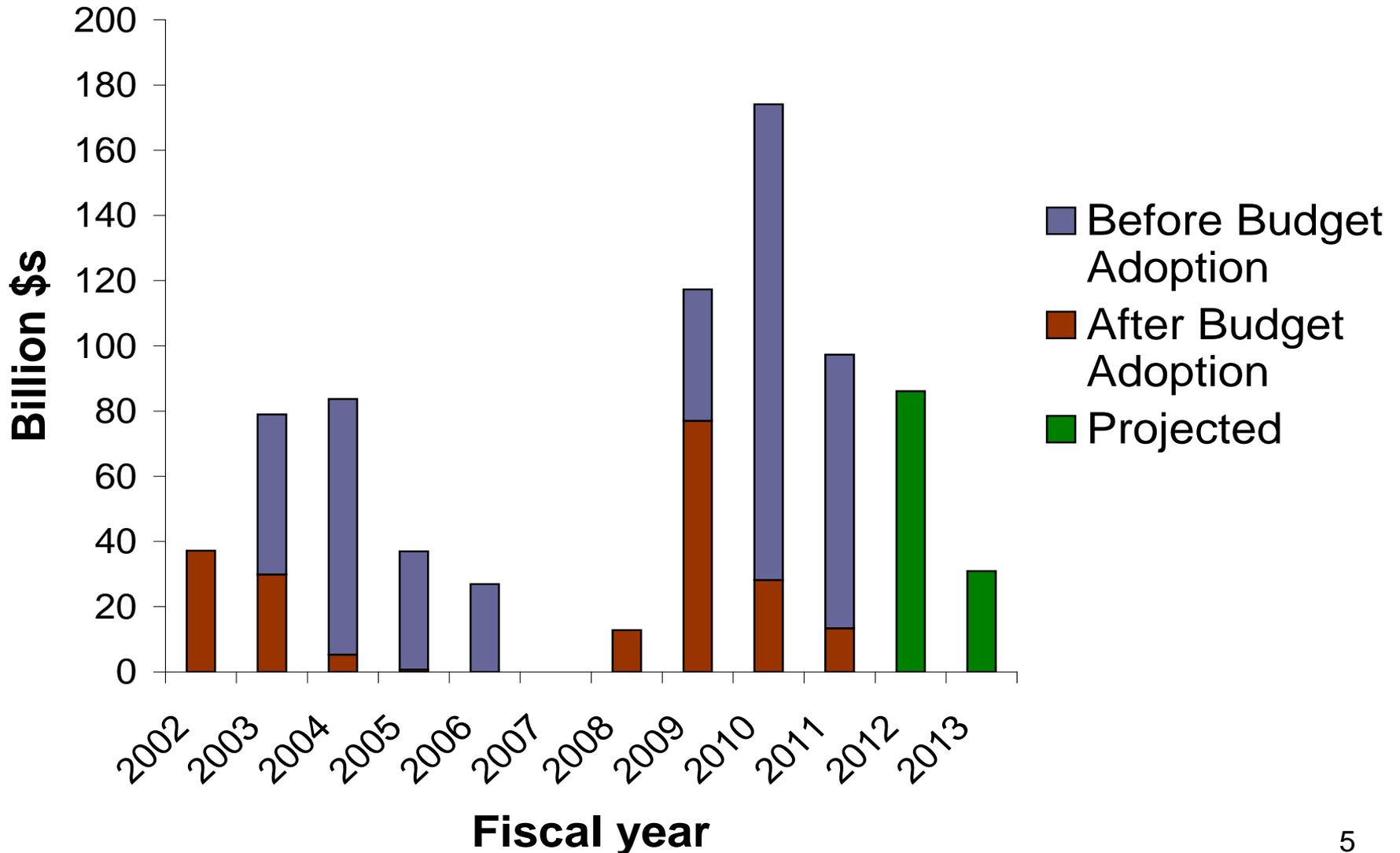


Source: Bureau of Economic Analysis

States In Particular Were Hard Hit in Great Recession



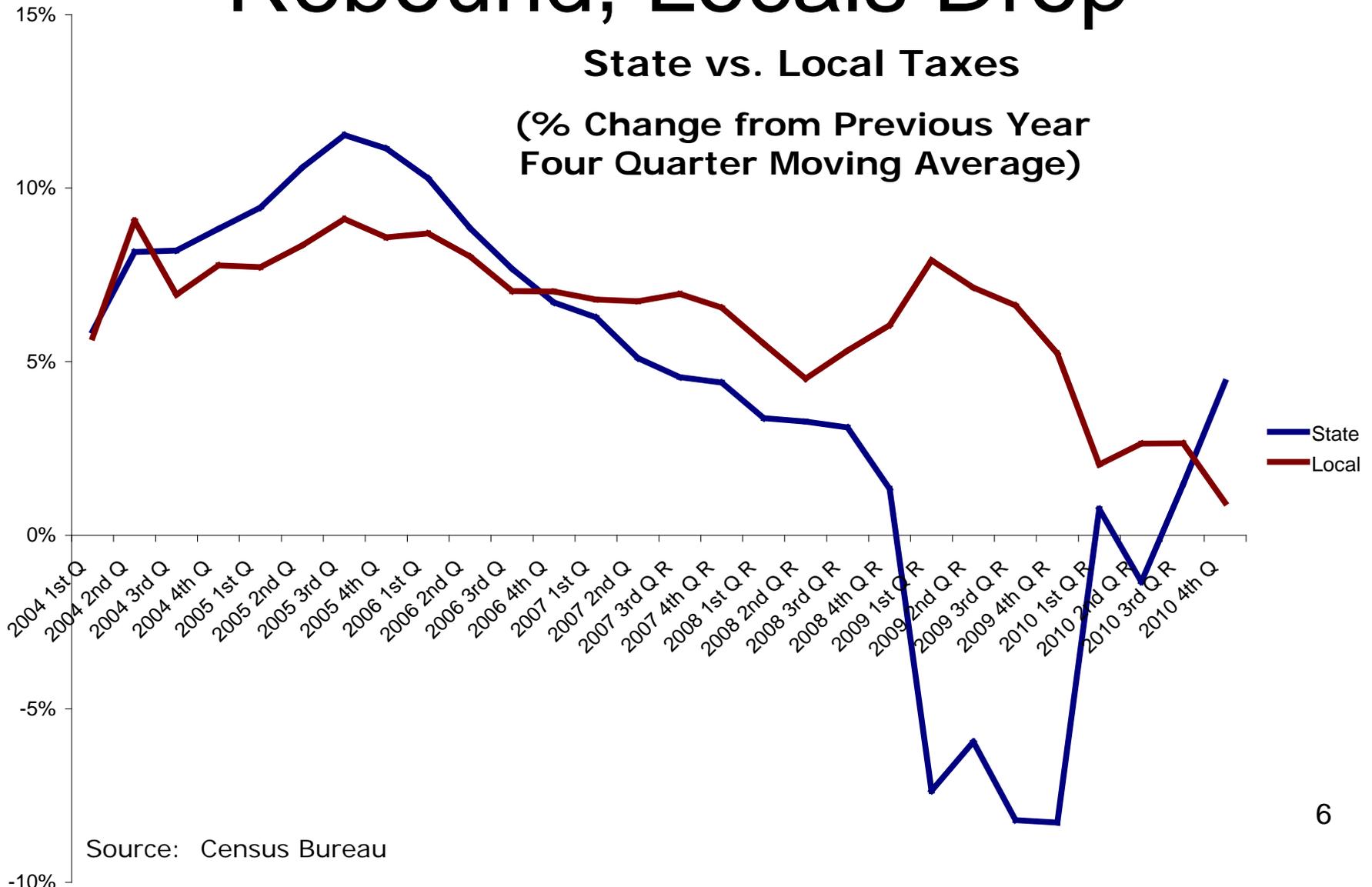
Result Was Massive Budget Gaps



Now, As State Revenues Rebound, Locals Drop

State vs. Local Taxes

(% Change from Previous Year
Four Quarter Moving Average)

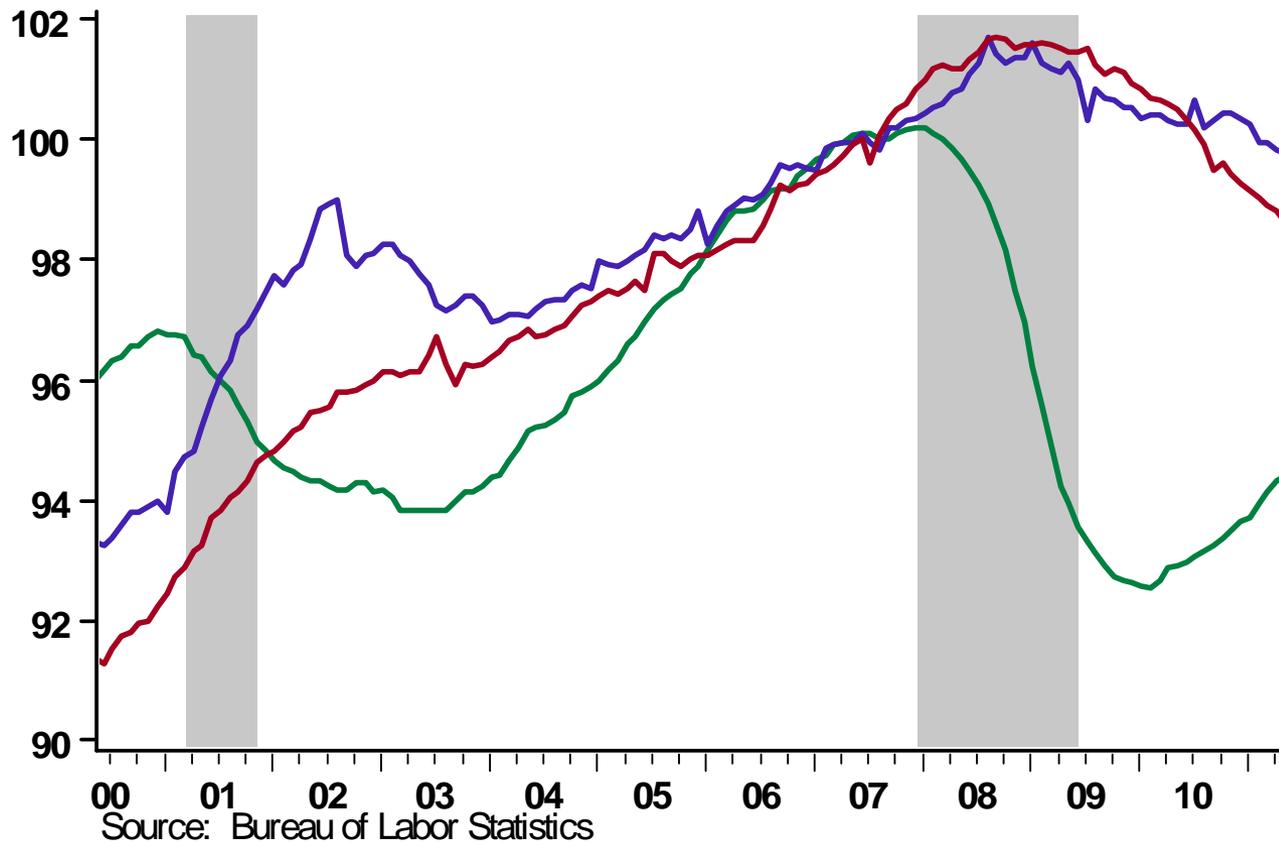


Source: Census Bureau

While State and Local Job Losses Continue

Job Losses since Start of Recession (2007=100)

Local govt
State govt
Total private nonfarm



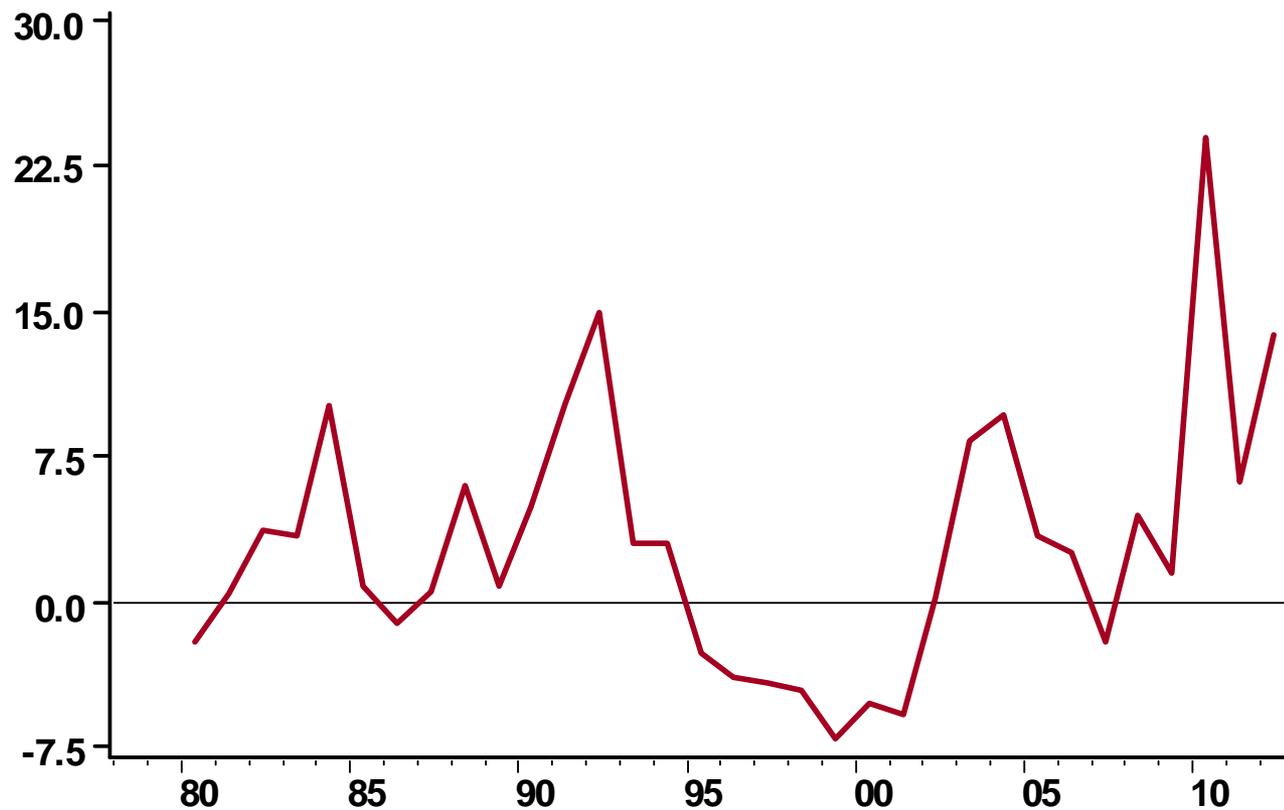
Three Questions

1. *What actions have states taken to close budget gaps?*
2. What could they do?
3. What should they do?

Actions Taken: Tax Increases

Enacted State Revenue Changes, Spring 2011

Bi.\$



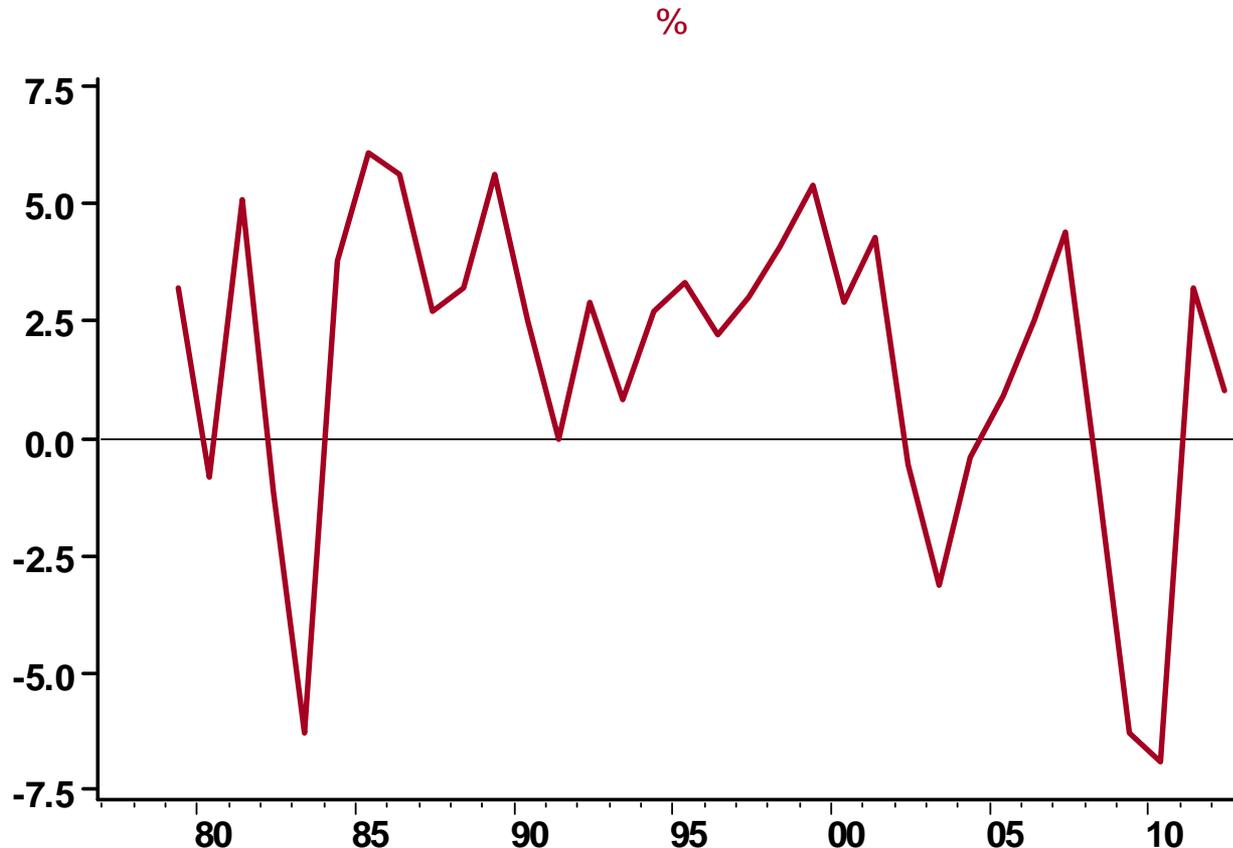
Source: National Association of State Budget Officers

Tax Examples

Significant tax changes in 2009-2012				
	Personal income tax	Sales tax	Corporate income tax	Cigarette tax
Increases of more than 5%	CA, CT, IL, NJ, NY, OH, WV	AZ, CA, IN, KS, MA, NC	AL, CA, CT, DE, IA, IL, MN, OR	AR, CT, DE, FL, HI, KY, MS, NC, NH, NM, NY, PA, RI, UT, VT, WA, WV
Increase of 1-5%	HI, MD, NC, OR, RI, VT	GA, KY, ME, NM, NY, VA, WA, WV	FL, KS, ME, NC, NJ, TN, VA	ME, TX
Decrease of more than 1%	AL, ME, ND, NM, OH	AR, CA, CT, LA, MD	AZ, CA, FL, GA, IN, MI, MN, MO, ND, OH, PA, RI, WA	
Source: Rockefeller Institute analysis of NASBO data				
Note: A few states both increased and decreased taxes in this period				

... But Most Action on Spending Side of Budgets

State Real Budget Changes, Spring 2011

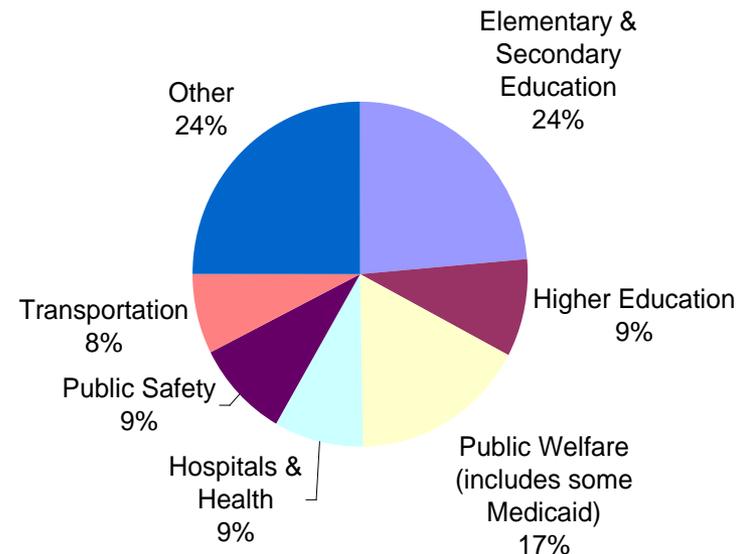


Source: National Association of State Budget Officers

Spending Cuts Hit All Major Areas

- According to CBPP:
 - **34** states have cut education
 - **43** colleges and universities
 - **31** health care
 - **29** elderly and disabled
 - **44** employee compensation

State and Local Expenditures, FY2008



There Were Also Some “Gimmicks” or One Shots

- Asset sales and lease backs
- Postponed or unpaid payments to vendors, nonprofits, local governments
- Borrowing from special funds
- Increased income tax withholding
- Tax amnesties or accelerated collection
- Phantom federal funds

Three Questions

1. What actions have states taken to close budget gaps?
2. *What could they do?*
3. What should they do?

Institutional Constraints

- **Balanced budget rules** in 49 states, anti-deficit-carry-over provisions in 38 states
- **Tax and expenditure limits** in 30 states
- **Supermajority or voter approval** for taxes in 16 states
- **Debt limits** in 46 states
- **Budget stabilization funds** in 48 states

Political Constraints

Public Votes "None of the Above" to Proposals for Balancing State Budgets

<i>To balance your state's budget, favor or oppose...</i>	<u>Favor</u> %	<u>Oppose</u> %	<u>DK</u> %
Cuts in funding for transportation	43	50	7=100
Raising taxes	39	58	3=100
Cuts in health services	27	65	8=100
Cuts in funding for police, fire depts.	25	71	4=100
Cuts in funding for K-12 public schools	22	73	4=100

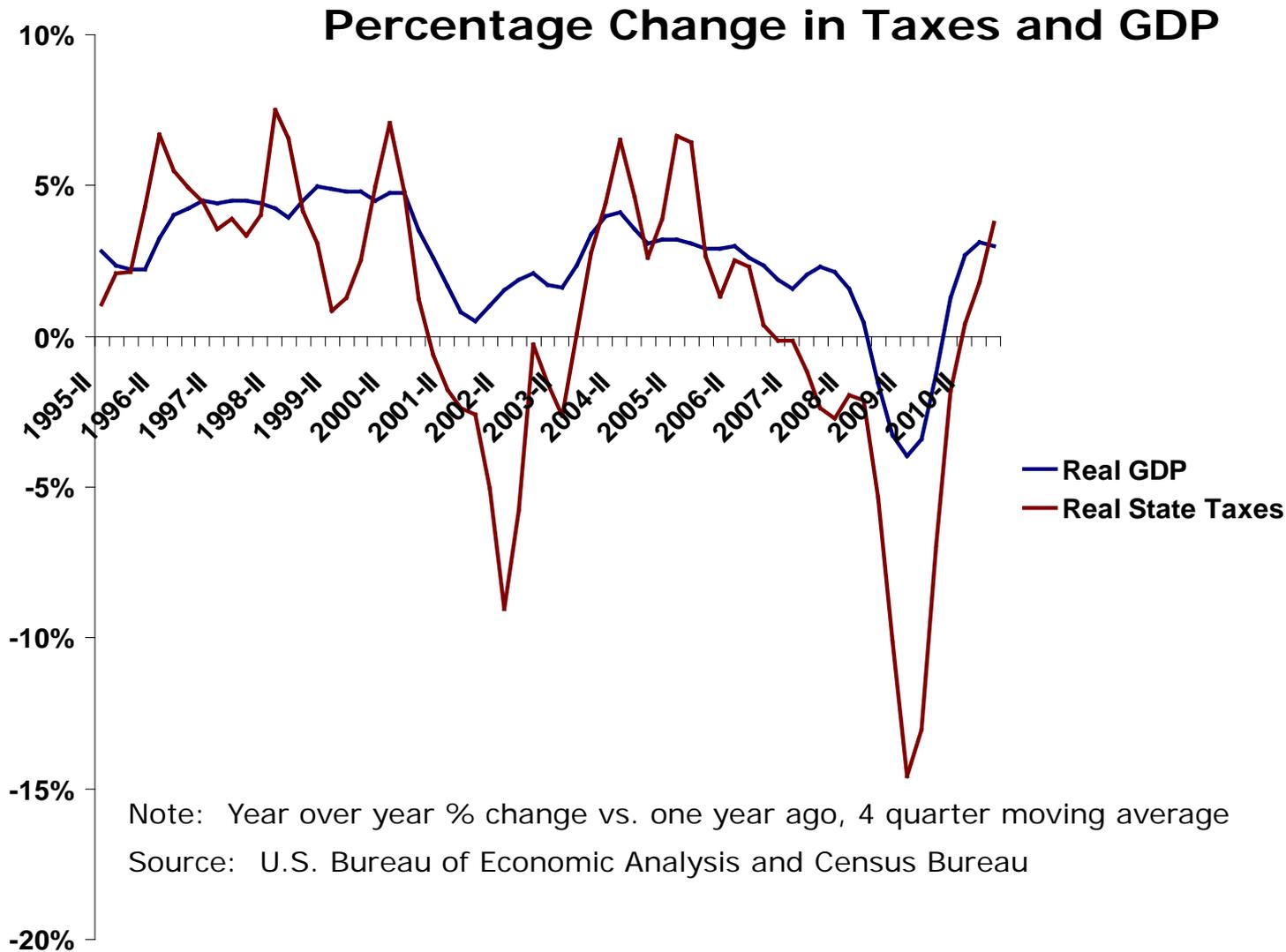
Pew Research Center/National Journal June 24-27, 2010.
 Figures may not add to 100% because of rounding.

Public to Struggling States: You're on Your Own

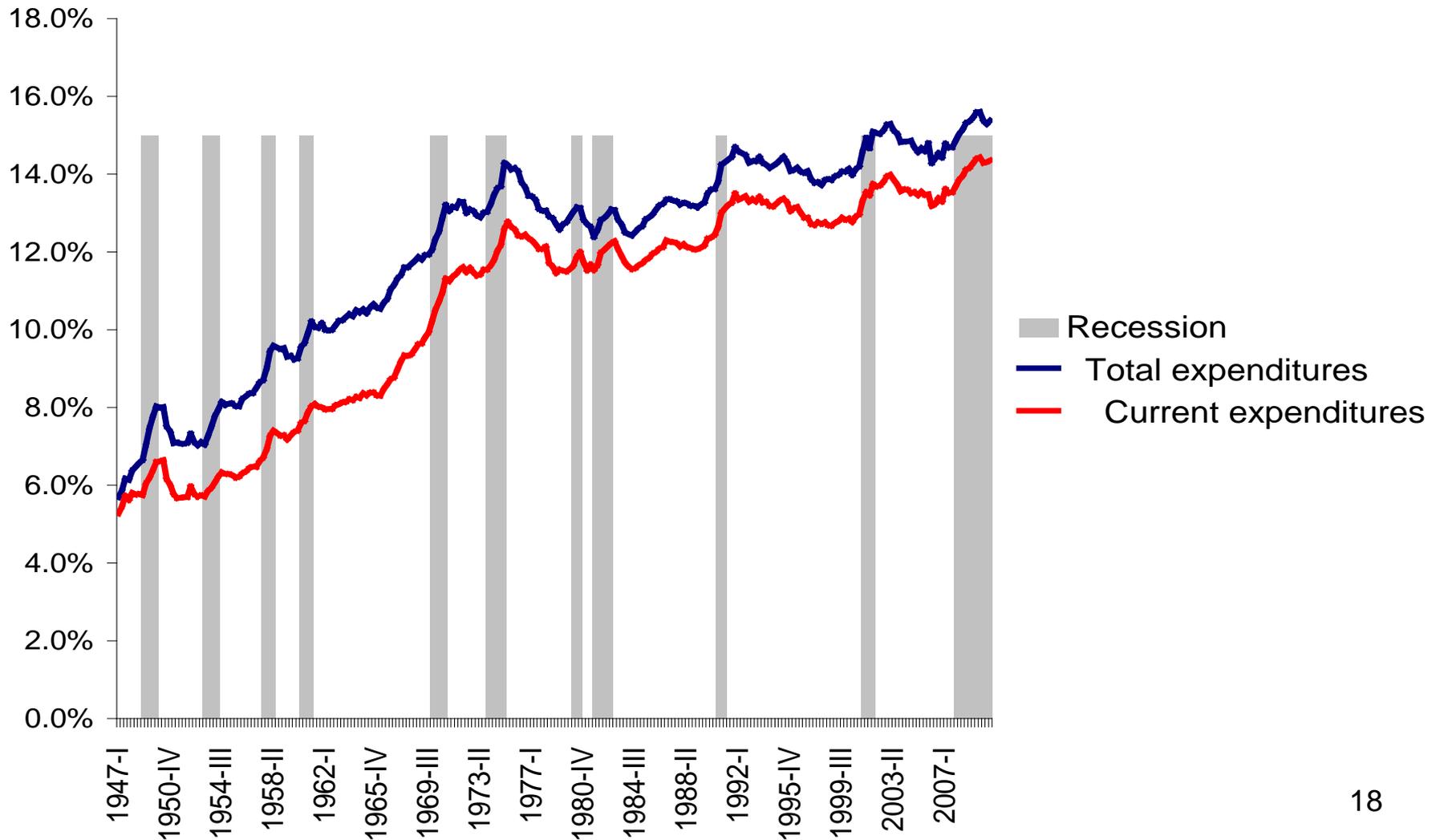
<i>Better way to address state budget problems...</i>	<u>April 2003</u> %	<u>June 2010</u> %
Federal gov't should give more money to states, even if it increases deficit	35	26
States should take care of this, by raising taxes or cutting services	57	58
Don't know	<u>8</u> 100	<u>16</u> 100

Pew Research Center/National Journal June 24-27, 2010.
 Figures may not add to 100% because of rounding.

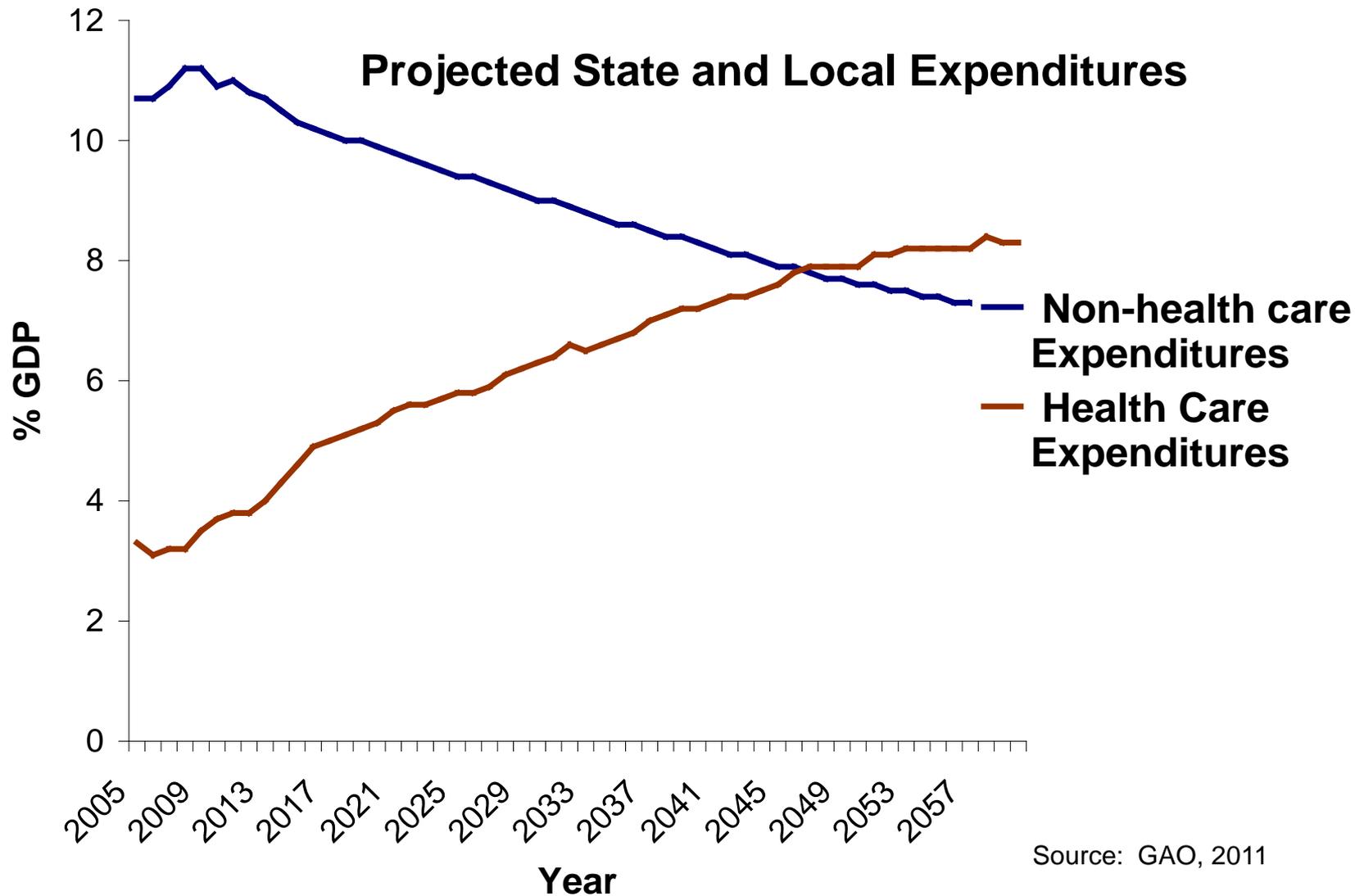
Structural Issues: Volatile Revenues



Structural Issues: Countercyclical Spending Pressure



Structural Issues: Rising Health Care Costs



Source: GAO, 2011

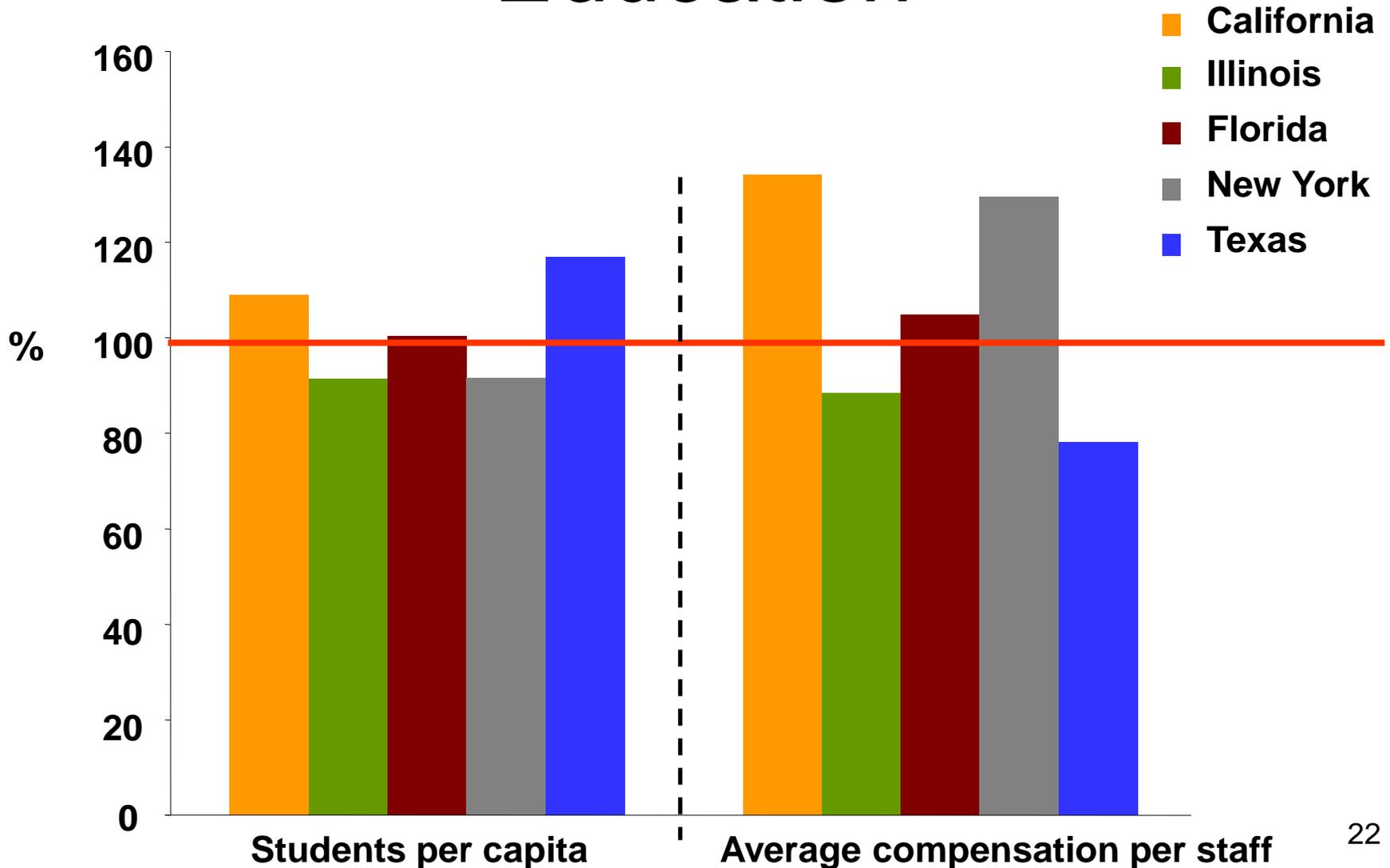
Three Questions

1. What actions have states taken to close budget gaps?
2. What could they do?
3. *What should they do?*

Are More Institutions the Answer?

- Resurgent interest in tax and spending caps, stronger rainy day funds
- But already a thicket of historical rules, voter initiatives, and federal requirements
- Some estimate as much as 40 percent of state budgets is “off limits”
- **Need to focus on budget drivers:** What to Texas and California have in common?

An Example from K-12 Education



Could Use An “Early Warning System”

- We know a lot about state budgets:
 - Where idea of control and accountability started
 - Strong tradition of open access (“e-budgeting”)
 - Network of organizations track (NGA, NASBO, NCSL, CBPP, RFS, Pew, etc.)
- BUT we also know very little
 - Budgets are prospective documents only
 - They cover flows and not stocks (i.e., no fixed assets or long term liabilities)
 - They are outputs of political process