Fiscal Realities: Facing State Budget Tradeoffs

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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

Average = 0.33 ppts/yr

Negative in 2009 and 2010

Source: Bureau of Economic Analysis
States In Particular Were Hard Hit in Great Recession

Sources: Bureau of the Census, Bureau of Economic Analysis
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

Source: Bureau of Labor Statistics
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

Bil.$

Source: National Association of State Budget Officers
## Tax Examples

### Significant tax changes in 2009-2012

<table>
<thead>
<tr>
<th>Increases of more than 5%</th>
<th>Personal income tax</th>
<th>Sales tax</th>
<th>Corporate income tax</th>
<th>Cigarette tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA, CT, IL, NJ, NY, OH, WV</td>
<td>AZ, CA, IN, KS, MA, NC</td>
<td>AL, CA, CT, DE, IA, IL, MN, OR</td>
<td>AR, CT, DE, FL, HI, KY, MS, NC, NH, NM, NY, PA, RI, UT, VT, WA, WV</td>
<td></td>
</tr>
<tr>
<td>Increase of 1-5%</td>
<td>HI, MD, NC, OR, RI, VT</td>
<td>GA, KY, ME, NM, NY, VA, WA, WV</td>
<td>FL, KS, ME, NC, NJ, TN, VA</td>
<td>ME, TX</td>
</tr>
<tr>
<td>Decrease of more than 1%</td>
<td>AL, ME, ND, NM, OH</td>
<td>AR, CA, CT, LA, MD</td>
<td>AZ, CA, FL, GA, IN, MI, MN, MO, ND, OH, PA, RI, WA</td>
<td></td>
</tr>
</tbody>
</table>

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

Sources: Center for Budget and Policy Priorities, 2011; Census of Governments, 2011.
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

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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

Sources: NCSL, NASBO
Political Constraints

| Public Votes “None of the Above” to Proposals for Balancing State Budgets |
| --- | --- | --- | --- |
| To balance your state’s budget, | Favor | Oppose | DK |
| favor or oppose… | % | % | % |
| 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 |
| --- | --- | --- | --- |
| Better way to address state budget problems… | April 2003 | June 2010 | % | % |
| 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 | 8 | 16 | 100 | 100 |

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

Percentage Change in Taxes and GDP

Note: Year over year % change vs. one year ago, 4 quarter moving average
Source: U.S. Bureau of Economic Analysis and Census Bureau
Structural Issues: Countercyclical Spending Pressure

Recession
- Total expenditures
- Current expenditures


0.0% 2.0% 4.0% 6.0% 8.0% 10.0% 12.0% 14.0% 16.0% 18.0%
Structural Issues: Rising Health Care Costs

Projected State and Local Expenditures

- Non-health care Expenditures
- Health Care Expenditures

Source: GAO, 2011
Three Questions

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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

<table>
<thead>
<tr>
<th>State</th>
<th>Students per capita</th>
<th>Average compensation per staff</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td></td>
<td></td>
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<tr>
<td>Illinois</td>
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<tr>
<td>Florida</td>
<td></td>
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<tr>
<td>New York</td>
<td></td>
<td></td>
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<tr>
<td>Texas</td>
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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